05-Feb-2020

Coty, Inc. (COTY)

Q2 2020 Earnings Call

Copyright © 2001-2020 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

OTHER PARTICIPANTS

Olivia Tong
Analyst, Bank of America Merrill Lynch

Robert Ottenstein
Analyst, Evercore ISI

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Nik Modi
Analyst, RBC Capital Markets LLC

Joe Lachky
Analyst, Wells Fargo Securities LLC

Ashley Helgans
Analyst, Jefferies LLC

Faiza Alwy
Analyst, Deutsche Bank Securities, Inc.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

William Michael Reuter
Analyst, Bank of America Merrill Lynch

Mark Stiefel Astrachan
Analyst, Stifel, Nicolaus & Co., Inc.

Wendy C. Nicholson
Analyst, Citigroup Global Markets, Inc.

Copyright © 2001-2020 FactSet CallStreet, LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. My name is Maria and I'll be your conference operator today. At this time, I would like to welcome everyone to Coty's Second Quarter Fiscal 2020 Results Conference Call. As a reminder, this conference call is being recorded today, February 5, 2020. On today's call are Pierre Laubies, Chief Executive Officer; and Pierre-André Terisse, Chief Financial Officer.

I would like to remind you that many of the comments today may contain forward-looking statements. Please refer to Coty's earnings release and the reports filed with the SEC where the company list factors that could cause actual results to differ materially from these forward-looking statements.

All commentary on like-for-like net revenue reflect a comparison of the business at constant currency in the current and prior year, excluding the impact of acquisitions and divestitures. In addition, except where noted, the discussion of our financial results and our expectations reflect certain adjustments as specified in the non-GAAP financial measures section of our earnings release. You can find the bridge from GAAP to non-GAAP results in the reconciliation tables in the earnings release.

I will now turn the call over to Mr. Laubies.

Pierre Laubies

Chief Executive Officer & Director, Coty, Inc.

Thank you, Maria, and welcome everybody to Coty's second quarter fiscal 2020 conference call. I will start by reviewing the progress we have made on our turnaround plan in the last few months. Pierre-André will then discuss our financial results, outlook, our newly introduced sustainability target, and some of the recent strategic developments.

Exactly one year ago, I was sharing with you and our key leaders my first impressions of Coty. My first impression at the time was that we had reserves of performance to unlock in the way we ran our company, and that the path to building a bigger business would have to go through building a better one. Our turnaround plan has been underway now for two quarters, and we are beginning to see clear evidence of progress in the key parts of the business.

Like we highlighted about it six months ago, our key priorities over this last two quarters have been: rebalance working media and non-working media; grow penetration by advertising our brands at scale with the right media mix; improve our gross margins by managing better our mix, price and promotion level; put together an organization more adequate with our size; find the right balance between discipline and creativity in everything we do; deliver consistent financial performance in a quality way. I am very happy to report that our teams across our business units, factories and corporate centers have been doing just that.

We are, of course, far from having solved all the challenges that we face and seize all the opportunities ahead of us. Yet, we can see that we are on the right track, that our plans are starting to work, and that now is the time for us to be consistent and persistent. This allows us to reconfirm our fiscal 2020 targets. At the same time, we are beginning our work to reshape our portfolio to both provide financial flexibility and raise our growth potential. We'll come back to that.

Copyright © 2001-2020 FactSet CallStreet, LLC

I will take now the opportunity to concretely illustrate our approach by sharing some details of our turnaround plan activation. We continue to grow our working media spend, which was up 8% in the quarter, as we focus on investing behind our priority brand/country combination, the media spend behind these priority businesses in Consumer Beauty grew over 15% in the first half of the year.

We also continued to refine the mix between traditional and digital media, activating digital-first campaigns in our younger orientated brands, while ramping up TV media behind our more mainstream brands. Our organization is very intentional in driving strong gross margin improvement, activating the levers at the center of our strategy. We have implemented list price increase in a handful of countries with a broader deployment on track for the second half.

Each of our divisions have been actively managing the mix of their sales, prioritizing higher value products and channels. We are continuing to monitor that we have the best possible alignment between sell-in and sell-out, thus avoiding value destructive selling tactics.

Finally, we are advancing on our objectives to be the leaner and more aligned organization, supported by an enabling culture with the right balance of creativity and discipline. The new organizational structure has been deployed effective January 1, and the teams are now working under a new regionally focused framework.

We have stepped up our service level to our customers, whilst at the same time increasing our [ph] focused security (5:42). And we have begun to execute on our fixed cost restructuring program. As part of our efforts to be the healthier business, we are steadily restoring the pricing architecture of our brands and premiumizing our portfolio, and we are making strong progress within both Consumer Beauty and Luxury.

In Consumer Beauty, the average net revenue per unit in the past six months has increased by approximately 2%, with even higher growth in Europe. This has been achieved through a combination of implementing net price management in a few countries, although the bulk of the effort will be deployed in the second half, active revenue management as we have prioritized and supported higher value products and more disciplined promotional activity while remaining competitive in the marketplace.

In Luxury, while we are starting from a stronger position, we are also capturing premiumization opportunities. The average selling price has increased by approximately 4% with improvement in each of our top three markets. The driver for this expansion includes: reduced promotional activity, improved mix management including greater emphasis on Eau de Parfums and reduced giftset activity, and selective price management.

Last quarter, we shared with you early progress in some of our priority brand/country combinations. With that progress continuing to build across a number brands and markets, I am pleased to offer the global view on our in-market performance.

As you can see on this slide, the global mass color cosmetic market, as tracked by Nielsen, has decelerated moderately over the past year. In our Q2, the mass color cosmetics market declined by approximately 3% compared to a decline of 2% for the last 12 months. At the same time, our progress on sales and marketing fundamentals has allowed us to improve our global sell-out by approximately 130 basis points even in a slowing market backdrop.

The improved sell-out trend in of our cosmetics brand reflects strong progress in the UK with Rimmel and Max Factor, in Germany with Max Factor, and in Australia with Sally Hansen and Rimmel. It is worth highlighting that the action plans we have activated in the UK behind Rimmel, including substantial increase in working media,

Copyright © 2001-2020 FactSet CallStreet, LLC

support on hero sub-brand and a couple of strong launches has allowed Rimmel to grow its penetration, hence, its market share of the UK cosmetics market by locating light and medium shoppers exactly in line with our strategic intent.

Our sell-out performance in the US has been more mixed, though our underperformance gap related to the category has been moderating in total and very positive on our core franchises. Some of these drivers of underperformance are due to external factors like competitive promo pressure. We can only live with those. But some are also in our control and we are taking the necessary steps to correct – the necessary corrective actions, sorry. It is important to highlight that due to the strong momentum we are driving on Amazon, our US cosmetics sell-out is over 100 basis points better than what is captured in the Nielsen data.

Complementing the gradual improvement of our performance in-store is the continuing strong growth in our e-commerce sales. In the first half of our fiscal 2020, Luxury e-commerce revenues grew by approximately 20% year-on-year. E-commerce now accounts for low-double digit percentage of our Luxury business, which is relatively consistent with the luxury fragrance market. This momentum was achieved despite the currently limited presence on Tmall. However, our conversations with our leading licensees about launching on Tmall are progressing well, and we are optimistic about the long-term opportunity for our Luxury business with this leading e-retailer.

In Consumer Beauty, while e-commerce penetration is still relatively low, we continue to make great strides globally. Our first half e-commerce revenue grew by approximately 20% fueled by strength on Amazon. Our Cyber Weekend sales on Amazon in the US and in the UK nearly doubled versus the prior year. In fact, in our core markets including the US, UK and Germany, we're gaining market share on Amazon, speaking to the strength of our color cosmetics brand when combined with disciplined focus on e-commerce fundamentals.

While we continue to strengthen our base business, I'm pleased to announce the expansion of some of our leading brands into the clean beauty segment. It is evident that consumers are increasingly focused on wellness, both their own and of the world around them. This is driving rapid growth for products and brands that serve these dual needs and we will seize this opportunity.

After an initial move in our Professional business with the weDo launch and as we have chosen to focus on our core categories of fragrances, cosmetics and skincare, in the last couple of months, we have launched clean label product line in each of these categories: Philosophy's Nature in a Jar, Sally Hansen's Good. Kind. Pure., Calvin Klein's CK Everyone, and CoverGirl's Clean Fresh are each vegan, cruelty-free, based on naturally-derived ingredient and free of many contested ingredient. Nature in a Jar and CK Everyone are also packaged in recyclable packaging, composed of post-consumer recycled material. We are very proud of the teams who are driving these efforts and capitalizing on the growing trend, while building Coty's reputation as a company that aims to do great by doing good.

With that, let me turn over to Pierre-André.

Pierre-André Terisse

Chief Financial Officer, Coty, Inc.

Thank you, Pierre, and good morning, everyone. About sustainability, sustainability is about, as Pierre just mentioned, consumer and innovation, but it's also about more than that. For the past few years, the Coty teams have been working in a number of areas to try and catch up with the industry. And while a lot of things remain to be done, the many progresses which we have made so far have made it possible for us to elaborate the first Coty sustainability platform and to make it public today.

Copyright © 2001-2020 FactSet CallStreet, LLC

I will not go into the many details present on the charts, but I will just say that we have chosen to call it Beauty That Lasts, and that it encompasses initiatives in the area of products, environment protection, and people and diversity. And for each of them, we have defined priority initiatives and set targets for ourselves which we will monitor transversely.

So, for instance, we will, by 2022, source 100% of our Indian mica from responsible sources. Or we will, by 2030, reduce our carbon emissions across our entire value chain by 30%, and there are more on the stage. This platform will further build our credibility as we deliver against these targets. It will also increasingly give us the ability to take initiatives in a market segment which will be one of the growth drivers of beauty in the coming years and, therefore, this is a major step for us.

But now let's move again to short term and let me turn to the earnings of the quarter. As said by Pierre, this was a quarter in line with expectations, and this is the fifth time in a row it is the case since Pierre and I had started this exercise more than a year ago, evidencing, I believe, an improved control over our business.

On revenues more specifically, Q2 was modestly down at 1.4%, with noticeable sequential improvement in Consumer Beauty. Beyond the percentage change, the evolution of our top line has been on quality with strong improvement on that front evidenced by the increase of our gross margin.

So turning to the divisions and to start with Luxury, in Q2, we launched the second pillar of our Tiffany fragrances called Tiffany & Love, which you have on the left side of the chart. It performed incredibly well in market. This launch confirmed the appeal of the Tiffany brand for both males and females and has driven market share gains for the overall Tiffany brand across the US, the UK, Germany, Canada and Italy. Our continued support and activation behind Marc Jacobs' Daisy has now firmly placed the iconic fragrance pillar into the top four fragrances in the US, in the UK, and Canada. And we continue to drive growth across our focus brands, Burberry and Hugo Boss.

Moving to slide 11, on the performance side, Luxury delivered a solid growth at 1.3% on a high comparison base. I remind you that the same quarter last year was growth 10%. This was helped by the previously mentioned innovations, but also by the strong performance of our Gucci makeup.

While the traction of our brands remain strong, we are, as we have been doing in Consumer Beauty, working to improve the quality of the top line. This has already allowed us to reduce the level of promotions and discount. We will, in Q3, take advantage of our new go-to-market by region coming to Consumer and Luxury to accelerate our work and cut low value sales, decrease value distribution, better control the grey market, amongst other initiatives. This will temporarily drive our sell-in into low-single digit negative in Q3, specifically.

At the same time, our sell-out will be supported by strong innovation pipe with CK Everyone coming in Q3, coming today I believe, as well as Hugo Boss Alive, both fragrance for women; and later in year, the expansion of the Gucci makeup branch and other innovations, including Burberry and Marc Jacobs or Hugo Boss. So, Luxury definitely remains a key growth engine for our company.

Let's now turn to Consumer Beauty, page 12. The launch of Rimmel Lasting Matte Foundation has been off to a great start. This is on the left. In core markets like the UK, we have been supporting this launch with a strong [indiscernible] (17:49) in media which has driven growth for the entire Rimmel Lasting sub-brand and contributed to Rimmel market share gains in the UK over the last five months.

Copyright © 2001-2020 FactSet CallStreet, LLC

Consistent with our focus on high-value business, we have been activating support behind our premium Sally Hansen Miracle Gel line, including media investments and innovative try-on features in select retailers. This has driven mid-single digit revenue growth for Miracle Gel in the US in Q2, supporting the overall brand.

And finally, on the right, for Max Factor, we are continuing to strengthen the product range with a Miracle Touch Second Skin hybrid foundation, which contains pre and probiotics to support skin renewal, and is capitalizing on the growing consumer demand for skincare-like cosmetic products.

Performance-wise, going to slide 13, Consumer Beauty continued showing progresses as illustrated by Pierre a few minutes ago. While North America continued to show a mixed performance with a solid delivery from Sally Hansen but continued weakness of CoverGirl, Europe kept strengthening with Rimmel in the UK or Max Factor in Germany. And in ALMEA, we kept being selective in our efforts in an attempt to continue improving the quality of our sales.

Our priority combo brand-country evidenced that our efforts are delivering. And while the overall top line of the division remains below where we would like it to be, it is clearly showing sequential progresses at minus 6.8%, more than 1 point versus last quarter, and the best performance for the past 18 months, and this is obviously to be continued.

And turning to Professional Beauty, slide 14, ghd continues to grow at a very strong pace, driven in part by the launch of the Glide hot brush. In our leading Wella brand, we have strengthened the range with the launch of ColorMotion+, a hair care regimen that improves colored hair quality. And last, OPI continues to invigorate our [indiscernible] (20:05) assortment with its latest Mexico City collaboration which you see on the right.

And so moving to slide 15, Professional continued growing in Q2 at 2.2% for the quarter, which means first half at 3.5%, all regions growing. Europe and the US delivering a steady performance, while ghd continued delivering strong growth helped by continued innovation. At the same time, the margins remained high in the 17s. These numbers talk for the health of the business and the quality of the Professional Beauty teams. At this time, we are working full speed in parallel on the strategic review. I'll come back to it.

I will now get back to Coty overall, slide 16. Looking at the profitability for the entire group, we are now well anchored in our virtuous equation. Gross margin was up 130 basis points to 63.4%, reflecting progresses coming from mix, price, but also channel management. At the same time, we kept increasing the support behind our brands with working media up high-single digits and key brands being advertised at sufficiency. In front of that, we continued being more selective on promos.

Together with the tight control of our fixed cost, this has fueled strong improvement of our operating margin to 13.9%, up 110 basis points. And this flowed down to the EPS, which is up $0.03 to $0.27, half of it driven by one-time tax benefit.

So we showed good progresses on the earnings side, but even more so on the free cash flow side, slide 17, with $364 million free cash flow for the second quarter alone; almost double that of last year. This was driven by tight control in all lines with a specific contribution of receivables, we have been reducing the overdues and the inventories thanks to a better supply chain working, a better service level, and a better S&OP process. Our debt closed at $7.2 billion, down from $7.4 billion the previous quarter, and free cash flow continues, of course, to be very high on our agenda.

Copyright © 2001-2020 FactSet CallStreet, LLC

So to sum up, slide 18, this was a quarter very much in line with expectations on all lines. It allows to reaffirm our target for the year with the delivery expected to be skewed towards Q4. Like-for-like net revenue is stable to slightly down year-on-year, adjusted OI growing 5% to 10% like-for-like with a strong working media reinvestment, and adjusted EPS growing mid-single digits and improvement of our free cash flow.

I move to slide 19 now, and would like to give you some last comments regarding the change of scope we are currently driving to complement our turnaround plan and build a stronger Coty. On the strategic review, first, we are very happy with the way things are going. First and foremost, as you have seen, the business keeps delivering well. This was the case in Q1 and is very much the case in Q2 in Professional Beauty and across the businesses under review, and we expect this to continue going forward. It's a clear testimony of the quality of the business under review as well as the quality and commitment of the teams running it.

We continue running the process and have now moved into a more complete phase. The information around that has been distributed to the interesting parties. We continue seeing many strong amount of interest and keep working with an unchanged timeframe with a decision to be made by summer 2020.

Moving to slide 20, Kylie is the second topic. As you have seen, we have closed the deal on January 6 and soon appointed Christoph Honnefelder as the CEO. The business has continued delivering well in the last month of 2019, actually ahead of expectations, with a strong skincare start and a strong Black Friday overall. We will consolidate Kylie globally as of the acquisition date, early-January 2020. However, we will report sales and margin as a scope change versus – instead of as part of the like-for-like performance for the first 12 months. We will use this time to define the right sequence of initiatives to accelerate the brand starting from calendar 2021.

Our first interaction and thoughts confirmed the potential we were seeing in the brand at the time of signing, and we will take the time to get things right before pushing and delivering our objective, which is, I remind you, to bring an additional 1 point of top line to the group. Finance wise, we will therefore just make sure in 2020 that this transaction is EPS neutral for the calendar year.

Moving to slide 21 and this is going to be the last one. A few words of recap [indiscernible] (25:37) before we move to Q&A. As detailed by Pierre, our turnaround is progressing well whether on the top line, OpEx or on the cost side. We start seeing the benefits come in. Out of the benefits, two KPIs are showing strong progresses and they are important: gross margin on the one hand, which talks of the quality of our top line and business; and the free cash flow, which is a proxy for the comprehensive business delivery. We will continue focusing very much on these KPIs.

As a result, we are confident in our ability to reach our targets for the year, and we are happy to reaffirm them. We are also happy with the progresses made on the reshaping of our portfolio and with each of the strategic review and the partnership with Kylie Jenner.

As you may sense, we are dealing with a very intense value creation and transformation agenda. If we manage to drive it and show so many progresses, this is thanks to the Coty teams who have been and keep showing talent, energy, courage and resilience. And on behalf of Pierre and myself, the two of us, I would like to conclude by thanking each and all of the Coty associates for this performance.

And now we'll be happy take your questions.

Copyright © 2001-2020 FactSet CallStreet, LLC

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Our first question comes from the line of Olivia Tong of Bank of America.

Olivia Tong
Analyst, Bank of America Merrill Lynch

Q

Great. Thanks. Good morning. First, just wanted to talk a little...

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Good morning.

Olivia Tong
Analyst, Bank of America Merrill Lynch

Q

...a little bit more on the strategic review, because there wasn't a ton more information just three months later, so just wondering if you could give a little bit more detail. And then, is the planned move of professional hair in Brazil in anyway influencing the timing of any projects you might embark on with respect to cost and efficiency improvements, free cash flow improvement that you plan to make? Thank you.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Hi. This is Pierre- André. I'm not sure I'm going to be able to give elements about the timing, so maybe just to repeat, we have started the process back in October. We took the time to prepare the information and to have everything we need to be able to run a smooth process. We are running the smooth process as from now. We took the time to make sure that we find the best possible solution for the business, but also for Coty shareholders.

Obviously, we're very comfortable with the timing we gave as an indication at the beginning, which is by summer 2020 in terms of decision. But, of course, as you can imagine, during this [ph] new (28:36) process, we just have to do it in a quiet manner. So we will come back to you in due course with more elements. But, for the moment, I just can tell you that things are proceeding really as we expected and well.

On the impact on restructuring costs, well, there's two elements. I don't foresee any change to what we have said so far because, on the one hand, we will have – Professional Beauty and Brazil were carrying part of the costs and they are going to leave, so these costs are not going to be incurred by us. But, on the other one, we think we have to make some further adjustment to the business to reach the same level of profitability. We are working on that. And therefore, altogether, I expect the same $600 million figure to remain on envelope of restructuring costs as announced before.

Olivia Tong
Analyst, Bank of America Merrill Lynch

Q

All right. That's helpful. If I could follow up on the price contribution, 4%, that's pretty healthy. Presumably, it's primarily in Consumer Beauty. But can you talk about your process of deciding what pricing levers to pull and how much more you think there is to go there?

Copyright © 2001-2020 FactSet CallStreet, LLC

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

I'll take the – this is Pierre speaking. The contribution actually is pretty balanced between Consumer Beauty and Luxury. Our objective is very clear. We do have a gross margin gap that we want to close, and price – and in that case, I actually talked mostly about net price as one of the key drivers to enable us to do that. So, our objective is very clearly on that case. Yes, we do want to participate into promotion but at an acceptable level and not necessarily at an over-intense level. Why? Because, again, it needs to come back to – we need to drive fundamentally the penetration of our brand, and for that we need the margin to invest. And therefore, we need to break this cycle. And so, there are more to come. We will continue to refine all of that. There is more to come in the short term because we are deploying this strategy in more markets than we have been doing so far.

So, so far, we have been focusing on four, five, six key markets. Now, going forward, we're expanding this strategy. And again, this requires a degree of granularity which is very fundamental. Taking a blanket approach is not very helpful in this situation because you have local competitive situation, you have mix which varies by market, point of departure is different a bit by market, so you exactly need the granularity of the market analysis. So, yes, there will be more to come, and I do not desire to disclose what it is, but clearly we will continue on this agenda. And once we have started this first one, we will make sure we stay on it for the next years and don't fall back.

Operator: Our next question comes from the line of Robert Ottenstein of Evercore ISI.

Robert Ottenstein
Analyst, Evercore ISI

Q

Great. Thank you very much.

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

Good morning.

Robert Ottenstein
Analyst, Evercore ISI

Q

Two questions on the US business. First, can you talk a little bit about your exposure to Macy's? There was obviously some announcements of some closures there, 125 stores. And then, tied to that, you spoke a lot about your progress in e-commerce. Maybe a little bit in terms of what you're doing with the specialty stores. And then, thirdly, we're going through the resets now in terms of the mass market, some of that data is going to start showing up. How does your shelf space look going forward? Thank you.

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

Okay. So, on Macy's, we do expect the exposure to be very limited and – for us in Luxury, so we don't feel very – that the impact is going to be big. The question – the second question was?

Robert Ottenstein
Analyst, Evercore ISI

Q

On the specialty channel, with Ulta and Sephora.

Copyright © 2001-2020 FactSet CallStreet, LLC

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.
A

Yes. Well, I think we are – our share on Ulta and Sephora on the Luxury business is strong, is doing well, and we are doing better than we keep going, and we keep going on e-commerce too, and also we know that, on Ulta, we had some good result with CoverGirl. So, again, we are taking our fair share of that market for the balance of the business that we have. So we see that this is really a channel that we want to continue to push and we want to continue to develop.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.
A

And maybe Ulta before Pierre takes over on the shelf, as I was saying, Kylie has been doing specifically well at the end of 2019, better than we expected, and that's been for a part with Ulta, of course, both by the way in cosmetic and skincare. And your next question was about...

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.
A

The reset.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.
A

...your expectation on the reset of the shelf?

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.
A

Well, I think we have been working very hard on managing the productivity and increasing the productivity of our shelf, and I think our customers are happy with our result. And the reset, we have nothing to add to what we already said in August. We anticipate this is exactly in line with where we are today, with slight decline – occasional slight decline. But, basically speaking, we should start at the end of Q3 exiting the, we call it, major impact and distribution losses that we have experimented over the course of last year.

Operator: Our next question comes from the line of Lauren Lieberman of Barclays.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.
Q

Great. Thanks. Good morning.

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.
A

Morning, Lauren

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.
A

Morning.

Copyright © 2001-2020 FactSet CallStreet, LLC

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

I was hoping you could talk a little bit about Luxury, and you'd specifically talked about the route to market changes. So, if you could just elaborate on that it would be very interesting. And then, more specifically, why the exit of the lower value sales would only be an issue in 3Q? Because just the way that my head was thinking about it, it would be something that would sort of linger for a year, so if you can explain a little bit more about that, it would be great. Thanks.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Sure. I'll take it or Pierre you want to...?

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

No, I can take the Luxury and route to market changes.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Yeah. Maybe I'll take this one, on your specific question on the timing. Fundamentally, we have the same goal throughout the company and throughout – in particular, the business we are going to retain, which are Luxury and Consumer Beauty. We've been starting very much in Consumer Beauty to be more selective about some sales, truncating some sales. We made mention of that in ALMEA in particular. And by doing so, we'd been able to reduce the grey market, and we believe that that's very important to drive [ph] C One (36:00), to reduce the impact on our main markets, and to make sure that we focus on the right quality of top line.

We've done already some things on Luxury, as shown by Pierre, but now we're going in Q3 to go deeper in Luxury, for one reason which is that we have a common go-to-market, as you know, starting from Q3 between Luxury and Consumer Beauty, and therefore it makes sense to do it now. And do it now means just cutting low value distribution sales, promotion, going a bit deeper, because we know that we have a big pipe of innovation coming, and we won't be able to focus on the [ph] minutia in the business as opposed to the...(36:50) So, in Q3, we'll accept that this has an impact on the sell-in and it's driving actually our sell-in into negative territory, but because we believe this is what we need to do to continue strengthening Luxury and continue making it a strong engine of growth for the company.

And Pierre, you probably like to add.

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

I will add another point on the Luxury route to market changes or Consumer Beauty route to market changes. Actually, we are not touching the customer-facing personnel and we are still having dedicated marketing team. We are delivering dedicated sales team at every market level. The thing that we are doing is that we are taking advantage of our relatively – or we are facing the fact that we are in some market that we need strategy scale and we need support scale, and that's what we are doing fundamentally from the route to market change. We are combining our back office infrastructure, but we're not changing the customer-facing personnel and the structure of our marketing teams at the local level.

Copyright © 2001-2020 FactSet CallStreet, LLC

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. Okay. Thanks. And then just on the US shelf space conversation, I understand that when we get to the end of 3Q, we start to cycle the losses, so just the comparisons will start to benefit. But do you have visibility into incremental shelf space? Or is this really more about just better productivity of what you do have currently?

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

I think we probably, hopefully, gain some incremental shelf space as we are working hard on our productivity. But I just can't commit to that at this stage, all right? And I think, at the end of the day, as you see, our objective was to clearly regain the confidence of our customers through our strategies and our focus. And that's what we are doing at this stage, all right?

And so, that's job – we need to complete the job number one. It's very mission critical for us that we, again, regain confidence of our customers and, after that, we can start about expanding. And I think if we want to expand, we need to expand meaningfully through a combination of innovation of portfolio buildup and not only just continue to stretch the current business that we have.

Operator: Our next question comes from the line of Nik Modi of RBC.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Hi, Nik.

Nik Modi
Analyst, RBC Capital Markets LLC

Q

Yeah, good morning, everyone. Hi. I guess just two quick questions for me. Just wanted to get an update on any progress that you've made in China. I know that's been an area that has been of high interest in terms of generating better business there. The second question, really, is on the makeup side. It's been several quarters now. Things seem to be getting worse. Do you have a better handle on exactly what is driving the [audio gap] (39:46)?

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

Hello? Okay. So, on China, we are very happy with our momentum in Luxury and [indiscernible] (39:58). And so, in our view, we keep progressing and we are happy, and particularly the expansion into cosmetics have really delivered incremental sales, which is, I think, a very good indication of the type of strategies that we want to do, partition coverage with the same brand. And I think many of our brands have the right to play into more categories than they do play today. And we have demonstrated that with cosmetics in Gucci, so that's a big learning that we will capitalize on.

On makeup, I think that with the combination of makeup, and I assume that you are a bit probably driving – talking about the US market makeup and the reason...

Nik Modi
Analyst, RBC Capital Markets LLC

Q

Copyright © 2001-2020 FactSet CallStreet, LLC

Yeah.

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.
A

...for the decline. Yes, I think it is – there are many driving forces for that. And I would say that the structural forces, I would say, have been, first, an exclusion of availability of new brands in a market which is very prone to novelty, has probably driven a level of stock at the consumer level, so that's one probably driver.

The second driver is that, I think that many retailers have given – and we have some data which demonstrate that – have given – probably mass retailers have given a lot of shelf space to new brands which do not have the necessary productivity and therefore, unfortunately, in – and they have been subsidizing that space by taking away from big brands, so that is probably driving the penetration of the mass cosmetic market.

And three, I think there is possibility, there is most likely a bit of a shift from – a consumer shift from makeup to skincare, and [ph] we've seen that (42:03) around the world. I would say these are, in my view, the three fundamental drivers, some of it we need to – some of these trends we need to capitalize on, and some of these trends we need to have conversation with our customers about.

Nik Modi
Analyst, RBC Capital Markets LLC
Q

Excellent. Thank you.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.
A

Thank you.

Operator: Our next question comes when line of Joe Lachky of Wells Fargo Securities.

Joe Lachky
Analyst, Wells Fargo Securities LLC
Q

Hi. Thanks.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.
A

Hi.

Joe Lachky
Analyst, Wells Fargo Securities LLC
Q

So, a couple follow ups, I guess. First, on Luxury, given the negative growth in Q3, I understand you're pulling back on lower value products, probably lower margin products. But will how that impact operating income growth in the third quarter? And then, more broadly, when you think about the flow between the quarters in the back half, right? So overall expecting pretty significant improvement in EPS growth, but Q3 is going to be pressured by the Luxury and now fully lapping distribution losses in Consumer Beauty. So, should we expect operating income, EPS growth will be weighted more towards Q4 in the second half?

Copyright © 2001-2020 FactSet CallStreet, LLC

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.
A

Yeah, it's Pierre-André. That's correct. What I will say about – you've seen that we reiterate our guidance, so obviously we still have the same objective for the EPS full year. You've seen that we have – we are a bit ahead of what we thought where we expected to be at the end of Q2. For Q3, I will say that EPS is going to be broadly in line with that of last year. And therefore, you're right to say that the EPS progress are going to be skewed to the Q4, which is not, [indiscernible] (43:52), by the way...

Joe Lachky
Analyst, Wells Fargo Securities LLC
Q

Okay. Great.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.
A

...given the seasonality of the business and the fact that, regularly, Q2 and Q4 are bigger.

Joe Lachky
Analyst, Wells Fargo Securities LLC
Q

Okay. And then just one quick follow-up on the strategic review. So, do you – as you're going through the deep review of the businesses, do you have any more visibility on potential stranded overhead? And then, also, if you have any additional details on the tax basis of the assets and how much tax leakage we could expect to see in a sale? Thanks.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.
A

Yeah, limited answers, but you will understand that I cannot go much more – much ahead at this time. On the stranded cost, maybe the two elements I can repeat are that, A, taking into account stranded cost, the average margin or the ballpark margin of the divested business is in the mid-teens, so that's one element.

The second element is that we have, in the initial announcement, reiterated our margin guidance, which is 14% to 16% by 2023, and everything we see today confirms that. We're working actually on strengthening further the plan to make sure that we have enough room to cover it and enough opportunity possibly to go further. But we definitely confirm the 14% to 16%. And then, for the rest, I will get back to you when we have more elements, which depends obviously on the progresses of the process.

The second thing about tax rate, we said that the tax rate would be the corporate tax rate, which is – of Coty, which is in the low – sorry – we said that it would be below and, in fact, meaningfully below the corporate tax rate of Coty, which is in the low 20s. Hope it helps.

Operator: Our next question comes from the line of Stephanie Wissink of Jefferies.

Ashley Helgans
Analyst, Jefferies LLC
Q

Hello. This is Ashley Helgans on for Steph Wissink. Thanks for taking our question. Do you have any update on the travel retail channel quarter-to-date with the virus impacting travel itineraries? And then, also, if you could just give a little color on the softening of the Pro Beauty margins.

Copyright © 2001-2020 FactSet CallStreet, LLC

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Sorry, a little color on the? Softening of the Professional Beauty margins. Well, on that one, frankly speaking, I will not see these as material. Margins remained at a high level in the 17%, which is not bad. That's with the performance of the top line, which is good, gross margin good. So, I would not read anything specific into it. The business keeps delivering and is going to be on track with its target. Actually delivered against its target internally for the first half and we expect it to continue for the second half.

On the travel retail and the virus, one thing on the virus, first, is that obviously we care about people, so we have organized process internally with a view to make sure that our people are protected at all time and in the best possible conditions at all time, so we are extremely vigilant on that point, I imagine as everyone.

Secondly, on the impact themselves, yes, there is and there will be impact on the travel retail, because the amount of traveling is decreasing. I think it's far too early to quantify an impact. The only two things we are sure of is that there will be an impact, first; and secondly, that the impact for Coty is going to be pretty small relative to competition since China represents only 3% of our sales. And Asia, generally speaking, we are underway, so this time is bad for a good in this case. But we'll get back to you once we have more visibility. Again, for me today, it's far too much early days.

Operator: Our next question comes from the line of Faiza Alwy of Deutsche Bank.

Faiza Alwy
Analyst, Deutsche Bank Securities, Inc.

Q

Yes. Hi. Good morning. So a couple of questions for me. First, I just wanted to talk about Kylie. Thank you for giving the calendar 2019 number. That's really helpful. But you talked about preparing the company for rapid expansion, and I was hoping to get a little bit more color around that. I know you talked about expansion previously, but sort of how should we think about the timing of that expansion?

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Well, again, a bit early to talk about that. Today, we are February 5, so we closed less than a month ago. As you can imagine, these are not things you get into a rush too soon. The first thing we wanted to do was to set up the right number of dialogue. Having Christoph appointed, Christoph connecting with the teams locally; and then we need to understand, within what we have defined, how do we operationally move from the current seller to broadening the number of markets, to accelerating the penetration of skincare in the US, elsewhere, to understand the way we are going to lead the innovation process with them, how Coty is going to be an asset to Kylie. This is very important.

We don't want to integrate Kylie, we really want to give Kylie the ability to develop and to grow for the benefit of the shareholders and the primary shareholder is, obviously, Kylie. How do we want to sequence things. So I think we need a bit of time to make that and to come back to you. The focus this year is really on preparing the plan. We have high ambition. The ambition is to bring 1 point of growth to Coty overall between 2021 and 2023, so CAGR. This is ambitious. We may be able to do more, but for that, we need to get prepared and ready. And this is what is going to be the priority of the coming 6 to 12 months.

Copyright © 2001-2020 FactSet CallStreet, LLC

Faiza Alwy
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thanks. And then just...

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

But I mean – sorry – and the element, as you rightly pointed, is that the traction is good. In fact, the traction in the last part of the year was even better than what we expected.

Operator: Our next question comes from the line of Andrea Teixeira of JPMorgan.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. Good morning and afternoon there. So, I have one question and a follow up. First, hoping you can talk more about how should we model travel retail. And if you can remind us the percentage of total sales coming from China and the contribution of travel retail globally, even excluding – and especially now excluding Professional going forward, if you have the number.

And my follow up is on the life post Professional Beauty and Brazil divestitures. Can you please confirm – you just reaffirmed the 14% to 16% EBIT margin goal by fiscal 2023. I know it's a long-term guidance, but even considered in stranded costs of both divestitures and how should we be thinking in 2021, I'm assuming that there is a timing to which you right-size the company to the new sales profile. So, how long should think about margins going down in the first moment in 2021? And then getting back to that goal by 2022 and 2023. Thank you.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Okay. I'll take the second question. Maybe I'll let Pierre answer the first one. On the second one...

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

Yeah, I'll do the first one, [ph] Andre (52:21). So travel retail is about 15% of Luxury, all right? So that gives you a bit of a modeling. So that's about therefore 5% of – I would say 7% of the company globally.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Okay.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

And travel – and travel retail. I'm sorry. Travel retail globally, how much is it currently?

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

As I said, 15% of the Luxury business.

Copyright © 2001-2020 FactSet CallStreet, LLC

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Oh, okay.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

That's global. And if you want to take Asia, Asia is about one third of that.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

One third of that. Thank you.

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

And China overall is 3% of the company.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Okay. Perfect. Thank you.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Yeah. And on the 14% to 16%, again, I repeat, we reaffirmed, and I reiterate it. We are definitely very confident in our ability to that deliver it. That was part of the turnaround plan. We have given the part of the initiative we saw, which is in the remaining perimeter. The additional opportunities we have, the pace of delivery of the plan, 14% to 16%, was and remain our objective for RemainCo for the margin by 2023.

Now, the real question is what is the path to it, and that's where I need a bit of time to be able to answer you. We're working on it. We have two questions, which is what level of margin can we expect for 2021 and what level of EPS can we expect for 2021. There are a lot of moving parts and moving pieces, including the price, including as well the use of proceeds, and the return to shareholders including the structure. And so, we're working on that. And when we have enough visibility on all these elements, we'll get back to you with an answer.

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

May I add that we are already anticipating definitely in our staffing particularly at reported quarter level that possibility. And therefore, are taking already preventive action to avoid us to create a future problem by rightsizing our future organization right now.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Yeah.

Operator: Our next question comes from the line of William Reuter of Bank of America. Good morning

Copyright © 2001-2020 FactSet CallStreet, LLC

William Michael Reuter
Analyst, Bank of America Merrill Lynch

Q

Good morning. I just have two. The first is, you didn't talk about leverage at the end of the asset sale. Do you still expect to be at 3 times once that's completed? And then you also talked about accelerating the growth of Kylie in calendar year 2021. Do you expect that Kylie will be growing in calendar year 2020 as well? That's all. Thanks.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

On Kylie, unfortunately, that's not the topic. Given the current trends, it will be legitimate to expect growth. But, at the same time, the priority is not going to be on the growth in 2020. It's really going to be on setting up the growth for 2021. So, we won't be too much looking at that, but today the asset is definitely growing.

On the leverage, yeah, we said to be accurate and precise that we would target leverage post-deal of approximately 3 times, and there is no reason for us at this stage to get away from that. This is our target and expectation.

Operator: Our next question comes from the line of Mark Astrachan of Stifel.

Mark Stiefel Astrachan
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. Thanks and good morning, everybody.

Pierre-André Terisse
Chief Financial Officer, Coty, Inc.

A

Morning.

Mark Stiefel Astrachan
Analyst, Stifel, Nicolaus & Co., Inc.

Q

I wanted to ask about pricing, just sort of broadly. So is this something that is now implemented strategically? Is this something that we should be thinking about contributing on a yearly basis going forward? Obviously not specific to what brand or category, but is this now kind of part of the fabric of the company going forward?

And maybe if you could talk a bit about any thoughts on how you think about it just maybe across the categories or what will be left of the company assuming the strategic review is complete between Luxury and Consumer Beauty, and any sort of early learnings so far from key price thresholds. Thank you.

Pierre Laubies
Chief Executive Officer & Director, Coty, Inc.

A

Yes. I think, overall, Mark, clearly, you can call it pricing, I can call it value too. At the end of the day, there are many ways to take pricing. There are, first, amount of business on deal; two, depth of the deal; three, balance between mainstream portfolio, premium portfolio. Typically, for instance, we do see, to give you a bit of flavor, for instance, that in Luxury, we are substantially over-playing in Eau De Toilette and underplaying in Eau De Parfum. That is, basically speaking, one of the way we will manage price or pricing. And you can call it pricing. I call it value creation. And so, yes, definitely, it is part of our strategic agenda to continue to push the value of our product set.

Copyright © 2001-2020 FactSet CallStreet, LLC

There is one systemic plan, and I will call it like the long-lasting trend in consumer goods in general and in beauty even more, it's wealth. Markets up-trade systemically and we have a bit of catch-up job to do, but it is definitely one of our vision of innovation going forward. Innovation for us going forward has two fundamental roles to play. One, it continues to enable us to premiumize the portfolio of the company. And two, it enables us to increase the penetration of our brands.

And sometimes we can do both, sometimes we do one, sometimes we do the other, but basically speaking, that's the way we are going to look at our innovation pipeline going forward. Does it contribute to impose the value of what we sell or does it give us more consumer or does it do both? And so, it is a big shift, and I believe it is one of the substantial shifts or systemic shift, which at the end of the day transforms and allows you to do at the same time better and bigger.

Operator: And we have time for one more question. Your final question will come from the line of Wendy Nicholson of Citi.

Wendy C. Nicholson

Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks for squeezing me in. I guess my question is on your comments on Amazon, which I thought were really interesting in terms of the strength of your business there. Do you have a sense for why that is? I'm curious that your brands would be doing so much better online than they are in mass retail. I know you talked a little bit about some of the execution issues in mass retail, but are you doing anything different online? Are you paying for more visibility on Amazon, if you will? And also, do have a sense for your market share trends on Amazon? I'm wondering if your sellout in Amazon is better just because the category is doing really well on Amazon. Or whether you yourself are outperforming your peers in a more notable way? Thanks.

Pierre Laubies

Chief Executive Officer & Director, Coty, Inc.

A

On Luxury and on Consumer Beauty, we are getting share in both categories, all right? So, we are happy with our development on retail. The main reason why we are getting share, basically speaking, on Amazon and we are not getting share on Consumer Beauty mass is we are not losing distribution in Amazon. And I think, fundamentally speaking, our brands are strong, they have the right to play and the right to win in this channel, and what we have done is that we are clearly professionalized ourselves.

Now, we have taken online as a very serious channel which is here to last and our capabilities have been increased and our effort has been increased, and we are sharing our business plan with Amazon, and I think they are very happy with this plan because they see an opportunity for them to grow their own penetration, whilst at the same time growing our own penetration. And coming back to one of the early questions of Nik, earlier over the trend of mass Consumer beauty. There is also an element in the decline of Consumer Beauty that a lot of – some of the business shifting to Amazon and that's not picked up Neilson too.

Pierre Laubies

Chief Executive Officer & Director, Coty, Inc.

Okay. So thank you all for following the call and for your questions, and we'll be seeing you on the road. Thank you and have a good day. Bye, bye.

Copyright © 2001-2020 FactSet CallStreet, LLC

Pierre-André Terisse

Chief Financial Officer, Coty, Inc.

Thank you so much.

Operator: Thank you, ladies and gentlemen. This does conclude today's conference call. You may now disconnect.

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2020 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.