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Coty, Inc. (COTY)

Q4 2020 Earnings Call

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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 Fourth Quarter Fiscal 2020 Results Conference Call. As a reminder, this conference is being recorded today, August 27, 2020.

On today's call are Pierre-André Terisse, Chief Operating and Chief Financial Officer; Peter Harf, Coty's Founder and Executive Chairman; and Sue Nabi, Coty's appointed CEO.

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 lists factors that could cause actual results to differ materially from these forward-looking statements. 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 release.

Later, we will conduct a question-and-answer session. [Operator Instructions] Thank you.

It is now my pleasure to turn the call over to Pierre-André Terisse to begin. Please go ahead.

Pierre-André Terisse

Chief Operating Officer & Chief Financial Officer, Coty, Inc.

Thank you, Maria, and good morning, everyone. This is indeed Pierre-André speaking. I'll start this call with the financials and then we'll hand the call over to Peter and then to Sue.

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To start the financial review this time, let's have a look at the scope of our reporting as there are some meaningful changes. As you know, we assigned the sale of 60% of Wella being our Professional Beauty division plus Retail Hair to KKR on the 1st of June 2020 with the sale not being subject to any substantial condition. As of that date, Wella is considered a discontinued operation in our GAAP. As a result, we have recasted your accounts for fiscal 2019 and fiscal 2020, and we now present continuing operations being the formal Coty less Wella revenues and direct costs and directly attributable costs.

The costs borne by Coty on behalf of Wella, following the closing, will for a part be re-invoiced through transitional service agreements and we have therefore prepared a set of numbers called Ongoing Coty, Ongoing Coty which better reflects what Coty ex-Wella is expected to be post-closing. Going forward, most numbers will refer to Ongoing Coty and I will specifically flag when I use other metrics. You can find the bridges from Total Coty to continuing operations and then to Ongoing Coty in the recast historical financial posted on our Investor Relation website as well as in today's earnings release and in the slide presentation.

In terms of numbers, Coty adjusted operating income in fiscal 2019 on the left was $950 million or 11% margin. Wella profit ex-central costs 459 million or after including the estimate TSA cost, $407 million, and as a result, Ongoing Coty operating income was $543 million or 8.7% operating margin, and Ongoing Coty EBITDA was $875 million.

Looking at fiscal 2020, Total Coty adjusted operating income stands at $161 million or 2.4% of net revenue. Wella stood at $271 million, and Ongoing Coty at negative $110 million adjusted operating income with an EBITDA of positive $226 million.

Fiscal 2020 variance versus 2019 reflected the impact of COVID and the closure during most of the fourth quarter of most of our sales channels as well as some of our production sites. And so, Coty fourth quarter was marked by external shocks. COVID-19 triggered a global real economy and supply crisis that led to turmoil in financial market. It did hit Coty harder than its competitors because of five reasons.

First, pre-crisis, the company was already experiencing a weak demand situation. Second, Coty's current category mix is skewed to our fragrance, color cosmetic, and professional beauty, which were the categories most affected by COVID-19. Within these categories, Coty was still losing market share in some markets. Fourth, the company is underrepresented in China, which is the market that bounced back first. And last, Coty is weaker than its major competitors in digital and e-commerce.

Against these backdrops, Ongoing Coty net revenues were down, therefore, a big 60% in Q4, with prestige being the most impacted at minus 73%, while mass was less negative at minus 48% as mass retailers remained partially open. April was the lowest point, but every month since then has showed progress across the portfolio in both mass and luxury as well as for Wella. And in particular, July and our latest expectation of the month of August showed significant progresses and stand at approximately 2.5 times April levels, reflecting the reopening of a number of stores, albeit with lower traffic than usual.

While many things remain to be done, Q4 also reflected continuing improvements with a strong momentum and market share gains in e-commerce, a good performance of CoverGirl, Clean Fresh, and Sally Hansen Good.Kind.Pure, and improving market share in color cosmetic in key markets in the US and the UK specifically.

In terms of profit, Total Coty Q4 net revenue drop of close to $1.2 billion, this is last year, led to an operating income drop of $526 million, which is 44% flow-through, as the fixed cost reductions initiated in the quarter were

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insufficient to offset the magnitude of the net revenue drops. This was exacerbated by three elements totaling approximately $50 million, bad debt provisions, plant under-utilization cost, as well as excess and obsolescence provisions as we tried to take a prudent view, including the fiscal 2020 account.

While Wella including TSA costs showed a minimal loss for Q4, Ongoing Coty adjusted operating income was a loss of $323 million for the quarter.

As for non-recurring elements, the drop of our stock price led to an increase of our discount rate, which was a primary driver of an impairment of close to $400 million of our brands and goodwill.

Turning to free cash flow. For Total Coty this time, the negative adjusted operating income translated into a negative free cash flow of $316 million for the quarter, which was in line with our guidance of $300 million to $500 million negative, as we manage to strongly limit CapEx, one-off cost, as well as to balance the working capital; thanks to good work from the procurement and the finance teams.

This negative free cash flow was more than offset by the first tranche of convertible preferred shares subscribed by KKR for $750 million. And net debt, as a result, decreased by $300 million, this is the end of March, to land at $7.8 billion despite close to $100 million negative foreign exchange impact. To be noted, as a post-closing event, we have received at the end of July the second tranche of convertible preferred for $250 million.

I will end up with some update on the side of Wella. While the closure of most salons resulted in a drop of sales of 41% in Q4, things improved from the lowest month, which was again in April; and July and August confirmed the strong progresses, with underlying trends negative mid-single digits.

While the business is recovering, we are obviously working on the closing of the transaction, which we expect to take place by the end of calendar 2020. And following this, Coty will both considerably reduce its debt and leverage to a level which will be adequate to support our turnaround plan. And at the same time, Coty will keep a 40% interest in the low-risk business with a strong potential.

And with this, I now hand over to Peter.

Peter Harf

Chairman and Chief Executive Officer, Coty, Inc.

Thank you very much, Pierre-André. Let me start by thanking all the people of Coty. They helped us and they gave their best to have the company weather the storm of the worst economic and health crisis the world has seen in the last 80 years. Too many people in many countries gave all they had to make the damage for the company as small as possible. I thank everybody for that very, very much.

We had a very challenging quarter. We had a challenging year. I don't want to repeat what Pierre-André already said, but he also talked about the green shoots. He talked about the fact that we are seeing improved business in fiscal 2021 in the first quarter, and I'm glad to report that we're going to be making money in the first quarter of 2021. We have significantly lowered our breakeven point, so the lowest sales level ending fiscal 2020, we will make a significant amount of operating income.

I've been now CEO for three months. Before that, I was working obviously very closely with the Coty management. And my focus has been all the way relentlessly to bring the company back on track, to realize its underlying potential. Right from the start, I was aware of the issues that were concerning our investors, our shareholders and the company. These specifically relate to capital structure, operational underperformance, the

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product portfolio and the top management. We've taken decisive action to take each and every one of these concerns head-on with bold step changes. In each of the areas concerned, we are showing clear progress during the past few months. Let me take stock.

Firstly, we recognize that Coty leverage ratio is high. To lower Coty's debt level and to strengthen our balance sheet, we entered into the agreement with KKR, selling 60% of Wella. We call it DivestCo to KKR, but maintaining, as Pierre-André stressed, I mean the 40%. These are very valuable and highly profitable assets for the company going forward.

We were going to get for that $2.5 billion net cash proceed. We expect the transaction to close by the end of calendar 2020. Between Q4 2020 and Q1 2021, KKR also injected negative $1 billion cash into RemainCo of convertible preferred stock. Upon conversion, this will give KKR a 70% stock share of RemainCo, but we will retain the absolute control over 50%.

Secondly, with Coty underperforming on operating margins and efficiencies, we have set rigorous objectives for fiscal 2021. We need to be profitable for the full year and significantly profitable for the full year and we are striving for constant like-for-like net debt, excluding the proceeds of the Wella divestiture, even if the ongoing COVID-19 pandemic will impact the beauty industry more strongly than many anticipate.

Second, make the balance sheet lighter and the business less complex through smart disposals, a reduction in the number of sites, outsourcing, and more third-party manufacturing. We also reduced third-party expenses, people, non-people costs, CapEx, non-working advertising and consumer promotion to the absolute minimum. Clear action plans and progress in these areas give us confidence that we'll deliver over one-third of the savings of our $600 million fixed cost reduction program in fiscal 2021.

We also realize that our portfolio exposure is lagging behind new consumer demands and trends. We've taken concrete steps to rebalance and to strengthen our portfolio to be competitive in light of these changing consumer demands. We built platforms that address Coty's structural weakness in skincare, Northern Asia, e-commerce, and D2C, direct-to-consumer, by acquiring the irrevocable rights to Kylie Jenner's and Kim Kardashian West's cosmetics.

We create also the space for additional brand building and brand investments in order to redynamize our existing portfolio and under Sue Nabi's leadership. With regard to Kim and Coty, Coty entered into a strategic transaction to buy 20% of Kim Kardashian West. That by the way secures the irrevocable rights that we have from Coty going forward into the Kim Kardashian brand name and all the activities around that brand. Coty will be responsible for the portfolio development in skincare, hair care, personal care, nail products and also in fragrances. Kim and Kylie give Coty the platform to sell skincare, a lot of beauty categories globally, in particular in Northern Asia. We are renegotiating licenses that we have in our prestige portfolio that do not provide sufficient profitability for Coty, and we are making progress also on that front.

Next, I realize that Coty's culture needs to be fit for the fast pace and the changes in our cosmetics industry, and that the initiatives the company is implementing need us to be very, very light-footed, so we're bringing back the agility and the nimbleness that is part of Coty's DNA. We have flattened the organizational structure, simplified the decision-making processes, formed a small group of leaders that can take important actions fast, so we're making Coty ready for the good things to come.

In July, we corrected the key shortfall, probably the worst issue that distract Coty throughout the years. We have not had a beauty industry veteran at the helm who truly understands the nuances of the beauty industry that can

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drive the business, the cosmetics business forward effectively. We corrected this problem by recruiting Sue. Sue Nabi, a proven successful beauty leader, who has the ideal prerequisites to become the CEO of Coty. Coty is a 27-year veteran in the beauty space with a breadth of experience across all of the areas which are most relevant to Coty's future. She was at L'Oreal for more than 20 years with leadership positions across the mass and luxury segment in color cosmetics, skincare, and fragrances and is well plugged into the key international markets. Particularly, she has deep knowledge of Northern Asia.

She not only brings deep expertise and experience in the area that Coty operates in but also in areas that we want to strengthen, including skincare, e-commerce, direct-to-consumer, and Asia. In her long career in the beauty business, she has successfully navigated countless cycles and trends, adversities including reinvigorating various established brands. With the uncertain markets and industry conditions ahead of us, the pivotal changes we will make at Coty, her breadth and depth of experience will be especially crucial. In her latest venture as the founder of Orveda, she has proven that she's also an adventurer entrepreneur who understands start-ups. This understanding, by having at the same time a strong corporate institutional background, brings a much needed nimble entrepreneurial mindset to Coty that could not be more relevant for our current needs.

Before I turn it over to Sue for comments, I want to leave you with a few key thoughts on the new Coty powerhouse that we will – we are underway of becoming. First, I highlight the Coty of today is very different from the Coty even a few months back because we have taken proactively decisive and bold actions, addressing the various key concerns identified head-on and re-pivoting the business. You can clearly see green shoots emerging despite this challenging environment, as we gain market share, build strong e-commerce momentum, successfully launch new products, and Kylie Skin in particular is on track to expand.

Like I said, we have seen a strong rebound in the last couple of months, which we expect to continue. Coty is back. For our investors, we have been making sure that as we block-and-tackle to sustain our business, we have also looked to future-proof the company with new initiatives that will enable Coty to operate more efficiently and that give us the room to grow the business. The new and different Coty has a more robust capital structure, improved operations, a streamlined and redynamized portfolio, a complementary stable of strong heritage brands and direct-to-consumer brands, is diversified across categories and channels, has the breadth to play in both value and in premium, has digitally and social media capabilities that will help us grow aggressively in these areas in the digital space, has growth potential both in the white spaces that we are trying to address, and from reinvigorating the existing brands, has a focused management team led by a proven and successful beauty expert.

With all this said, including when I took over the role of CEO a few months ago, there's a lot of potential in Coty. Today, I'm even more convinced that the new Coty has more potential than ever before to unlock and to create value. We are rewriting the Coty story to elevate it to a beauty powerhouse with the right to grow and the right to win.

Sue Nabi will lead us, and with pride, I hand over to her now.

Sue Youcef Nabi

Founder and Chief Executive Officer, Orveda

Thank you very much, Peter, ladies and gentlemen. For me, there is no better moment to join Coty. Although my official first day will be in five days, I'm happy to share with you why I'm strongly convinced of a bright future ahead for Coty.

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First, I would like to thank you, Peter, for pivoting the company to the new Coty and putting in place the necessary changes to set up a strong foundation for me to build on. In over 25 years in this industry with many opportunities, I have learned my lessons on what makes a beauty business or a brand successful. As I took a step back to assess the potential of Coty, I realized very quickly that this is a diamond in the rough.

Coty is transforming. Now is the beginning of something new, something hopefully very exciting, and something clearly modern. Today, stakeholders want something meaningful. What people love are great comebacks, success stories they can be part of. I want to create an inspiring, very nimble, successful new Coty with the whole Coty teams. The seeds of the new modern Coty are, in fact, already in place.

We have two key and well-positioned operating franchises mirroring the world of beauty and a new continent to be explored. All modern beauty groups are simplifying their organizations for more clarity, and they all end up having a luxury franchise and a mainstream mass franchise. Coty is the first and only company at this level that is exploring the potential of the new continent of the direct-to-consumer business model through personality-led beauty with strong social media engines and followers. The new Coty will be driven by three key factors for me.

First, the mass franchise, which is a key one, especially in the new norm that we are in, characterized by uncertainty, and of course, economic difficulty, yet its mission is essential and vital more than ever. When the COVID-19 crisis hopefully will end, it will be the place where large number of people around the world can access the latest trends and innovations, find the best quality at an affordable price, experience the diversity of all kind of beauties, and probably, and this is very important, the place where many will buy their first beauty products and fall in love with the beauty of tomorrow.

Secondly, the luxury franchise is key, as it allows everyone to access iconic fashion brands, yet still at an affordable price compared to fashion itself, to enter the world of red carpets, in one word, dream. Luxury beauty would become the entry point for many to buy iconic global brands at affordable prices, even as luxury fashion is more severely impacted by the current pandemic.

Third, the new continent of opportunities. The new continent of DTC personality-led beauty. I'm thinking about Kylie and Kim Kardashian West, of course, is key, as it is a continent full of promises. This has nothing, nothing to do with the business of celebrity fragrances. It has, by essence, what every brand is dreaming of, a large, very large captive, data-reach audience, and it is probably the most profitable and relative of all retail models. It's nimble by essence, and it will allow us to adapt to trends and make corrections on a daily basis. It will not only be a new continent but also a major lap for the whole group where we will test, learn, correct, and expand our success to the rest of Coty brands.

This in mind, this new continent will allow Coty to show to the world also, and this is very important, that our company, our group, our brands can and will formulate top quality skincare with a mapping of the market that will be comprehensive in terms of positionings, prices, but also technologies and psychologies. Personally, having said that, I do not see any other company that combines these three key engines.

When it comes to brands, Coty has also one of the most beautiful portfolio of brands: brands that stand for something universal; brands that are deeply rooted, some of them being love brands; brands like CoverGirl, Rimmel or Bourjois are brands that are rooted in American, British or French culture. This is unique, this is precious, this is powerful and this is a great basis to write a new chapter for all these brands. These brands, like all our brands at Coty, have a big responsibility though. They need to act flawlessly, they need to be role models and at the forefront of everything.

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The magic of our brand is not just about image. It starts at the product level, always; products that are hopefully new, better and different. A brand like CoverGirl invented modern long-wear, non-transfer technologies. It has also invented modern molded mascara brushes. It has also invented Clean Beauty decades ago. And with CoverGirl's Clean Fresh becoming number one foundation launch this spring, the brand is once again leading the way in a key area.

The luxury business of Coty has one of the most amazing portfolios of the beauty industry, with the trendiest and most successful fashion brands such as Gucci or Burberry that shall become makeup leaders and also the most iconic leaders in the fragrance arena. All our brands need to be the champion of something. This will be one red thread of my philosophy, of Coty's philosophy.

For all these reasons, and these are the reasons why I believe in Coty and I believe strongly in its bright future. French writer Victor Hugo said, there is nothing more powerful than an idea whose time has come. I would add the time for the new Coty has come. I look forward to starting as CEO and to sharing more specific plans with you at the next earnings session.

Thank you very much.

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

Thank you. We're now ready to take some questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Faiza Alwy of Deutsche Bank.

Faiza Alwy
Analyst, Deutsche Bank Securities, Inc.

Q

Yes, hi. Good morning, everyone.

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

A

Good morning.

Faiza Alwy
Analyst, Deutsche Bank Securities, Inc.

Q

So my question is for Sue. First of all, congratulations. It's great to hear you on the call. I wanted to hear more from you about what you think Coty needs to do over the next couple of years to get to the place that you want it to go. You mentioned skincare, you mentioned a few other things, you mentioned this transformation. Can you talk about investments? Sort of what needs to happen, what would you like to see over the next couple years to get to the place that you want to be?

Sue Youcef Nabi
Founder and Chief Executive Officer, Orveda

A

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Hello. Thank you for your warm welcome. Thank you for your question. I think for the next years, the work that has to be, that's on my road map is, first, to really make everything to repair and correct what has been doing wrong recently with the makeup brands, et cetera. And we've been working, by the way, quite hard during this July and August month. As even if I'm not yet in Coty, we've been working with the teams to strengthen these brands, to strengthen their brand equities.

So, first, I would like to strengthen the makeup portfolio and the consumer beauty portfolio. Second, I would like to accelerate the luxury division. And third, I would say, it's really to take full advantage of the fabulous, promising, very profitable and dreamy business model of new direct-to-consumer led beauty brands. So these are the three simple ideas I have in mind.

Of course, this acceleration will happen in all categories: repairing makeup brands, making sure makeup brands are in link and in sync with the beauty needs of people today and tomorrow; in the fragrance industry, what is the new way to sell fragrances, how can we use online abilities to get to people's houses; and of course, in skincare, it's really to build an expertise in-house with the right talents, with the right research and, of course, the portfolio that will allow us to be visible from what I call a simple, very, very accessible skincare to probably the most high-end.

Faiza Alwy
Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thank you.

Operator: Our next 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. Sue, this question is sort of a bit of a follow-up to the first one. It's great to hear your perspective on beauty and what you believe is important for the recovery path for Coty. But it sounds like you're mostly aligned with decisions the company has made already, the divestitures, the partnership and social media brand, et cetera. So can you talk a little bit about where you differ in view versus prior decisions?

And then, Pierre-André, just one quick one for you is, if you could just talk about the key drivers of that first $200 million of cost savings that you're expecting for fiscal 2021? Thank you very much.

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

A

Yeah. I'll take the second part first. Well, it's very much the same as what we had already shared in May and June. And, fundamentally, the work which has been done in the summer – of summer, sorry, by the team under the leadership of Peter has been to start the implementation and to make sure that all the action were embedded into the management and with very clear action plan.

So we know that the $600 million plan touches many areas including, by the way, supply chain. But the immediate actions are very much linked to, A, the Oxygen project, which we have been discussing for the past few quarters and its execution, acceleration and amplification. So we are now in an action mode on that.

Secondly, the reduction of the non-people costs with new golden rules within the group which aim at reducing very, very meaningfully the IT, finance, HR, administrative costs; I mean all the costs which create complexity in

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the business. And, of course, we continue working in many different axes. But the primary source of cost reduction for this year are going to be the two areas I mentioned, and we are talking of something which is going to be north of $200 million.

And then I leave it to Sue for the other part of the question, which was about the difference in point of view versus what has been done so far in the areas she mentioned and what she brings new.

Sue Youcef Nabi
Founder and Chief Executive Officer, Orveda
A

Okay. So, thank you for the question. So, the difference of point of view, I will try to summarize it as simply as possible. I think we need to work on products. We need to become the best experts in the world when it comes to creating beauty products, as simple as this, and this is probably something that had been lacking in the past. So, I really would like this company to become a product-driven, product-centric, but also new business model-centric company, and this is my passion, my expertise, and this is my wish.

So this is going to be a strong driver. Because at the end of the day, what happens is that it's always in the bathroom, in the intimacy of a bathroom that a customer, be it a male or a female customer, has a relationship with a product. And if your product is not the best one on the market, if it's not the one that delivers better than the others, if it's not a product that's perfectly designed for usage, but also for performance, and last but not least, if it's not a product that you feel not guilty by using because it's sustainable, then you'll be happy to stick to this product. So, it's all about products. Beauty industry is all about products.

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

Thank you. Thank you, Olivia. Next question?

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

Stephanie Wissink
Analyst, Jefferies LLC
Q

Thank you. Good day, everyone. I also have a follow-up question, Sue, for you just based on your comments about products. If you could just help us think through how the company has invested its R&D dollars and the changes that you would make to emphasize that product development. You also mentioned in your prepared remarks the idea of formulating top-quality skincare, and then you gave an example of CoverGirl's Clean Fresh product which would be in color cosmetics. Can you maybe talk a little bit about skincare development, R&D focused on skincare, and how you see that from a financial perspective over the course of the next couple of years? Thank you.

Sue Youcef Nabi
Founder and Chief Executive Officer, Orveda
A

Thank you for your question. As you can imagine, this is a bit early for me to present a full strategy, to comment all the elements you're asking me to comment. But the only thing I can tell you is that there are key trends all around health in a way, and these trends are key things we would like to implement through all our portfolio. And the second biggest trend that everyone has noticed is digital, and this one is also another key trend that we would like to implement 360 degrees into all our portfolio. So, these are the two key things I'm working on, health and digital.

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Operator: Our next question comes from the line of Javier Escalante of Evercore ISI.

Javier Escalante
Analyst, Evercore ISI

Q

Hello, everyone. I have a question for Pierre and one for Sue. So, Pierre, if you can revisit a little bit Q4, because it feels that destocking was an issue. At least, in the US, we see that US sales in track channels were down 20%. You are reporting twice as much. So would like to understand the gap between retail sales and reorder and to what extent that contributes to, refilling the pipeline contributes to the swing in profitability in Q1. And also, if you could expand on the outsourcing piece. You have manufacturing plants. My understanding is you want to divest them and set up some sort of third-party manufacturing. And for Sue, I'm sorry for the long question. For Sue, I'm interested in what can you do with makeup right now, given the situation we're in. I've been very impressed with what Kering is doing with Gucci Beauty. They're putting a lot of creative and investment behind it. So, with that in mind, shouldn't this be something that Tmall in China would – should work there? And what is the impediments to open up a shop in Tmall? Thank you.

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

A

Yeah, sorry, it's Pierre-André. I'll take the first part of the question. And by the way, about Tmall and Gucci, we are working towards an opening before year-end. I'm talking calendar. So this is absolutely on the table. We'll get back with more news when we have something more [ph] developed (00:37:25) to say, but this is definitely something we are going to proceed with.

On the performance of – well, maybe on the outsourcing first. I mean, when we said that we would review the cost base, we said that we would basically review everything. And in the everything, there is obviously the core processes of the company, the administration, the finance. There is as well a lot of things to do in procurement. And then there is the use of the capacity of the factories, and the fact that we are not using the capacity enough, and we need to find a solution or solutions which will basically optimize the way we use our supply network. And we are looking at every possibility to do that, exploring it. We are not yet in the project mode, but we are really in an exploratory mode. And I think it's our duty to see what we can do to optimize our supply chain. And within that particular issue, to optimize the use of our capacities and the use of our existing plan. So, nothing else to say at this stage. But as part of the overall $600 million program, we are indeed looking at this as well.

On the performance of Q4, well, April – I mean, March already was very difficult. April was definitely very, very tough. We basically had most of our channels closed, talking about obviously travel, retail, and that remains true as of today, but also the department stores, the beauty stores. And as Peter said, we are under-indexed. We are catching up now, but we are under-indexed in e-commerce. And so we had a very, very large impact. And of course, destocking at retailers was part of the reason that I think there was as well financially a reason of consumer. And the testimony of that is the impact on luxury, which I said in my speech was definitely much higher than the one we have had on mass.

Now, the good thing is that we are recovering. I mean, April has been very low, at minus 67%. May was better. June was better. And definitely, July and August show very meaningful improvement. There is an element of deloading for sure in Q4, and there is an element of reloading in Q1, but in a way, which for me reflects the confidence of the retail, basically.

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So the retail, so no people coming anymore, and they were basically scared, so they had to adjust their stocks and they had to manage their treasury. And today, they are seeing consumer coming back. I mean, it's not full speed, but they're basically more confident, and they are revealing some level of inventory.

But the fundamental thing is that consumer is coming back and that's true in mass, that's true in luxury, and that's true as well at Wella where the adaptation of the hair dressers to the new normal has been remarkable and is today helping. So there are many reasons to be careful because this COVID crisis is not over. There's further development. But we are definitely seeing a good start of the year.

And I leave it to Sue to answer.

Sue Youcef Nabi
Founder and Chief Executive Officer, Orveda

A

Yes. Let me maybe try to understand that other question. If – what's the program on our color cosmetics brands? I would say that we are going to work on three parts. Of course, re-strengthening the sense of purpose of each brand, especially CoverGirl, working on the products, and working on anything that's around retail, be it brick-and-mortar or e-commerce retail. And when it comes to the products, I think everyone knows the story as you know. Clean makeup, which was the first medicated foundation, and this is very modern. This is exactly what people are looking for today. In a way, they are looking for medicated products to put on their faces. And the success of Clean Fresh, which was the latest launch becoming number one in the US during the spring, says a lot about what people are going to look for in the coming months. The movement of the cleanification of beauty is also a key one, and our brands, especially CoverGirl can lead this movement. There are also many other trends, but I will keep these between the team and myself, so that we can surprise the world with new amazing launches in the future. Thank you.

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

A

So long question, long answer.

Javier Escalante
Analyst, Evercore ISI

Q

Thank you very much.

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

Joe Lachky
Analyst, Wells Fargo Securities LLC

Q

Hi. Thanks. First, congratulations to Sue. Welcome aboard. Pierre-André, I wanted to ask a question on leverage. And, obviously, your leverage is extremely elevated exiting fiscal year 2020 given the pressure on earnings. But I wanted to maybe get some perspective on how we should think of it evolving going forward. And I know you're not giving specific guidance but was hoping to get some thoughts on where you think your leverage will be this time next year. Do you expect to use all the proceeds from the Wella transaction to pay down debt? And then longer-term, do you still think you'll be able to achieve your medium-term leverage ratio of 4 times? And how long does it take to get there? Thanks.

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

A

Yeah, I mean I'm not going to – as you said, so I agree with you. I'm not going to give any guidance on that. The only thing I can say is that – I mean the dynamics of all that, the following, the $1 billion from KKR is in the bank now. We ended the quarter with $7.8 billion, which is, indeed, too high. We've managed to deliver a pretty good performance, I should say, given the level of net revenues we had in terms of cash flow at minus $320 for the quarter. We are confident because we are very much paying attention on that, and it's one of our priority to deliver an even better performance, so to stabilize the cash flow for fiscal 2021. And this is before taking into account Wella. So we are definitely on the right track.

Then, in terms of closing of the Wella transaction, we expect to close it by the end of the calendar 2020, so within the coming few months. The process is basically going well. There are no substantial conditions. We keep working well and the business is doing well, which is to me a very, very important element and reassuring element. The business of Wella, helped by nail, by the way, which is definitely doing very good, and by hair all together has been recovering pretty fast compared to Q4.

So the dynamic of the debt is very simple. You take the debt at the end of Q4. You take into account the kind of cash flow I've given you. You take into account proceeds, which we have already said would be $2.5 billion. We have, of course, the $250 million coming from KKR, which are not in the $7.8 billion. At the same time, we have Kim absolutely coming. And that's basically it. You have all the elements. And that will build Coty, which will be definitely much, much sounder and solid in terms of balance sheet and financial position.

I hope it answers a bit your question, even though I did not guide.

Joe Lachky
Analyst, Wells Fargo Securities LLC

Q

Thank you [indiscernible] (00:46:04).

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

A

Thanks.

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

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning. And, Sue, I wanted to congratulate and welcome you as well. I have a question for Sue on how the most recent M&A with Kylie and Kim fits into the brand attributes and sustainability you mentioned.

And also, the two questions for Pierre-André are related to M&A. First, on Kylie, if my math is correct, Kylie only contributed $2 million in the first quarter. And I understand the use of another third-party manufacturer and also the KKB (sic) [KKW Beauty] is related to that, and that perhaps you may want to take the time to find the right partner and also make other Coty products as Sue was mentioning before. Should we see this announcement by calendar year of a new partner, or should we still see delays in the timing of KKB (sic) [KKW Beauty] closure because of that?

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And just a clarification, Pierre. On the Wella deal, is there a potential change in valuation, given that the trends in professional hair became worse than it was in spring or is the valuation intact? Thank you so much.

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

Yeah, sorry. Can you repeat the last question, and then be a little bit more precise on your question about Kim and Kylie and what you call the new partner, which is not very clear to me.

Andrea Teixeira
Analyst, JPMorgan Securities LLC
Q

Yeah, sorry. So two questions for you, Pierre, is first on Kylie. If my math is correct, and correct me if I'm wrong, it only contributed a few million dollars in the fourth quarter. I understand there was a disruption in your third-party manufacturing and, of course, the issues with consumption itself. So I want to understand like what is the negotiation with the third-party manufacturing. I'm assuming you're getting a new partner as we speak. And should we see that announcement soon? And if that announcement also kind of precludes or presents you to actually execute or close the KKB (sic) [KKW Beauty] deal. Because I understand they could be...

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

Okay. I understand the question. And I'm sorry, and your question about Wella was what?

Andrea Teixeira
Analyst, JPMorgan Securities LLC
Q

Yeah. If Wella – basically you – if there is anything, given that the announcement was made back in the spring, and then obviously COVID has become worse than expected. So I think if there is any risk to that valuation?

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

Okay. So I'll take these two questions, and then I will leave it to Sue to give some elements about Kylie, Kim and sustainability. So on Wella first, no, the answer is no. I think the first part of the agreement was in May. Then, the second part was at the beginning of June. By that time, we knew already what the effect of COVID will be. And, in fact, we had already passed the worst month, which was April, and we had already seen some improvement. And if any, the evolution of the situation has been better than what we thought at that time with all the parameters we had in mind.

So absolutely no risk on that. And by the way, we have an agreement with the price, so there's no question of adjusting to the valuation, neither up or down, but certainly not down. So that's for Wella.

On Kylie and Kim, so just to remind the exact parameters, Kylie is $600 million for 51%. We have already paid that. That was in January 2020, so at the beginning of the second half 2020. It's in our record. In fact, you have a number on the cash flow statement, page 4 or 5 of the deck, which was $666 million. And that's, for the most of it, the payment of this $600 million for Kylie, and there is nothing else coming on Kylie.

On Kylie, we have obviously to work on the situation. I'm not going to comment on potential disruption of partner [audio gap] (00:50:13) as other businesses has been impacted by COVID and by some shutdown of factory. But the important thing to have in mind is that meanwhile we have been working a lot on skincare. There was some elements of skincare in Kylie when we took this stake of 51%, and we are developing it and developing it rapidly.

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We have already expanded the range – the distribution of the range with distribution in Europe with Douglas. We are working as well on expanding the direct-to-consumer. So it's going okay.

And then, with respect to Kim, we are talking of $200 million for not 51%, but 20%, and that will be coming at the beginning of calendar 2021. So we are talking of the third quarter of fiscal 2021 for us, January, February. And, again, it's very much going as planned and we already are working on skincare on this particular time. So that's for me.

And, Sue, you'd be...

Sue Youcef Nabi
Founder and Chief Executive Officer, Orveda
A

Yeah. If I understand, the question is about the potential sustainability of influencer-led beauty businesses, et cetera. So, I have to say that I'm very intrigued by the new possibilities offered by brands like Kylie Beauty and Kim Kardashian West. All these personality brands have, as you know it, hundreds of millions of followers on social media. These followers are consumers, who are very engaged with the brands who offer their feedback. They are going to directly or indirectly provide a lot of data points, which will allow us to strengthen, adjust, and create the best products possible precisely for them. More importantly, I should say that at Coty, we are focused on developing very strong skincare ranges for both brands. Skincare products, as you know it, they see much stronger loyalty than other beauty products such as fragrances for example. And in addition, both Kylie and Kim, skin will play one of the fastest growing areas of skincare, which is the mid-range, of course, and the entry prestige areas. So, as a summary, I would say that people will first buy because they love and trust Kim and Kylie, and they will repurchase because they love our products.

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

Thank you. And maybe we'll take one last question.

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

Mark Astrachan
Analyst, Stifel Financial Corp.
Q

Yeah, thanks. And hello, everyone.

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

Good morning.

Mark Astrachan
Analyst, Stifel Financial Corp.
Q

I wanted just to start to clarify. So, in looking at the July-August commentary, trying to triangulate on a bar chart in a presentation admittedly, it looks like if you kind of extrapolate the sales average, the July-August would be down something in the order of kind of high single-digits year-on-year. So, I just wanted to make sure that I was looking at that or interpreting that correctly. And then just bigger picture, perhaps for Sue, so how do you think about what needs to be done to make CoverGirl, Max Factor, some of the bigger brands, relevant again? Obviously, you've seen, certainly for CoverGirl, multiple brand relaunches in recent years. So, what could potentially get you to a

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different spot this time around? And admittedly early, but how do you think about EBIT margins for the business over time in terms of trying to, how to grow sales but also invest appropriately in the business? Thank you.

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

Yeah, I'll take the first question first. I'm not sure you can read the chart the way you do, among other reasons, because you have Q3, but you don't have the quarters before. What I will say is that so on the back of a minus – or close to $70 million, then $50 million, then $40 million in the course of Q4, we have definitely changed the shape of the net revenues. We are around minus $20 million for July-August, which is a real big improvement. Having in mind, for instance, that the travel retail, which used to account for about 9% of our net revenues is still extremely penalized by the absence of traffic. And, therefore, the rest, and here I'm talking of RemainCo only, I'm not talking of Wella, is progressing rapidly compared to what we had in Q4. Now, the very important thing for us is not only that. It's the fact that, as mentioned by Peter, we've been doing ahead of the work on the cost side, lowering the breakeven point, and therefore, creating the condition for this quarter to be profitable, even though we are not back yet to the level of 2019. And therefore, we are really entering 2021 with a new cost base, a new management of course, which allows to protect the profitability and to protect the cash flow. And if we continue seeing some good news on the net revenue side to invest and to fuel the growth. But if we don't, we are protected. And that's the most important element.

Sue, can you just remind...

Sue Youcef Nabi
Founder and Chief Executive Officer, Orveda
A

So, your question is about relevancy of brands such as CoverGirl, Sally Hansen, et cetera, correct?

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

And Max Factor, yeah.

Mark Astrachan
Analyst, Stifel Financial Corp.
Q

Yes, exactly. What it takes to refresh them to get back to sustainable, profitable growth.

Sue Youcef Nabi
Founder and Chief Executive Officer, Orveda
A

We'll have to work for sure. But again, I'm quite convinced about the potential of these brands, especially CoverGirl, which is, I don't know if you know it but it's the most loved brand in America, far ahead of many competitors. This is a key point. But CoverGirl probably is in need of a new sense of purpose to really strengthen its visibility and messaging to its customer and to the new generation. Secondly, as I said it before, it's all about creating new, better, and different products that are better than what the competition is doing. And for this, we're going to work hard to make this happen. We're going to focus more on the key products that we feel are going to change the destiny of each brands. And of course, we'll do a very strong SKU management also because this is the kind of things that can make your fabulous innovation invisible in stores. So, this is also something that we are working on very, very hard. And of course, we're going to focus very strongly on ways to convey this new brand equities and sense of purposes through digital media like social media, but also on our e-commerce platforms, and probably see how we can take these brands into the DTC world. So, these are really, for me, the three areas.

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But the most important again is to make sure we are proposing people, women, men, whoever is looking for makeup, the right makeup post-pandemic, and the right makeup versus the competition.

Pierre-André Terisse

Chief Operating Officer & Chief Financial Officer, Coty, Inc.

Okay. Well, thank you for these questions and for your attention. We'll stop now. As Peter said, we are very excited of this new page working with Coty, extremely focused because there is a lot of things to do, but very excited. And we look forward to seeing you on the road. Thank you.

Sue Youcef Nabi

Founder and Chief Executive Officer, Orveda

Thank you. Bye.

Operator: Thank you, everyone.

Pierre-André Terisse

Chief Operating Officer & Chief Financial Officer, Coty, Inc.

Bye-bye.

Operator: This does conclude today's conference call. You may now disconnect.

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