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Coty, Inc. (COTY)

Q2 2025 Earnings Call - Q&A

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MANAGEMENT DISCUSSION SECTION

Operator: Please stand by. Your program is about to begin. [Operator Instructions] Good morning and afternoon, everyone. My name is Margo and I'll be your conference operator today. At this time I'd like to welcome everyone to Coty's Second Quarter Fiscal 2025 Question-and-Answer Conference Call. As a reminder, this conference call is being recorded today, February 11, 2024, at 8:00 AM Eastern Time or 2:00 PM Central European Time.

Please note that on February 10, at approximately 4:05 PM Eastern Time or 10:05 PM Central European Time, Coty issued a press release and prepared remarks webcast which can be found on its Investor Relations website. On today's call are Sue Nabi, Chief Executive Officer and Laurent Mercier, Chief Financial Officer.

I would like to now 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 Coty's financial results and Coty's expectations reflects certain adjustments as specified in the non-GAAP financial measures section of the company's release.

QUESTION AND ANSWER SECTION

Operator: With that, we will now open the line for questions. [Operator Instructions] We'll take our first question from Oliver Chen with TD Cowen. Please go ahead.

Oliver Chen

Analyst, TD Cowen

Q

Hi, Sue and Laurent. Thank you. On your commentary about a sell-in relative to sell-out, what are your thoughts about when retailers might undergo replenishment as that's an issue you're seeing? Also, on your comments on China, Travel Retail Asia, Australia and Consumer Beauty, I mean, how would you characterize the magnitude of the issues relative to what you mentioned? China is not a large percentage of total, but it sounds like things are more cautious there. Thank you.

Laurent Mercier

Chief Financial Officer, Coty, Inc.

A

Yeah. Thank you. Thank you, Oliver. Thanks for the question. So just to give you, I would say some, as you said, some magnitude, indeed, as we flagged indeed in -during the last quarter and we discussed that we were seeing some pockets of the business, okay, where there were some challenges, and we were expecting that these pockets, I mean, will stabilize. And in fact, we see that they are worsening in the Q2. In fact, we are talking about 20% of our business, so, which is China, but also Travel Retail Asia, Australia, ANZ and also Consumer Beauty. So this is really the scope we are talking about. And indeed, so if combination of China, Travel Retail Asia and Australia are impacting our Prestige business in terms of sell-in by roughly 3 points, this is really what you need to have in mind.

And if we look at the Consumer Beauty side, indeed this is really on the US consumer beauty challenges, which is also impacting by 3 points. So these are really the two areas of disruption, if I can call them these, where at the same time – so indeed about retailers, indeed, I mean, we had good – especially in prestige, especially in fragrance, I mean, we had good sell-out during the holiday season, but we are seeing low replenishment from retailers. So we are seeing that there is a global pattern, that they are very cautious on their inventory management and indeed managing these – their inventories very, very cautiously. And this is indicating also the gap between the sell-out and the sell-in.

And if I just take concrete example on fragrance where indeed we had – I mean, fragrance as a whole is performing well, I mean, we feel sell-out being between the mid to high-single digit, but indeed, we are seeing sell-in below due to this very cautious behavior by the retailers. The sell-out is very healthy.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

A

And Oliver, this is Sue. Just to complement on Laurent's answer, we don't see this replenishment happening in H2. That's what explains our prudent guidance. And we hope that this will happen at the moment or another, especially given what Laurent just described, which are the very strong sell out we saw during the rainy season, and we continue to see behind our fragrances in both divisions.

Operator: Our next question comes from Rob Ottenstein from Evercore. Please go ahead.

Robert Ottenstein

Analyst, Evercore ISI

Q

Great. Thank you very much. You obviously touched on it in the release. Was wondering if you could go into a little bit more detail on both the structural challenges that you're seeing in US color cosmetics and the competitive challenges and how you look to combat those going forward. Thank you.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

A

Yeah. Good morning, Rob. This is Sue speaking. So indeed, you're right. We mentioned some structural challenges. Some of them are also, I would say, challenges of the moment, specifically when it comes to the closures we are seeing in the pharma drugstore environment. So it's not just structural. But a bit of these challenges is indeed structural.

I believe, and this is one thing that I addressed in the earnings call – during the earnings script, sorry, that what makes the color cosmetics category – because this is the category we are referring to much healthier in prestige – is the combination of both the heritage couture brands, if I may call them like this and indie brands, which is not what we are seeing today in the Consumer Beauty color cosmetics space where only new brands are favored and these new brands are not able to make up for the decline of the market. So I think it takes two to dance, and this is what I believe is the strength of the – any market.

And the heritage brands, by the way, are still doing the biggest chunk of the sales. So I believe that the color cosmetics market, specifically in the US, but also elsewhere, would highly benefit from same exposure between heritage brands that are doing an exceptional job. I'm thinking about CoverGirl that is the, among legacy brands, the one that is the best among heritage brands. I'm thinking about Rimmel outside of the US, together with, of course entering, new brands, new indie brands, which are going to give a kind of excitement, trendiness, et cetera. So it really takes both to grow the market. So if this – and this is part of our discussions with our partner

retailers – if this is what is going to happen, I believe that there is no reason for the color cosmetics market not to be back to its traditional low-single digit growth.

Robert Ottenstein

Analyst, Evercore ISI

Great. Thank you.

Q

Operator: Our next question comes from Filippo Falorni with Citi. Please go ahead.

Filippo Falorni

Analyst, Citigroup Global Markets, Inc.

Good morning. Good afternoon, everyone. You talk about the – some of the weakness coming out of fiscal 2025 persisting potentially in the first part of fiscal 2026. But at the same time, you're expecting an improvement in sales growth in fiscal 2026. So can you comment on kind of the levers that you have in fiscal 2026 as you entered fiscal 2026 to kind of accelerate organic sales growth? And in terms of like how should we think about the year relative to your medium-term outlook of 6% to 8%? Thank you.

Q

Laurent Mercier

Chief Financial Officer, Coty, Inc.

Thank you very much, Filippo. So first, let me just remind everyone, because I think this is an important element, but this first half and the second half, by the way too is in front of our best year ever. Okay. Fiscal 2024 was a year where the company has grown with the highest growth potentially in prestige, 18%, and the highest growth ever in the Consumer Beauty division, which was around 7%, if I recall well. So this is really what explains, in a way, how much the comparative has been high for us when it comes to fiscal 2025.

A

In fiscal 2026, we believe that, one, hopefully the good news would be that retailers will come back to more, I would say, classical or normal inventory levels because they cannot forever stay at this level of inventories. I think this was an overreaction following the stocking post-supply chain crisis a year and a half ago. So, hopefully, there will be a kind of stabilization. Second thing, you know our market is a market that's driven by offers. Some competitors speak about stimulus. We speak about an offer-driven market, and it's all about this. So we will contemplate for fiscal 2026 two very big blockbuster launches.

May I remind people that Coty has been putting on the market and still today some of the best performing launches of the industry. Thinking about Burberry that is continuing to grow by double-digit growth, between 20% and 30% year-on-year, which is really unprecedented. Kylie Cosmic, the number one volume launch in the US and in UK; Marc Jacobs Daisy Wild; Hugo Boss, which has become the number one brand of the division and of the company, by the way. So it's really an offer-driven business. So we had a big innovation in the first half, same thing in the second half.

We are also accelerating our distribution gains when it comes to some of our key pillar brands in the prestige division. Some brands, and for example, Chloé, was really not a brand we were playing with in the US market. We decided to do so in the first half and with very strong results. So we will expand this. So the conjunction of big launches together with the distribution expansion of some of our key prestige brands in the US, but also in other emerging markets, will help us to be back to growth in fiscal 2026. This together with anything that is not in our control such as back to more classical retailer inventory levels, and hopefully, hopefully Travel Retail in Asia and China, even if these are low-single digit percentages of our mix, they are still heavily disrupted in the moments we are in right now.

Operator: Our next question comes from Korinne Wolfmeyer with Piper Sandler. Please go ahead.

Korinne Wolfmeyer

Analyst, Piper Sandler & Co.

Q

Hey, good morning. Good afternoon. Thanks for the question. I'd like to understand some of the puts and takes of the margin outlook a little bit better. Can you just describe a little bit on the fixed versus variable cost structure you're dealing with for the back half, how much deleverage you're baking in with the guidance and how much reinvestment in A&P and innovation and things like that? And then also, I believe in the prepared remarks, you discussed some softer promotional activity last quarter. Is that something that you might decide to pull on a little bit more here in the back half to help drive volume performance, or are you committed to other forms of volume activation? Thank you.

Laurent Mercier

Chief Financial Officer, Coty, Inc.

A

Yeah, thank you. Good morning, Korinne. So, first of all, what I want to highlight is really that we are showing in this fiscal 2025 and in H1 that we have a very healthy P&L and a very healthy balance sheet. So you saw the result is really that with, I mean, gross margin expansion in H1, I mean, which is close to 200 basis point, and we are close to 67% gross margin end of Q2. So it shows really that all the work we are doing really managing the full equation, we do it in a very disciplined manner and we keep focusing on this gross margin expansion, which for us is really the strong KPI because, of course, this is really then what's fueling our investment behind the brands, and really, we keep this very strong discipline.

So now looking ahead, talking again about gross margin, as you remember, last year we had also, I mean, very strong gross margin expansion in the H2, which was around 150 basis point. So now, we are going to rebalance. There is a seasonality effect so that our H2 gross margin will be slightly lower versus last year due to this high base, but it will remain 100 basis point above fiscal 2023 gross margin. So it means that our full year gross margin will end up about 100 basis point improvement.

Now, of course, [ph] base (00:13:31) starting from this gross margin expansion, and I can detail later, but is really the combination of productivity. We still have some pricing effect, I mean stronger in H1, because we have the carryover from the previous year, but we will have still some positive impact in the H2 also benefiting from the mix. Then we make sure that we keep our AnCP in the high 20s, as you saw in the H1, and we continue in the H2 to support the initiatives that Sue has just described and really to continue to fuel the sell-out.

Then we – I mean, as you know, we are putting in place very strong savings initiative. We confirm one of the \$20 million this year. So it's a combination of short-term actions, but also more medium, long-term actions which will keep fueling, I mean, the margin for next year. So that's really all this that we are showing that we are being disciplined, but also agility to manage and to continue EBITDA margin improvement, even in a context which is more uncertain and volatile than before. So that's really – and that's why we confirm really that our – we see our EBITDA margin growing from 70 basis point to 90 basis point fiscal 2025, which means that our EBITDA margin will be close to 19% at the end of this fiscal.

Operator: Our next question comes from Olivia Tong with Raymond James. Please go ahead.

Olivia Tong

Analyst, Raymond James Financial, Inc.

Q

Great. Thanks. Good morning. Good afternoon. I was wondering if you could talk about why you think prestige fragrances has been able to hold on better with respect to growth versus other categories, and in terms of the other categories, particularly mass, what you can do to – with respect to innovation – to help offset the externals. Thank you.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

A

Yeah, Olivia, thank you for your question. This is Sue speaking. So indeed, it's very interesting questions, and I say because this is really what is the key element of the growth of the market. I believe that prestige fragrances are holding much better because they are not easily replaceable. When you like a scent, you're going to buy the scent, and anything closer is not exactly the scent that you like. While on other categories specifically, for example, on color cosmetics, if you like, I don't know, the latest lip color or a primer, whatever, you'll always find something that's very close and trying to buy something closer.

So I believe that the entry barriers of prestige fragrances are higher because of the uniqueness of the creation, because of the quality of the juices, and also because of putting inside this bottle things that have been crafted for two, three years that are really creations together with science know-how. I'm thinking about what we've been doing recently, by adding molecules that act on the longevity of a fragrance. So these are barrier to entry to the category that explain why fragrances, specifically prestige fragrances or fragrances with a cool, I would say, vibe are really resisting better than other categories.

So what can we do in terms of innovation and other categories to fuel the growth? Well, the answer is in the first part, in fact. It's about creating entry barriers. I believe that the color cosmetics world have given up on real innovation. It has become a world of TPMs where everyone is buying from the same TPM the same kind of innovation, and you end up buying the cheapest option. So it's really this that is missing today in this market and that we are fighting against, and we are working on through agile innovation that we put in place recently. It's to be able, of course, to be on trend and to launch the latest buzz of the moment, but also to be able to put on the market high entry barrier innovation, something difficult to copy, something that's worth the price that you're putting on it, and something that will grow back the market by re-attracting consumers who decided that it's worth it only if it's the cheapest option.

Operator: Our next question comes from Ashley Helgans with Jefferies. Please go ahead.

Ashley Helgans

Analyst, Jefferies LLC

Q

Hey, thanks for taking our question. So last quarter, you mentioned some upcoming kind of product introductions. Just curious if maybe you've held off on some of those given the environment or maybe if they didn't perform as expected. And then just following up a little bit on Olivia's question, on fragrance being such a strong driver, what's embedded in your underlying assumptions for the second half about the fragrance industry? And then anything you can tell us on fragrance quarter-to-date, that'd be helpful. Thank you.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

A

Okay. So let me take the question part-by-part. So last quarter, we mentioned some upcoming launches. Indeed, we released them. One of the biggest highlight was indeed the Gucci Flora Orchid, which is really one of the biggest successes of the fall Q1 and Q2. This is really something that was part of the agenda, yes, to a lesser extent than what we did with Burberry Goddess two years ago. But still, it's something that is really part of the best-selling innovations in the US. And we started, that's why probably you did not see – we didn't see an effect that was so high. We started with an exclusivity at one key retailer globally, which in a way didn't allow us to take a benefit from all the impact of this launch. Now it's the case. It's rolled out everywhere, and we can really see that this flora innovation is doing very, very well. So that's number one.

Number two, we are continuing to do key innovations on Boss, specifically on Boss The Scent and the Elixirs and the Eau de Parfum we have launched. This is what explains that Boss has become the number one brand of the company with a stellar growth which is close to high-single digits. So this is really also something that explains the two key launches that we have done in the first half.

So what are we assuming on fragrance category growth in the second half? We are also going to continue to have launches without revealing what are going to be these launches. We will continue some of the key initiatives we started in fiscal 2024 in the second half by anniversarying these initiatives. Last year, we launched Kylie Cosmic and Marc Jacobs Daisy Wild, which, by the way, for Daisy Wild has become the number one SKU in terms of innovation in the UK market. So these two innovations will be anniversaryized. Last but not least, as you heard during the earnings script, we are back also to key innovations behind entry prestige brands. I'm thinking about Davidoff, who will see for the first time a very strong innovation represented by a Gen Z favorite, Charles Melton, which you will see during the second half of the year.

Operator: Our next question comes from Patty Kanada with Goldman Sachs. Please go ahead.

Patty Kanada

Analyst, Goldman Sachs & Co. LLC

Hi, Sue and Laurent. Good morning. Good afternoon. Thanks for taking my question. I just had one on Asia Travel Retail and just Travel Retail in general. So we've been dealing with pressures there for a while now. So wondering if you could talk about Travel Retail outside of Asia and how you're performing there. And related to that, are there opportunities to perhaps resize or reshape your strategy by rebalancing toward non-Asian regions where maybe there is less volatility and more growth opportunity? I would love your thoughts there. Thank you.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

Yeah. Good morning, Patty. This is Sue. Again, this is a good question. We started to do this, in fact, in the second half of the first half of this year, meaning October, November and December. We've shifted significant resources from Asia markets, specifically China, but also the Asian Travel Retail to the US and to European market, but mainly to the US. That's the reason why even if we do not communicate on this, but we show our sell-outs, reaching some weeks at 50%, 60% of growth in terms of sell-outs prior to the holiday season. So this was really the result of shifting resources from these regions to regions, specifically the US, where there is growth, where the momentum behind the fragrance category continues. The prestige fragrance category is still growing in the high-single digits and it's still continuing to premiumize and the – I would say the – and the adjacent categories of fragrances such as body mix are also booming there. So it's something that we have done and that we will continue to do, to answer the second part of your question.

Now, regarding the first part, which is around Asia Travel Retail, you're totally right to say that the Asian Travel Retail is the one that is really lagging behind the other regions. Americas and Europe are doing very, very well, which is something that is better than what we saw in Asia. But Travel Retail in Asia, I can tell you that it's really behind one key category, which is prestige color cosmetics. It's really the restrictions that happened between Korea and China with regulations on both sides that really stopped literally a key stream of the sales between these two regions that was mainly focused what it comes to Coty and our color cosmetics prestige category. So the rest of the categories, be it fragrances or even skincare, are continuing to grow much better than what we saw on these color cosmetics. So it's really the color cosmetics category that is hurting us, which is, I think, a difference versus what our competitors are seeing in this region where it's a lot behind skincare.

Operator: Our next question comes from Anna Lizzul with Bank of America. Please go ahead.

Anna Lizzul

Analyst, BofA Securities, Inc.

Q

Hi. Good morning. Good afternoon. Thank you so much for the question. I was wondering if you could discuss the retailer channel shift. You mentioned in your prepared remarks, particularly in the US, it seems like some online platforms like Amazon are gaining market share here, and just wondering how you're adjusting to this environment. And then also if you can comment on the different parts of your business, Consumer Beauty versus prestige, and just how they're performing on this channel? Thank you.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

A

Yeah. Thank you very much, Anna. Good morning. So indeed, you are totally right, and this is one of the reasons why I believe that this fierce competition between online players, offline players, of course, e-retailers, who are usually offline players too, it's this fierce competition that is probably also explaining why all these retailers are really, really pressuring their cash management through inventory management. So that is one of the key explanation and which also explains a lot of door closures we are seeing in the country, be it behind department stores, but also behind pharma direct channel when it comes to Consumer Beauty.

So indeed, you're right to mention Amazon. They are gaining market share in the beauty industry. You've seen a lot of players, including some of our brands going to Amazon. I have to remind everyone that we were the first to be partnering with Amazon maybe six, seven years ago with brands such as Boss or such as Calvin Klein. And this has created a very special relationship between us and Amazon.

The other element I can tell you when you asked me about CB and prestige performing on e-comm and Amazon, indeed the growth of our e-comm is stellar on both divisions. And if you think about a brand like CoverGirl, if I take the US market and Consumer Beauty brands, CoverGirl is growing faster than the e-comm market on color cosmetics in the US and therefore gaining market share which omnichannel-wise gives us this possibility to say that CoverGirl is almost stable in the US since we are growing very, very fast on this channel.

I can say the same thing about our prestige brands. They are really doing wonders on Amazon, growing very fast, much faster than in the brick-and-mortar, which is also a very good indicator of the health of the brands, because you know when you look at the health of a brand online, you really have the pure equity of the brand in front of consumers. While when you think about brick-and-mortar, there is a lot of – there is a lot to do with how the store looks like, how your shelves looks like, et cetera. So for us, it's a strategic channel that we've been outperforming and that we are continuing to outperform in both divisions.

Operator: Our next question comes from Susan Anderson with Canaccord Genuity. Please go ahead.

Susan Anderson

Analyst, Canaccord Genuity LLC

Hi. Good morning. Thanks for taking my question. I was wondering if maybe you could talk about your plans around pricing, given the higher FX impact for fiscal 2025 now, and I guess where you're expecting pricing to land out versus units for fiscal 2025.

Laurent Mercier

Chief Financial Officer, Coty, Inc.

Yeah. Good morning, Susan. So indeed, as you know, I mean, we shared many times last year that, okay, with the high inflation, we put in place a price increase, which was a mid-single digit. And even at the moment, we even push towards price increase during the year. So now of course, looking ahead, we are now seeing inflation slowing down, and so, of course – but we will continue price increase, more moderate. So it's going to be low-single digit because, again, with innovations and all what we are bringing to the market, we have a pricing power, and again, that's really all the power of our technology, the innovation. So we will continue. And we keep monitoring in a very precise manner managing also versus elasticity so that it's not going against volumes.

And fragrance is a clear demonstration that we are really well in control. We keep working on pricing in fragrance on both segments, on both divisions, by the way, prestige but also mass. We keep improving the mix and volumes keep growing. So it shows really that we are really well in control of this equation.

Operator: Our next question comes from Andrea Teixeira with JPMorgan. Please go ahead.

Shovana Chowdhury

Analyst, JPMorgan Securities LLC

Hi, this is Shovana Chowdhury on behalf of Andrea. Thanks for taking our question. Can you comment on the inventory levels at wholesalers and retailers? I'm just trying to decompose the sell-in versus sell-out. Just trying to understand if you are still seeing positive sell-in for fragrances and your outlook is flattish to negative even in fiscal 2026, so – or entering, rather, wouldn't retailers run out of inventory in like six months or so? And also more near term, can you please comment on the most recent trends from exiting the quarter and if February has improved? Thank you.

Laurent Mercier

Chief Financial Officer, Coty, Inc.

Yeah. Hello. Good morning. So indeed, inventory at wholesalers and retailers, this is really what we flagged, and indeed, we are still seeing some adjustments. And again, as we just shared, there is also this fierce competition between brick-and-mortar and e-commerce, which is also, in a way, creating some additional tension. Now, when you were raising the question about fragrance, again fragrance is really by far where we are seeing, I mean, really good sell-out in this category keeps growing. And this is the case in prestige fragrance. And this is also the case in the – in mass fragrance. So category is growing. We are growing our sell-out. We are bringing some new initiative. So indeed, we are expecting some improvement really in our sell-in fragrance.

And this is also added with what Sue has just described. So big launches next year, and we have also some pockets of opportunities. Of course, we [ph] remain (00:29:47) in the US where, absolutely, we have some potential. But also, we have still some upside in the e-commerce where there is also greater upside. And last but not least, also in the growth engine markets where we have also some promising plans.

Operator: Our next question comes from Chris Carey with Wells Fargo. Please go ahead.

Chris Carey

Analyst, Wells Fargo Securities LLC

Q

Hi, everyone. I have two questions. So, number one, what is your thought process around long-term algorithm? I think this has been a discussion in this forum for the past few quarters. There was clearly some commentary in prepared remarks about adjustments. I think you had talked about best-in-class total shareholder returns, but have – you have avoided the prior targets that you put out there. Clearly, which makes sense, given the evolution of the category. I think we could hear more next week. But it feels like an important shift to recalibrate expectations more appropriately for the longer term. So I'd love your thoughts on what the business is effectively trying to accomplish in the coming years with a longer-term perspective.

The only second one which I'll add on is can you explain what's going on with the swaps and the prepayment that you have to make in Q3? But mostly, I'm curious on the first question, but I'd love a little bit on the second question as well. Thanks.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

A

Good morning, Chris. This is Sue speaking. So, yes, indeed, this is a very important question. So let me start sharing with you our thoughts. First, this year the beauty market growth, as we've seen it all, is normalizing to a steadier growth level. But I have to say that this low to mid-single digit growth is broadly consistent with what we have estimated several years ago, even if the market was much higher, but this is the assumption we made years ago. And the growth algorithm was based on a market that was growing between plus 3% and plus 4%.

As before, our goal is to outperform the beauty market. This is very, very important. However, in this, as you know, various macro environment, retailer environment, regional uncertainties, now there are potentially tariff wars that could happen here and there, which are honestly at a level that has not been seen, indicates many, many disruptions. I think, and we think that it is no longer prudent to put specific sales growth targets, and we are therefore committed, like some of our peers, to outperform in the market whatever the level of growth we see in our core markets and specifically in our core categories.

So how would we support this outperformance of the market? I believe that we have several drivers in our hands. First, a robust fragrance category with still penetration and usage that are still increasing structurally and across many markets around the world. Second, the company is expanding its offering in fragrances now to mass. So we are really leading and we are the global leader worldwide when it comes to premium fragrances up to mass fragrances.

Number three, we are expanding our businesses in categories where we are currently under-indexed. I'm thinking about prestige, color cosmetics category, including the launch of the new Marc Jacobs color cosmetics line, but also in thinking about skincare. And this gives me the occasion to really say that one brand at Coty is doing wonders in China. Fastest growing skincare brand of the market is indeed Lancaster during this quarter. It's growing on a market that is minus 10% at almost 200%. And some key SKUs has become part of the top 20 of the Chinese market. So this is really the start of our first green shoots when it comes to skincare on the most difficult market at the moment, but the biggest market when it comes to skincare.

Number four, we will continue to grow our penetration and market share online. Hence the question I've been answering a few minutes ago: this is really an area where we are growing faster than the rest of the market and

we reached the billion-dollar threshold a year ago when it comes to online sales. And number five, we'll continue to strongly grow our business in growth engine markets. I'm thinking about South Africa, to take one example, where the company has become the number one prestige fragrance maker. I'm thinking about Saudi Arabia. I'm thinking about Southeast Asia growing by 16%. I'm thinking about Mexico, where the company is doing also wonders.

So, clearly, the addition of this fifth growth – of these five, sorry, growth drivers is really what will allow us to grow our sales above the market. And at the same time, our target remains to continue to grow our gross margin. You've seen our gross margin reaching a record level this quarter, up almost as – almost 70%; 68%, to be precise. And of course, this will allow us to continue to grow our EPS and free cash flow. Laurent, you can do the first question.

Laurent Mercier

Chief Financial Officer, Coty, Inc.

A

Yeah, absolutely. Good morning, Chris. So indeed, on the first – first of all, I mean, I really want to remind that as you noticed, I mean, for the first time ever, over the last eight years, I mean we are reaching now a leverage ratio below 3 times. And we made very clear that at the moment, I mean, we will resume return to shareholders either through share buyback or dividends. So the swap is really a mechanism we put in place indeed to reserve some share buyback. So it's about 48 million shares. So now the mechanics guarantee that it's happening as we are seeing some pullback in our stock price in the recent quarters. So there is a mechanism that, okay, we need to have – to give a true-up cash payment to the banks according to the current stock price. So in a way, this is really an anticipation, but it's also the confirmation that at the moment, indeed, we will operate this share buyback.

Operator: Our next question comes from Mark Astrachan with Stifel. Please go ahead.

Mark S. Astrachan

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. Thanks. Hi, everyone. So, I guess, first one on retailer stock levels. What give you confidence as they return back to levels over the last couple of years, and maybe if you could just comment on whether the inventory levels prior to the recent slowdown, especially in prestige fragrance, which had accelerated coming out of the pandemic, was elevated or not relative to historical levels for fragrances, just from a retailer perspective?

And then secondly, in the press release, you talked about evaluating the operation to fuel long-term success. You're obviously talking about an increasing focus on reducing leverage. I guess what are you thinking in terms of the business footprint today versus maybe three years ago? It does seem like Consumer Beauty is a bit more challenged. You talked about more heritage brands not being the focus of customers at this point. Does the portfolio have today the right one? Would you consider divesting that business? Would you consider M&A to increase exposure to faster moving categories? Just any sort of color there would be helpful. Thank you.

Laurent Mercier

Chief Financial Officer, Coty, Inc.

A

Yeah. So, hello, Mark. So on retailer stock levels. I think this is what we have explained and indeed that we are in a transition year, I mean. So I think it's important to step back a little and we need to understand that indeed over the last two, three years, there were a lot of, I mean, disruptions on the market. So of course, it started with COVID and then there was all the supply crises. And at that moment indeed, some – there was some shortage of products, components. Then retailers also rebuilt some inventory, and now indeed, we are seeing that they are going the other way around.

So difficult to tell you how long it's going to take. But there will be a moment where, I think, I mean the behavior of the retailers will be back also to healthy inventory and then we can really be back to normal combination and more closer connection between the sell-in and the sell-out. Again, assuming that the pocket of disruptions that we are seeing again in Asia and also, as we explained in the Consumer Beauty business in the US, of course, are getting stabilized at least, which is not the case today. So that's really what I can tell you on the inventory for retailers.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

So Mark, this is Sue. On the second part of the question which is around evaluating operations to fuel long-term success, so I – you were referring to our Consumer Beauty color cosmetics brands. Again, in this area, it's first, let me start by saying that it's very encouraging to see that our cosmetics brands, specifically in the US, but not only in Europe too, they continued to outperform most legacy players. And this is very important because it means that despite having much less means than some legacy players, we are doing a very good job by putting in place the right innovation, powered by the right advocacy strategy in the different markets. And we are activating even more and more agile beauty innovations that are supposed to put on the market innovations in as quickly as every six months. So this is on one side. And we continue, I have to say, to see the benefit of operating across multiple beauty categories, multiple markets and of course in multiple channels.

At the same time, like I guess most of the corporations, we are always evaluating our portfolio. This is very important. We are looking very, very closely to the portfolio of the company, and to, of course, where are the long-term opportunities and return on investment presented by each category, by each brand in the different divisions, the different categories and the different markets. So it's really both options that are in our minds continuing the fight, while at the same time looking at what could be done better in the future and what could be pivotal for the company.

Operator: And our next question comes from Carla Casella with JPMorgan. Please go ahead.

Carla Casella

Analyst, JPMorgan Securities LLC

Hi. Just two quick ones. One, you've got a couple of bonds maturing in 2026. And I'm wondering if that's something that you want to get ahead of a year before maturity so they don't go current, or does that matter?

Laurent Mercier

Chief Financial Officer, Coty, Inc.

Yeah. Hello. Good morning, Carla. I mean, of course, and you know this is really a great improvement now with this deleveraging that we constantly work on our debt maturity so that we can really be in a healthy place. So, of course, I mean, these are always – bond maturity is always the option that we are looking at.

Carla Casella

Analyst, JPMorgan Securities LLC

Okay, great. And then the Wella stake declined by about 3% sequentially. Is that – can you give us any update on the performance of that business or maybe the timing of a potential sale of it?

Laurent Mercier

Chief Financial Officer, Coty, Inc.

A

So the business is performing well. So the value that you can see in the books is just some, I would say accounting methodology and strongly driven by the work or interest rate which needs to be used. So it's really not reflecting really the performance of the company. Then on second part of your question, as we reminded in our last earnings call that end of November was the end of the standstill period. So, in this context, yeah, I mean, we remain opportunistic and pragmatic, of course, to monetize this asset, which is a great asset in our books.

Carla Casella

Analyst, JPMorgan Securities LLC

Q

Great. That's super helpful. Thank you.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

A

Thank you [indiscernible] (00:42:19).

Laurent Mercier

Chief Financial Officer, Coty, Inc.

A

Thank you.

Operator: I would now like to turn the call back to our speakers for any closing and final remarks.

Sue Y. Nabi

Chief Executive Officer & Director, Coty, Inc.

Thank you very much. So again, thank you everyone for attending this earnings call. Again, to conclude, of course, as we said it during the earnings call, we are not satisfied by the current sales trend, but at the same time, we continue to believe that this beauty category, both historically and even now and in the future, specifically behind the fragrances, whatever is the price of the fragrances, will continue to be a key driver of growth of this market. We are very happy with the improvement of our fundamentals throughout the last four years, specifically this year. You've seen our gross margin, our EBITDA growth, our EPS double-digit growth, and Laurent just mentioned our deleveraging, which is the lowest since eight years under 3 times.

And last but not least, we continue to outperform the market categories we are playing in. Sell-out is the ultimate indicator of the health of our brands, and this one continues to be very good. Thank you very much.

Operator: Thank you. And ladies and gentlemen, that does conclude today's conference. We appreciate your participation. Have a wonderful day.

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