THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

COTY - Q1 Fiscal 2014 Coty Inc. Earnings Release Conference Call

EVENT DATE/TIME: NOVEMBER 07, 2013 / 2:30PM GMT

CORPORATE PARTICIPANTS

Kevin Monaco *Coty Inc. - SVP, Treasurer, IR*

Michele Scannavini *Coty Inc. - CEO*

Sergio Pedreiro *Coty Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

John Faucher *JPMorgan Chase & Co. - Analyst*

Olivia Tong *BofA Merrill Lynch - Analyst*

Bill Schmitz *Deutsche Bank - Analyst*

Dara Mohsenian *Morgan Stanley - Analyst*

Neely Tamminga *Piper Jaffray & Co. - Analyst*

Chris Ferrara *Wells Fargo Securities, LLC - Analyst*

Wendy Nicholson *Citigroup - Analyst*

PRESENTATION

Operator

Good morning. My name is Sue, and I will be your conference operator today. At this time, I would like to welcome everyone to Coty's first-quarter fiscal 2014 results conference call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. As a reminder, this conference is being recorded today, Thursday, November 7. Thank you.

I will now turn the call over to Kevin Monaco, Coty's Senior Vice President, Treasurer, and Investor Relations. Mr. Monaco, please go ahead.

Kevin Monaco - *Coty Inc. - SVP, Treasurer, IR*

Good morning, and thank you for joining us. On today's call are Michele Scannavini, Chief Executive Officer, and Sergio Pedreiro, Chief Financial Officer.

Before we begin, I would like to remind you that many of our comments may contain forward-looking statements. Please refer to our press release and reports filed with the SEC where you will find factors that could cause actual results to differ materially from these forward-looking statements.

Except where noted, the discussion of our financial results and our expectations do not reflect certain nonrecurring and other charges, and the discussion of our revenue growth is on a like-for-like basis and therefore constitute non-GAAP measures. You can find a reconciliation between GAAP and non-GAAP figures in our press release, as well as on the investor relations section of our website.

I will now turn the call over to Michele.

Michele Scannavini - *Coty Inc. - CEO*

Thank you, Kevin, and good morning, everybody.

As anticipated on our last call and as you read in our earning release, we are facing some challenges at the start of fiscal-year 2014. Today, I will begin by describing the key dynamics that are currently impacting our business in the first part of the year, and then how we plan to return to growth in the second half.

Let's start with the market dynamics, focusing on the key segments where we compete. Today, over 70% of our business is in the fragrance segment and nail product category. In those segments, we have seen a significant deceleration in the market trends in the last few months.

The fragrance market in Q1 was negative 2% in Western Europe and down 1.4% in North America. The trend was slightly negative in prestige and more concerning in mass, where the decline was 4% during the quarter.

Looking at the nail color category, we saw a 4.4% decline in the US mass market in the quarter, and a 7.5% decline in the month of September. This represents a sudden and sharp trend change as the nail market in the US was still growing in the double digits through May 2013. The decline was mostly triggered by lower consumption of special effects product, which boomed in the last two years, fueled by innovation like crackle effect and nail stickers, which made nail color one of the most coveted fashion accessories.

As this part of the business is settling to a more normalized level, the overall nail category can't sustain the accelerated growth it enjoyed in the recent past. It is worth noting that the minus 4% trend in the quarter compares to a plus 21% for the same quarter last year, which means that the category has kept most of the substantial growth that has enabled the nail category to become bigger than the lips category in the US market.

The above market dynamics have directly impacted our US business. Lower consumption has generated a significant inventory reduction by the trade, particularly mass retailers, across all our product categories. We estimate the destocking activity impacted our mass business in the quarter in the US by roughly $35 million.

In this context, our net revenues in the quarter declined 2.6% on a like-for-like basis. The decline was primarily due to the challenges we described in the US mass market.

As a consequence, our business in the Americas declined 10% in the first quarter. In the remaining regions, our business grew, with EMEA up 2% and Asia-Pacific up 7% on a like-for-like basis. Overall, emerging markets grew 8%. Our global travel retail business grew in the double digits, ahead of the traffic increase pace.

By channel, our revenue decline was entirely driven by the mass market, while our prestige business had healthy mid-digit growth.

Let's now analyze in more detail our business by region. In EMEA, our business expanded by 2% like for like, driven by strong performance in the UK, Middle East, and travel retail.

In Europe, and particularly southern and eastern Europe, the business climate remained soft and uncertain. The intense competition for market share in declining markets has led to pricing pressure and greater focus on promotion and value offers. This is particularly true in the mass market, where discounting has increased. This business dynamic is impacting our gross margin, as trade discount and promotion are deteriorating our gross to net revenues ratio.

In the Americas, our business was down 10% on a like-for-like basis. The decline was triggered by the US mass business, which was severely impacted by the concession slowdown and retailer destocking in the markets where we compete.

There is a cautious sentiment for the upcoming Christmas season. Retailers are ordering Christmas promotion at a slower trend than last year. So far, this has not resulted in order cancellation.

While business is challenging in the US, our business in Latin America is growing fast. In the quarter, we recorded a 15% increase, driven by travel retail, Chile, and Brazil. Our new joint venture in Brazil started operating at the very end of September, and we expect to see the impact of our new setup in the second half.

Our door-to-door fragrance business with Jequiti is off to a good start, and the most recent launch of Playboy fragrance has been the most successful fragrance launch ever handled by our Brazilian partner.

Our Asia-Pacific business grew 7% on a like-for-like basis. Australia and southeast Asia were the key drivers for growth. In southeast Asia, we benefited from the initial impact of our new [Star Asia] subsidiary and the healthy development of our prestige business.

Looking at our product segments, we registered 1% like-for-like growth in fragrance, despite the soft market trend we discussed earlier. The growth in the segment was supported by our power brands in prestige, spurred by innovation in Calvin Klein, Chloe, Davidoff, and Marc Jacobs, as well as increasing contribution from Roberto Cavalli and Katy Perry.

On the other hand, our mass fragrance business was affected by the slow market dynamic and by a launch phasing, which this year is favoring the second half. While in the first half of last year, we had the huge Lady Gaga launch, which makes for a tough comparison to this first half.

After several quarters of growth ahead of market pace in the segments and geographies where we compete, color was the segment which suffered the most from the mass market trade destocking in the US, and ended the quarter down 10%. Particularly affected were our nail business and the Sally Hansen brand, which holds one-third of the total nail mass market in the US. Impacting Sally Hansen performance was not only the sudden decline of market demand and the related sharp inventory reduction by trade, but also the escalated competitive environment with many new players competing in the nail arena with increasing investments.

To be noted that net of the nail category, our core cosmetic business was only marginally lower.

Rimmel kept growing, though at a slower pace, as this brand also was somewhat impacted by the general destocking in the US market. Just to give an idea of this dynamic, Rimmel consumption performance in the US in Q1 was outstanding, with sellthrough growing 21% in Q1, while sell-in inched up just 2% in the same period. It is worth highlighting that Rimmel has been the fastest-growing color brand in the US mass market among the top 10 brands in the last 12 months.

The skin and body care segment was flat, as reported, and down 2% like for like. Here the good news come from philosophy, which had solid growth for the second quarter in a row. In the US, the brand recorded consumption growth, mostly driven by good initial results of our new innovation program. Particularly strong was the growth in our [dadas] to consumer business, with both TV sales through QVC and e-commerce growing in the double digits.

Also, the brand's international expansion is off to an encouraging start, with good results coming from the UK and from the first doors opened in Asia.

The adidas business was in line with the previous year. Growth in the emerging markets were offset by softness in the European markets and the US.

In China, while TJoy revenues declined in the quarter, the new TJoy management is progressing with the reorganization and re-engagement of the distribution network. We expect to see the first positive impact of this activity start in Q3, together with the launch of an exciting new moisturizer line.

While we keep investing in strengthening our structure in the emerging markets, and investing behind our brand's initiative, we are keeping tight control of our administrative cost. During this quarter, our administrative costs declined by approximately $3 million on a constant-currency basis, reflecting our focus on cost containment.

We're also progressing in line with our target on our productivity plan, which is expected to generate $40 million to $45 million savings over the next three years.

Looking now at the short-term outlook, we expect to see challenges continuing in the course of Q2 as the turbulence in the US market is not over yet, and we could see further destocking and cautious ordering until the segments where we compete start showing more encouraging trends. Also, we have some unfavorable innovation phasing in comparison with Q2 versus the same period last year.

Looking to the second half, we expect to return to topline growth, as several key product and distribution initiatives will kick in Q3. We anticipate that most of these initiatives will structurally enhance our growth potential, helping to recover trajectory toward our long-term strategy to grow in line or better than the markets and segments where we compete.

Let me mention some of these key initiatives. In prestige fragrances, we have two important initiatives in second half on Calvin Klein, with the launch of Endless Euphoria, an important line extension to our iconic Euphoria franchise, and the launch of Ck 1 [Red], a fragrance for him and her, which we expect will resonate particularly with young European consumer.

We also anticipate our mass fragrance business will be energized by important launches in Beyonce and by the introduction of a new fragrance and body line called [Love to Love] in exclusivity with a top mass retailer, developed to cover the low price point segment with a high-quality floral product, offering great value for the money.

Speaking of new fragrance brand, I can't help sharing our satisfaction and ambition behind the newly-signed Miu Miu license. Until recently, Miu Miu was one of the few big global fashion properties without a fragrance license. It is one of the most successful and fastest-growing brands in fashion, with a strong personality and attributes which create a perfect fit for fragrance.

We are very excited the product group chose Coty as their partner in this important step, which we believe is an acknowledgment of our outstanding track record in building and cultivating strong and lasting brands. We are confident in our ability to build this brand into one of our power brands to strengthen our leadership position in the prestige fragrance market. The first launch is scheduled for calendar-year 2015.

In color, our main objective is to resume share growth in Sally Hansen. We expect positive impact from the Triple Shine launch, which is underway as we speak. We're also working on an exciting major innovation to be introduced at the end of this fiscal year.

In OPI, growth will come mostly from new distribution opportunities in the US and the acceleration of the international business. In the US, we have signed a distribution agreement with a sizable chain in the professional business, with OPI set to enter approximately 2,700 new doors. Also, we have agreed on a first step of cooperation with another major prestige retailer, distributing OPI in few top doors.

We expect this, together with another new outstanding creative collection, to spur an acceleration of OPI growth in the US in the balance of the fiscal year.

We plan to leverage our multichannel distribution capabilities to accelerate OPI international expansion in the prestige and professional channels. In Q3, we are scheduled to begin [data to] manage OPI retail business in key countries such as UK, Germany, Italy, and Australia, which we anticipate to boost brand investment and revenues. We have seen the success of this strategy in Spain and in travel retail, where after a few months, OPI was one of the top two prestige nail brands in both markets.

In skin and body care, we plan to restore growth, particularly [cents] to adidas. We expect the brand to leverage our progress in emerging markets, particularly in Brazil and in China, where in January we plan to launch a male shampoo as a first step to establish the brand after male shower gel and male skin care. Upside opportunities will also come from the launch of the [Get Ready] line inspired by the upcoming soccer World Cup.

We also expect further progress in our philosophy business, thanks to the national rollout of the newly-launched time in a bottle, which is off to a very promising start, as well as new initiatives under the miracle worker franchise.

In the second half, we target a clear boost to our growth from our business acceleration in the emerging markets. We expect to see the impact of our new setup in Brazil and southeast Asia. In addition, I'm happy to announce that we just opened a new Coty subsidiary in South Africa through an agreement with our current distributor, Indigo, that will act in the future as a sales manufacturing and logistics provider.

Indigo, which is part of the AVI Group, is one of the leaders of the South African beauty market, thus enjoying strong market penetration and excellent trade relations. The establishment of our own subsidiary will allow us to step investment behind our mass brands, with focus on power brands such as adidas and Rimmel, which have already strong franchises in South Africa.

Also, our South Africa subsidiary will act as a hub to improve our penetration in the sub-Saharan region. We are confident that the establishment of the subsidiary will allow us to build [coated] share in these fast-growing emerging areas.

In summary, while we are presently confronting some challenges, we are focused on our long-term business building strategy, particularly leveraging the growth in our power brands and emerging market acceleration. We believe we have a strong and concrete action plan that, starting in the second half, should bring us back to long-term growth trajectory, even in the presence of unfavorable trends in the markets and segments where we compete.

I will now hand the call over to Sergio, who will bring you through the key financials of the quarter.

Sergio Pedreiro - *Coty Inc. - CFO*

Thank you, Michele, and good morning, everyone.

First, I would like to remind all of you that my commentary today on our results and outlook include the discussion of adjusted results, which excludes the impact of nonrecurring items, private-company share-based compensation, and restructuring costs. When applicable, I will also discuss our adjusted results at constant currency.

This presentation is consistent with how we plan to report results and provide our outlook in future quarters. You can find the bridge from reported to adjusted results, including foreign exchange translation impact, in the reconciliation tables in the earnings release.

In the first quarter, we saw a decrease in net revenues of 2.6% on a like-for-like basis. Consistent with our comments on our last earnings call, this was due to a significant deceleration in the market trends in the last few months. And as Michele discussed, the decline was primarily due to the challenge we described in the US market.

Despite this challenging backdrop, we delivered revenue growth in our business outside of the Americas, driven by EMEA and Asia-Pacific, including travel retail.

Our gross margin decreased to 59.9% from 60.7% in the prior year. This 80 basis-point reduction reflected higher customer discount and allowances, as well as negative foreign currency impact, which more than offset the improvement we saw in cost of goods from our supply-chain savings program, as well as some positive mix reflecting growth in our higher-margin prestige business.

Our reported operating income remained stable at $165.6 million, versus $165.9 million in the prior year, as lower net revenues and the decreasing gross margin was largely offset by lower SG&A. The primary driver of lower SG&A was the change from liability stock option plan accounting to accretive plan accounting following our IPO in June of 2013.

Our adjusted operating income at constant currency declined 7% to $188.3 million from $203 million. As a percentage of net revenues, adjusted operating margin at constant currency decreased 70 basis points, from 16.7% last year to 16% this year. This decline was primarily driven by lower gross margin.

We remain focused on controlling our administrative costs, while continuing to invest in our brands. As a result, adjusted SG&A expense remained flat at 42.2% of net revenues and decreased 30 basis points to 41.9% at constant currency. This reduction reflected lower administrative costs, which declined by approximately $3 million at constant currency, and lower advertising and consumer promotion, while increasing straight marketing spend.

Importantly, total market investment behind our brands, which includes advertising and consumer promotion, as well as trade marketing spend, increased by 20 basis points as a percentage of net revenues. As a reminder, trade marketing spend, which is booked as a reduction to net revenues, includes advertising and consumer promotion spend for which we are reimbursed -- we reimburse the trade, such as co-op advertisements, in-store displays, in-store promotions, and exclusive launch-related expenses. It does not include any discounts and allowances.

Our productivity program, launched in the last quarter of fiscal 2013, remained on track to deliver at least $45 million of annualized savings when fully implemented in fiscal-year 2016.

Looking at our performance by segments, we saw expansion on our operating income margin both in fragrances and in skin and body care. This improvement was more than offset by pressures in the color cosmetics segment.

Adjusted operating income for the fragrance segment increased 14%, compared to the first quarter of fiscal 2013, while the operating margin expanded by 260 basis points to 21.7%. Our skin and body care adjusted operating margin increased 60 basis points, and we continue to anticipate gradual improvements in this segment as we grow scale and streamline our operations.

Color continued to face a challenging business environment with significant destocking in the US, a slowdown in nail, and the increased competitive activity that drove higher discounting and allowances. Revenues declined by $36 million, and we saw this impact flow through the P&L, resulting in a $37 million decline in the segment's adjusted operating income and in an adjusted operating margin that declined to 11.8% from 21.1% in the previous year.

The margin decline in our color business was primarily driven by lower volume, higher discounts, and the increased marketing spending to protect our position in a challenging market environment. We expect to increase our margins in second half as volumes progressively recover upon trade inventories normalizations.

Our adjusted effective tax rate in the quarter was 30.7%, compared to 32.4% in the previous year. The decrease was caused by a higher effective rate in the prior year, due to the expected expiration of certain US tax credits on foreign source income that were reinstalled in 2013. For the full year, we continue to expect an adjusted effective tax rate of 28%, plus or minus 3%.

The increase in Q1 rate versus the 28% full-year tax rate reflects a normally higher rate in the first quarter, given the effect of discrete items and also a change in the expected mix of profits with higher profits in higher tax jurisdictions, reflecting, for example, faster growth in emerging markets.

During the quarter, cash paid in income taxes was 10.5% of adjusted income before income taxes, reflecting the benefits of historical net operating losses in the US and Germany, as well as the tax deductibility of goodwill amortization for OPI and philosophy. For the full year, we continue to expect a cash tax rate of 18%, plus or minus 3%.

Reported net income increased by 8% to $93.5 million as a result of stable operating income and lower tax rates. On an adjusted basis, our net income decreased by 8% to $108.3 million, primarily reflecting lower adjusted operating income, partially offset by lower income taxes.

Accordingly, our adjusted net income margin (technical difficulty) this year.

Despite the weakness we saw in some of our key markets, and the consequent topline and margin pressures, I am particularly proud of our strong execution in continuing to improve net working capital efficiency, with positive impact on our cash flow. In the first quarter, we achieved net working capital improvement in accounts payables, inventory, and receivables. This resulted in an increase of $123 million in net cash provided by operating activities, excluding cash used for private-company stock options exercised in the prior year.

And after $66 million in capital expenditures, our free cash flow was $36 million in the quarter, which is an increase of $117 million compared to last year's negative $82 million.

With that, I would like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). John Faucher, JPMorgan.

John Faucher - *JPMorgan Chase & Co. - Analyst*

Wanted to ask two questions. The first one is can you talk a little bit about the cadence of holiday selling? Is it different than what you have seen previously? And if so, is it the similar channels and geographies where you were seeing issues in this most recent quarter?

And then, the second question to get a little bit more detail oriented, you have got a much easier gross margin comparison, but you're still, obviously, seeing a lot of this promotional pressure. Can you talk -- from the second quarter, you have got an easier comparison. Can you talk a little bit about the cadence of gross margin as we go through the year, as you lap that easier comparison and then look for what hopefully is a more normal environment in the second half? Thank you.

Michele Scannavini - *Coty Inc. - CEO*

Okay. First of all, good morning, John. So let's talk first of what is our view on the holiday season.

So let me say that at this stage, it's very difficult to predict what is going to happen for the holiday season. What we are seeing clearly is that, as I said before, the first quarter has been soft in terms of market, particularly in the segment where we compete. We have seen a cautious ordering of Christmas sets and promotion from the retailer. Talking with the retailer, they are cautious in their estimates and in their guidance for the Christmas season, also considering, as you know very well, that we have six days less than last year to generate sales and consumption.

So as I said on my script, we don't see so far order cut. Still, I believe the retailer are planning to have at least a moderate growth in the Christmas season, but honestly, I believe that everybody is a bit in a wait-and-see situation and to see if October and November are confirming a certain comeback.

As you know, the Christmas business is extremely important in two country, in two region, US and UK. I should say that we see in this moment a similar attitude also in UK. There is a very cautious sentiment for the Christmas season as of now, and we're seeing, particularly in UK, an increase of the promotional fight before the Christmas season, in the back-to-school season, so I think that at this stage, it is difficult to predict. And we are just trying to caliber our business and projection based on what we are going to see progressing in the next weeks.

As far as gross margin, (multiple speakers)

Sergio Pedreiro - *Coty Inc. - CFO*

John, as we discussed, our gross margin is clearly under pressure, given the volume impact, given the discounting activity that we see in the market, and given the decision that we take to protect our market position and protect our brands, both in terms of investing more in trade marketing spend to support the brands together with the trade, and also, in some cases, taking a discount to protect our position.

Going forward, if we see the trade inventories normalizing, we will also benefit from that. The overall orientation and decision to protect our brands, protect our market position will continue, and therefore it will be much more dependent on how fast we see this trade inventory normalization to be able to see also the benefit flowing through our margins.

John Faucher - *JPMorgan Chase & Co. - Analyst*

Okay, thank you.

Operator

Olivia Tong, Bank of America Merrill Lynch.

Olivia Tong - *BofA Merrill Lynch - Analyst*

First, just one quick housekeeping. How much of a sales contribution did you get from the acquired third-party distributors?

And then, secondly, why are you so confident in the second-half sales improvement? You have obviously got a few innovation initiatives in the emerging-markets build, which is great, but it also sounds like male got quite a bit worse and that destocking was also worse.

Michele Scannavini - *Coty Inc. - CEO*

Okay, let me start with the second part. As I said before, I believe there are two key reasons why we are so confident in coming back to growth in the second half.

The first one is clearly related to all the investment that we did in emerging markets to create a set-up to develop our business. And I'm talking specifically of the set-up that we have created in Brazil, that we have created in southeast Asia, that we created earlier in last fiscal year in Korea, the new one that we have created now in South Africa.

And on top of that, I am also referring to a numbers of specific product initiative geared and tailored for these emerging markets. I was talking before, for instance, of the launch of adidas shampoo in China, as well as the continuous development of specific fragrance for Middle East with a kind of Arabian effect and duration that is boosting big time our business today in Middle East.

So the first reason why I believe that we're going to go back -- we are targeting to go back to a growth in the second half is because of the impact on the emerging markets.

Then there is a second point that are related to more specific activities on our power brands, and particularly in the color category that in this moment is suffering more than the others, related to both a particularly strong initiative plan and distribution initiative that would enlarge the scope of our key brands, like Sally Hansen and OPI, and will allow us to reach more consumer.

So those are clearly two, let me say, building block for make us targeting a comeback to growth.

Now, related to the market trends, you are right. Actually, we have seen, for instance, a trend in nail color that we couldn't anticipate and the sharp deceleration, so it's difficult for us at this stage to anticipate if there is going to be a short or medium trend.

As I was explaining before, most of the decline is related to that part of the business that is special effect, while, let me say, the more basic [bundle in the brash], the more basic nail color business is sustaining. But as I said before in my script, I believe that the strength of our initiative and the initiative in emerging market -- by the way, we will announce structurally our ability to growth -- will allow us to target growth even in presence of difficult market condition.

Sergio Pedreiro - *Coty Inc. - CFO*

So in terms of the sales contribution from third-party distribution, let me explain first, this is part of our business model. This is something that we have done and we believe it is a good approach to entering markets where we start to build our presence together with a distributor. We see the brands build momentum. At some point, we may form a joint venture or we may convert them.

In terms of the sales dynamic, during this conversion, normally what happens is before the transaction itself, sales tends to go down. After the transaction, in the first couple of months, there is normally -- I worked with a distributor that has brands from other companies that are discontinued, so the first impact is normally a very small pickup or may even be slightly negative.

The benefit comes with the conversion because now, as with a fully-owned subsidiary, we have the margins of the business that we can invest, increase the marketing, and then see the sales pick up and see the full potential of the market materialize. That is happening normally in the second/third quarter after the acquisition.

The one that we are talking about is very recent. We just completed the -- it is obviously the Asian acquisition -- and we should see that dynamic develop and bring benefits toward the second half.

Michele Scannavini - *Coty Inc. - CEO*

Yes, this is something that we have seen consistently in all the joint ventures that we created in the past. We created a joint venture that we have the majority stake in the Middle East; joint venture in prestige China; joint venture in southeast Asia, a prestige.

And so far, we have seen exactly the dynamic of the business as Sergio was describing, a development due to a data control of the business, more investment counting on the full margin and not splitting the margin with a distributor, and a progressive build of business and market share. It is exactly what we expect to see from the most recent set-up.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Bill Schmitz, Deutsche Bank.

Bill Schmitz - *Deutsche Bank - Analyst*

Can you just talk about how you are seeing October trends, because there has been some conflicting data out there? And I think L'Oreal was pretty cautious about October and said the consumer, and even in the US, was looking for a deal a lot more than they had in the past, so it looks like the holiday season is going to be a lot more promotional. So any color you can give on that would be terrific.

Michele Scannavini - *Coty Inc. - CEO*

Look, as I was saying before in my script, I do not expect to see improvement in the next quarter. The trends that we have seen in terms of consumption, promotionality, and attention to managing inventory down didn't change in October. So as I said before, I believe that still we are going to face challenges in our second quarter and we are targeting to come back to growth from Q3 on.

Bill Schmitz - *Deutsche Bank - Analyst*

Okay, great. And then, Sergio, just in terms of the inventory levels, obviously on the working capital side, it looks like it was terrific. So I am a little bit confused because if you had all this destocking, you would think that you'd have a big spike up in inventory as a result of destocking. So where am I wrong on that assumption?

Sergio Pedreiro - *Coty Inc. - CFO*

Yes, what we can see, and this is more on the math side, what we have seen is a trend for -- of volumes coming down. And we, if you look back at our results a few quarters, you can see that the level of inventory was stable or increasing. That despite a few months ago an initiative, internal initiative, to increase our efficiency in inventory, which actually worked very well because at the same time that we see an acceleration in the business, we see an improvement in terms of days of inventory, and therefore helping the total amount to be still going down in spite of the lower volume. So this is really the dynamic that is driving the efficiencies in our working capital.

Michele Scannavini - *Coty Inc. - CEO*

Yes, I must say that to add to that, we have a very, very effective connection between markets, in terms of planning, so we are pretty fast in adjusting our production schedule and inventory depending on the trends that we see in the market.

And recent we saw, and we discussed also this last time, the trend of male going down pretty dramatically in the market, so we have adjusted our manufacturing schedule very, very fast, and this allows us to manage our inventory to a very good level, despite this fluctuation on the marketplace.

Bill Schmitz - *Deutsche Bank - Analyst*

Great, thanks so much, and then, just lastly, can you just give us the breakdown now of the business? I know it used to be 50-50 between mass and prestige, and I know you said that prestige grew mid-single digits, so if it is still 50-50, how much did the mass business decline in the quarter?

Sergio Pedreiro - *Coty Inc. - CFO*

So let's say that the split of the business doesn't change materially. Clearly having prestige growing and mass declining, this is going to shift the split more versus prestige, but the difference doesn't change the overall picture. So still, our business is, by and large, 50-50 between prestige and mass.

Bill Schmitz - *Deutsche Bank - Analyst*

Okay, and then, so how much -- because you said prestige is up mid-singles, so just to back into it, does that mean that mass is down 8%, about, if you could back into the negative 3?

Michele Scannavini - *Coty Inc. - CEO*

We are not disclosing, as you know, but you can make your own calculation and try to figure out what is the trend. The reality is that clearly in this moment, we see very different trend between our business in prestige, our business in mass, and I must say that this is particularly true in the US for the reason that we discussed before.

Bill Schmitz - *Deutsche Bank - Analyst*

Great, thank you very much.

Operator

Dara Mohsenian, Morgan Stanley.

Dara Mohsenian - *Morgan Stanley - Analyst*

You mentioned you expected to grow in line or above the category in the back half of the year. I am just wondering, are you expecting category growth similar to your 3% to 4% long-term range in the back half or do think some of this recent weakness could linger a bit from a category perspective as we look out to the second half of the year?

Michele Scannavini - *Coty Inc. - CEO*

Yes, let me say it is -- first of all, given the volatility of the markets now, it is a little bit difficult to anticipate what it's going to be.

So I believe that the overall market, and particularly the segment where we compete, are going to grow in the next few months -- I'm including the second half -- a bit slower than the trend that it had before. So that we are clearly targeting growth that is above what we see in the Coty-weighted business scope.

Particularly, we do not anticipate a trend -- a continuous negative trend as we have seen so far in the nail segment, particularly in the second half, when obviously the comparison will progressively become easier for the category. Again remember, as I said before, that today the market in the quarter was minus 4% compared to plus 21% it was last quarter, last year. Progressively, the comparison will become less tough, so that means that also the, let me say, trend of the market should be eased up by an easier comparison.

Dara Mohsenian - *Morgan Stanley - Analyst*

Okay, that's helpful. And then, I was hoping you could highlight if there are additional cost-savings opportunities that you guys are looking at, beyond your announced productivity program, to help offset some of the profit impact from this category weakness that we are seeing?

Sergio Pedreiro - *Coty Inc. - CFO*

Yes, naturally when we see a slowdown in the market, we look for opportunities where we can take savings. And as we commented when you look at our SG&A on an adjusted basis, you see a reduction already in the first quarter, and we think this will continue to flow through our results moving forward.

So yes, there are a few opportunities in addition to the restructuring, not, I wouldn't say, large and significant, but we constantly look for them, and this helps in terms of keeping the costs under control and contributing to offset any negative impacts of the slowdown.

Dara Mohsenian - *Morgan Stanley - Analyst*

Okay, and we should look at that as more belt-tightening type of cost cutting than something that is really incremental from a productivity standpoint?

Sergio Pedreiro - *Coty Inc. - CFO*

That is correct. Yes.

Dara Mohsenian - *Morgan Stanley - Analyst*

Okay, thank you.

Operator

Neely Tamminga, Piper Jaffray.

Neely Tamminga - *Piper Jaffray & Co. - Analyst*

So I have a couple questions here, if I may. So first on the Miu Miu, is there any way that you could help us contextualize how big you think that this business could be for you? Are you treating it as one of your key power brands, or considering that it doesn't have a road map necessarily in fragrance at this point in time, how should we be thinking about it?

And then related to that from a modeling perspective, it sounds like you're going to launch it in 2015. Is that fiscal or calendar 2015? Is it going to launch for, let's just say, holiday 2014, so your fiscal 2015? And how should we be thinking about the A&P spending related to that brand-new launch? And then, I have two follow-ups. Thanks.

Michele Scannavini - *Coty Inc. - CEO*

Okay, so first of all, let me say that Miu Miu is one of the biggest, fastest-growing, more interesting brand in fashion that was without a fragrance agreement. And we worked on it for several months with a strong determination because we believe that Miu Miu can be a great brand for fragrance.

I believe it can be part of our power brands. I believe that it is a brand that can have a potential just refer to some brand of our portfolio similar to Chloe. It is a brand that has a good awareness globally. It is a brand that is very strong in Europe and also in Asia, and it is a brand that has a very, very, very strong personality. And as you know, to be successful in fragrance with all the different number of brands, you have to have a clear point of difference.

And we believe that the brand has a clear point of difference, starting with the name. Miu Miu is a fantastic name for a fragrance.

So we are ambitious. We believe that in the long run it can have the potential of a Chloe, so it can clearly be among our power brands.

In terms of the planning, we at the moment are targeting to launch the first Miu Miu fragrance in September 2015, so it is the calendar-year 2015. In terms of advertising spending, it's clearly a bit early to discuss about that, but usually with this kind of brand, with the potential that they have and strong and high image position on the market, in the first year or two you invest a lot of money to be sure that you establish faster a business that is stronger enough and important enough to be a real contributor to the revenue of our fragrance segment.

Neely Tamminga - *Piper Jaffray & Co. - Analyst*

Thank you, Michele, that's helpful. And then just a big-picture question for you, you guys have talked pretty publicly about potential acquisition targets and the profiles related to that. I am just wondering with some of the movement that we have seen on the unexpected side of the color cosmetics business skewing a little bit more towards mass, would you be looking for some diversification in that segment at this point in time, based on prestige or maybe even mass-tege or are you looking for brands that have single-country dominance that can roll out to these emerging markets, or has there not been any change whatsoever in your acquisition target or thinking?

Michele Scannavini - *Coty Inc. - CEO*

Okay, first of all, let me say one thing. We believe that the slowdown that we have seen in color cosmetics is a short-term impact.

We still have a lot of confidence on the long-term potential of expansion on the color cosmetics segment. And we are still bullish in expanding and investing behind our power brands in the color cosmetics segment. So we still believe it is going to be an important driver for our growth in the future.

In terms of our acquisition strategy, it's not changing. We are looking to potential moves that is going to improve our competitiveness in area in which today we believe we can increase our competitiveness. Clearly, this area includes segment like skin and body care, includes emerging markets where we are making a significant effort. But I can tell you these do not exclude, for instance, fragrance and color, where we have a strong position today, but we are welcoming opportunity to even strengthen our leadership and leverage on all potential revenues and cost synergies are coming from acquisition in those segments.

So we're really looking for things that are clearly improving our position in the marketplace and that financially make sense and are accretive.

Operator

Chris Ferrara, Wells Fargo.

Chris Ferrara - *Wells Fargo Securities, LLC - Analyst*

Guys, I just wanted to talk about color a little bit. I understand the cost of deleveraging -- or the fixed-cost deleveraging is a big piece of the margin decline, but I guess to what extent can you parse out how much of this is competition, right? And has your thought process shifted at all to perhaps you are seeing more semipermanent erosion in category economics because of that competition? I was just hoping you can comment on that.

Michele Scannavini - *Coty Inc. - CEO*

Yes, I can start answering, Sergio, and then you can add to what I'm saying. So let me say, first of all, our decline in color margin is mostly volume driven. There has been an impact due to the increased promotional activity in marketplace, and we participate to protect our market share, but it is also driven by the fact that we didn't decrease. To the contrary, we increased our marketing spending to defend our share position.

So if you look overall what is happening, there is the nail category US where we have a solid, shall we say, asset with Sally Hansen. We lost market share in the recent quarters, and we are now working to ensure to connect all the dot that we have the right initiative and investment to stop this decline and to come back to market-share growth.

On the other side, we have a brand like Rimmel that is our biggest color brand that is gaining market share big time everywhere in the world, and as I said before, for instance in the United States, it has been the fastest-growing color brand among the top 10 in the last 12 months, in the last four months, and in the last month.

We are clearly looking now at even more in the second half to restore growth and to protect or restore market share when we lost market share. And this is our number one priority. That means that we would keep on focusing. We will not compromise on investment behind our power brands, even in situations in which the market is unfavorable with this decline. This might put pressure on our margin. We are conscious of this, but we believe that our number one priority now is to restore good sustaining topline growth, and this is going to be our focus going forward.

Chris Ferrara - *Wells Fargo Securities, LLC - Analyst*

Great. And, I guess, what made Sally Hansen's market share vulnerable? I understand the category dynamics, but what specifically went on there? Do you think it was a lack of near-term innovation, and I understand -- did you have a larger share of the special products that were out last year and that is why share is down now? Just trying to understand that dynamic.

Michele Scannavini - *Coty Inc. - CEO*

Let me say there are, I should say, two explanation here. The number one explanation is that when competition has seen the nail market developing at the pace of the market develop in the last two years -- we are talking of growth that range from 10%, 15%, even to 30%, depending on the month and on the quarter -- the appetite has increased dramatically, and we have seen in the last 18 months, 24 months, the entry of numerous new brands that were not existing in the nail category, many of them with a very, very aggressive price positioning, so offering very low prices, and on the other side, the big player increasing investment behind the category.

So this has impacted clearly the competitive position of Sally Hansen, and where before Sally Hansen was a huge leader with very little competition, now the competitors are much higher -- much stronger.

Number two, what you mentioned is the fact that Sally Hansen has always been leader in innovation, and, yes, created and built a lot of increasing market share behind those very fashionable innovation. That has brought a strong gain in the share brand, but now they are feeling a bit of a dig, so we see, as I said before, that while the basic business is keeping position, we are keeping our share in this basic business, the decline of the total category, in particular Sally Hansen, is mostly focused in the special effects.

So to react to that, we are focusing our future innovation on area that we believe can be more sustainable on the long run. We will also continue to offer consumer entertaining and fun special effects because anyway this is a complement that is important to the category, but we're going to refocus more our attention, let me say, on basic product -- performance and basic product and innovation related more to the performance than to the, let me say, fashionable aesthetics.

So those were the two reason why we lost market share, and also I answer how we plan to go back to increase our market share.

Operator

Wendy Nicholson, Citi Research.

Wendy Nicholson - *Citigroup - Analyst*

My question is with just following up on that, actually, with regard to the nail category, and given how much you have seen the nail category slow down, is there a chance as you go into the new year and some of the drugstores do their planograms and what not, is there a chance that the shelf space allocated to the nail category shrinks? And then, secondarily, I know you said you have -- was it 2,700 new doors for OPI or what exactly is the new distribution relationship? Thanks.

Michele Scannavini - *Coty Inc. - CEO*

Okay, first question. Now, obviously, it is very difficult for me to speculate on what is going to be the trade decision when they do the world reset, and this is happening usually in January/February. So in a few months, we will see.

I believe that we are not going to see a reduction or a significant reduction on the space. Let's remember that nail today is bigger than lips, so the growth, it's been enormous, and I believe that given the decline, it's mostly due to the special effects. If we are able to replace the impact of the special effects with innovation that are exciting to the consumer and more sustainable on the long run, I think it is going to be a very good reason for the retailer to keep on believing and insisting on the category.

But honestly, this is going to be revealed to us in January and February when it's going to be done, the reset of the world.

Another discussion we are having with the trade now is related to the value of the category because the decline is also driven by the fact that, as I said before, many cheap brand, many value for money brands got into the category, not increasing the overall consumption and use, but reducing the value of the total category.

And we are firmly convinced that the right way is to insist on product that bring real added value to the consumer, not only based on price, as such as stopping the decline due to reduced value of the overall category and to bring back a healthy growth that is volume, that is value as well.

As far as OPI, yes, this is a new distribution agreement with a big, big professional chain that sell product to professional institution, and we're going to be in 2,700 new doors for OPI. These represent around 50% of the total chain door count, and this is going to start happening as we speak. And this, clearly, we see as an important contribution to the OPI business in US imparting particularly in the second half.

Operator

Thank you. This concludes the question-and-answer portion of today's call. I would now like to turn the call back over to Mr. Monaco. Please proceed.

Kevin Monaco - *Coty Inc. - SVP, Treasurer, IR*

Thank you all for joining us, again, here today. We do appreciate all of your questions. Please feel free to reach out to us in the investor relations department if we can answer any further questions or assist you in any way. Thank you.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect and have a great day.

Michele Scannavini - *Coty Inc. - CEO*

Thank you very much, everybody.

Sergio Pedreiro - *Coty Inc. - CFO*

Thank you.
