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COTY - Q3 Fiscal 2014 Coty Inc. Earnings Release Conference Call

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PRESENTATION

Operator

Good morning. My name is Matthew and I will be your conference operator today. At this time I would like to welcome everyone to Cody's third quarter fiscal 2014 results conference call.

(Operator Instructions)

As a reminder, this conference call is being recorded today, Wednesday, May 14. 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. Thank you for joining us. On today's call are Michele Scannavini, Chief Executive Officer, and Patrice de Talhouet, 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 our 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.

I will now turn the call over to Michele.

Michele Scannavini - *Coty Inc. - CEO*

Thank you, Kevin. And good morning everyone.

Before I begin my comments regarding our businesses outlook, I want to take a moment to welcome Patrice on his first quarterly call with Coty. Patrice has now been with Coty for several months and will be reviewing the financials during his prepared remarks.

Let's turn now to our quarterly results. On the last call we outlined several Coty initiatives which gave us confidence that we would return to revenue growth in the second half. Specifically we discussed our new structures and investments in the emerging markets, increased support behind our power brands, and some key launches and product initiatives.

Today I am pleased to say that we have started reaping the benefits of our efforts. In Q3 we delivered against all three strategic objectives. Our emerging market revenues increased 15% in the quarter.

Most of our power brands saw growth and the launches we aligned for Q3 are performing in line or ahead of expectations. As a result, overall revenues grew 2% like-for-like in the third quarter with positive results in both fragrances and skin and body care and solid growth in EMEA and Asia-Pacific.

Looking at the market dynamics in the quarter, beauty consumption in the developed markets remained overall flat in the product segments where we compete. Western Europe witnessed some improvement across several product categories. Including color cosmetic, deodorants, and shower gels.

At the same time, the fragrance market remained flat to slightly positive. After adjusting for these third shifts.

In the US, the market environment remains challenging, particularly in the mass channel. The fragrance market, adjusting for the calendar affect, was flat in prestige and declining in mass. The US mass color market decelerated again in Q3 recording a 2% decline.

We saw even stronger declines in the nail category with 12% consumption decrease compared to a 12% increase in Q3 of last year. This represents a further deceleration versus the mid single digit decline in the first half. Lower consumption was driven by lower traffic in-store, high inventory in consumer's houses, and the contraction of the special effects makeup category.

On a positive note, we saw moderate destocking across our mass retail customers in the US. As inventory positions are now by and large reflecting the underlying category demand trends.

At this stage, we have no visibility on when the US mass channel market will approve in color, particularly in nail. However we have reason to be optimistic about our business in the second part of the calendar year. Due to a stronger innovation calendar, including Sally Hansen robust launch planned for June.

Also the comparison versus the prior year is going to ease up as in the second half of calendar 2013 the nail category shifted to a mid single digit decline. Against this backdrop, our third quarter revenues grew 2% on a like-for-like basis.

Our prestige portfolio saw strong growth in the quarter also aided by the Egypt comparison to the prior year where prestige fragrances declined 1%. Our mass portfolio was a little flat in the quarter, rebounding from the pressure we saw in the first part of the year.

Let's now look more closely at our performance in each of our segments. In fragrances, our revenues increased 6% on a like-for-like basis. During the quarter we saw growth in both our prestige and mass fragrances.

On the prestige side, growth was driven by strong performance in our power brands; Calvin Klein, Marc Jacobs, and Davidoff.

Leveraging its strong brand recognition worldwide, Calvin Klein recorded significant revenue growth in emerging markets such as the Middle East, Australia, Eastern Europe, China, and Travel Retail. Calvin Klein launches in Q3 are off to a good start. The launch of Endless Euphoria in the US propelled double digit growth on the total Euphoria franchise, with gains in ranking and market share.

Our growth in mass fragrance is primarily resulted from the new fragrance initiatives such as Beyonce Rise, Guess Nights, and David Beckham Classic, and distribution expansion for Katy Perry.

Additionally, as we discussed on our last call, we launched in exclusivity with Walmart a [man to] priced fragrance brand called Love2Love. We are proud to say Love2Love was the number one new fragrance brand launched in Q3 at Walmart, exceeding our expectation.

Color cosmetics declined 6% on a like-for-like basis which is an improvement versus the minus 10% that we witnessed in the segment in the first half of the year. We experienced continued headwinds in nail driven by further declines in the nail category, difficult comps for Sally Hansen, up against last year's strong launch of the premium priced line, and pressure on Sally Hansen market share. While we are progressing in our comprehensive plan to upgrade and rejuvenate several elements for Sally Hansen mix, including online, off-line, and in-store emerge and communication. We are getting ready to launch in June the next robust initiative for Sally Hansen.

As anticipated in our previous call, we are refocusing our effort on developing new products to set the new standard of performance in the nail category. This new Sally Hansen product, called Miracle Gel, will provide consumers with the highest standard of nail lacquer performance guaranteed by the gel formula with a much easier, faster, and consumer friendly application. In contrast to classic gel formulation, Miracle Gel will not need curing with an artificial light. And can be removed as easily as normal nail polish.

The launch will be supported by an extremely strong communication plan, including digital, TV, and print advertising. And retailers are granted strong in-store visibility and support. We are optimistic that these initiatives will help Sally Hansen regain momentum in the second half of this calendar year.

While we are challenged on the nail category, Rimmel continues its strong performance with revenue growth in the UK, France, Eastern Europe, Middle East, South Africa, and Australia. The brand continued to gain share in the US and core European markets, speaking to the success of Rimmel innovation and marketing platform.

In skin and body care, revenues grew 8% like-for-like. We witnessed broad-based growth in the segment, driven by our two power brands, philosophy and adidas, and by Lancaster.

We continued to see solid growth momentum in philosophy for the fourth consecutive quarter, and increases across all the three channels, including retail, QVC, and philosophy.com. With growth coming from both the new innovation and core franchises, we believe the brand has a renewed traction in the core US market.

We also see good progress in international developments. In the UK, our second biggest market after North America, the brand is making encouraging inroads, and even with innovative selective distribution, it's progressively gaining awareness, share, and ranking.

Adidas also increased in the quarter supported by strong momentum in the emerging markets, such as Brazil, China, Middle East, Southeast Asia, and South Africa. The Get Ready line celebrating Brazil World Cup was launched in this quarter and so far it's performing well and in line with our expectations.

We are also excited to announce that we have signed an agreement with the Nueva Soccer Association to sponsor the upcoming champions league, the most important soccer cup competition in the world. Which will give us the opportunity to develop strong initiatives starting next fall. These three pillars have added us growth, including the acceleration of emerging market penetration, the initiatives related to mega sports events, and the extensions of new category, such as male shampoo and male skin care in emerging countries should keep nourishing the brand growth going forward.

Let's turn to our region by region. In EMEA, sales increased 8% like-for-like. We saw strong growth in developed countries, nurtured by signs of market recovery in certain Western European countries as well as by lower comp as a result of last year [rededication]. Emerging markets in the region also experienced growth supported by our new structure in the Middle East and South Africa.

In the Americas, our net revenues declined 9% like-for-like. As previously discussed, our US business remained under pressure, primarily as a result of weakness in the mass channel in nail. On the other hand, we reported double-digit growth in Latin America.

In Asia Pacific, our business grew 19% like-for-like in the quarter. Driven by momentum in Southeast Asia and Australia. In China, we grew mid-single digits in the quarter, driven by strong performance of our prestige fragrances, Lancaster skin and sun care, and adidas.

On the other side, T Joy performance remains far below our expectations. The execution of the brand revamp plan developed by the new management is not gaining expected results. The T Joy under performance is currently a drag to the profitability of our China operations and their overall skin and body care segment.

We are currently working on scenarios to reorganize our overall mass business in China with the objective of bringing significant benefits to the profitability of Coty China and to the overall skin and body care segment. We expect to be ready to disclose our action plans by the next earnings release.

As we have continued to a light, expanding our presence in the emerging markets remains a top strategy for the company. With new joint ventures and subsidiaries now in place in key markets such as the Middle East, Southeast Asia, Brazil, and South Africa, I'm proud to report that our emerging market revenue accelerated to 15% growth in the quarter from 7% growth in the first half.

As part of our emerging market strategy, I am also happy to announce that on May 14, Coty and Avon signed a formal distribution agreement to release the new Coty's celebrity fragrances in Brazil, which is the number one fragrance market globally. The agreement will allow us to leverage Avon's substantial force of 1.5 million Brazilian sale representatives. At this stage, we expect our brands to start to be included in Avon product catalogs in time for the 2014 Christmas holiday season.

As part of our strategy to fuel growth in the business, we remain committed to investing behind our power brands. During the quarter, advertising and promotional spending grew 140 basis points as a percentage of net revenues. We continue to invest into our new emerging markets of penetration. To fuel those activities, we are applying a strong discipline to our construction in the developed markets and keep improving cost of goods down to our productivity program.

During the quarter, we reported strong 29% adjusted earnings per share growth to $0.22. This growth includes $14 million increase in one-time tax benefits. And our strong focus on cash flow generation has driven $248 million in free cash year-to-date, up 38% versus the prior year.

Turning now to the near-term outlook, market conditions remain challenging in certain product segments and in certain markets. And particularly in the US mass market. Despite this, we remain focused on continuing our growth momentum through the remainder of calendar year 2014.

In light of the uncertainty of market dynamics and the more challenging comparison versus last year growth, we are anticipating fourth-quarter revenues overall in line with last year. And from there, we are targeting an acceleration of growth in the first half of FY15. Driven by a strong innovation planned in most of our power brands, an increase of our market expanding to support growth and innovation, and the continuous momentum in our emerging markets.

Above the digital initiatives in fragrances in the first half of FY15, we will count on the launch of new products for Calvin Klein, Marc Jacobs, and Chloe in the prestige channel, and the launch of the new Enrique Iglesias line of fragrances in mass, which should resonate particularly well with Latin consumers.

In color, on top of the new Miracle Gel technology in Sally Hansen, we have a very competitive plan in Rimmel to keep fueling its outstanding growth. In skin and body care, we will launch of the new champions league product initiative on adidas and the new anti-aging franchise of philosophy, called Nothing to Hide.

In summary, as we anticipated, we returned to revenue growth in Q3 as we executed against our three strategic objectives. We saw strong momentum in the emerging markets, supported by the infrastructure we have put in place over the last year.

We invested behind our power brands, increasing our market in Spain. And this, coupled with a strong innovation pipeline, drove revenue growth in most of our power brands.

We continue to believe that this three-pronged strategy will help us to accelerate our growth in first half of next fiscal year to approach our long-term target of growing revenue in line with or better than the markets and the segments where we compete. In the meantime, we will continue to identify further areas for improvement in our cost structure and focus on gaining further efficiencies in working capital in order to drive strong free cash flow generation.

With that, I will turn the call over to Patrice who will walk you through the key financials for the quarter.

Patrice de Talhouet *- Coty Inc. - CFO*

Thank you, Michele, and good morning everyone. First, let me start by saying I'm very excited to join the Coty team and be here with you to discuss our quarterly results.

I would like to remind all of you that my commentary today on our results and outlook includes a discussion of adjusted results which exclude the impact of a nonrecurring items including 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 the 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 third quarter, our net revenue grew 2% on a like-for-like basis. As you heard earlier from Michele, this was a result of accelerated growth in the emerging markets, leveraging continued joint ventures and subsidiaries, strong momentum in most of our power brands supported by strong innovation and marketing support, and somewhat easier comparison in the prestige business versus last year.

This revenue growth came in the context of a weak market condition in the US, and moderately improving market conditions in Europe. It is worth noting that foreign-currency had a negligible impact on our top line during the third quarter and year-to-date.

Within our power brands, we saw growth in Calvin Klein, Davidoff, Marc Jacobs, Playboy, Rimmel, adidas, and philosophy. Calvin Klein, Davidoff, Rimmel and adidas performed particularly well in the emerging market, speaking to the global appeal of our power brands and the benefits of our balanced prestige and mass portfolio. In total, emerging markets grew 15% during the quarter, accelerating from the 7% growth in the first half of the year.

In the third quarter, we have recorded a non-cash impairment charge of $316.9 million in the skin and body care segments. As Michele discussed, this reflects the challenge we continue to face in China on the T Joy brands, despite efforts to organize the brand's management team and introduce new product innovation, resulting in an overall decline of the fair value of that business unit, which triggered the need for an impairment analysis for the quarter.

This led us to record a $256.4 million reduction in the segment goodwill, a $54.5 million reduction in trademark and customer relationship, and a $6 million reduction in property, plant and equipment. It is worth noting that following this impairment, there will be no further intangible assets remaining on the balance sheet to the mass and skin and body care reporting units, or the T Joy brand.

The impairment actions should drive improve ongoing profitability for the skin and body care segment as we benefit from an annual $8.3 million reduction in amortization expenses. Overall, we are actively evaluating a number of different options to optimize our China mass business and mitigate the drag on our skin and body care profitability and expect to share our action plan by the next earnings call.

Our adjusted gross margin for the quarter slightly decreased by 10 basis points to 61.6%. Higher discounts in allowance needed to compete in the highly promotional markets, particularly in the mass channel, as well as unfavorable foreign exchange were largely offset by productivity gains in our supply chain.

Our reported operating income decreased to an operating loss of $272 million, from $30.1 million profit in the prior year, primarily driven by the $316.9 million of impairment charge. Reported net income decreased to a loss of $253.3 million from $20.4 million profit in the prior year, primary driven by lower operating income as a result of the asset impairment charge partially offset by a $14.3 million increase in income tax benefit during this quarter.

On an adjusted basis, operating income declined 22% to $81.4 million. As a percentage of net revenues, the adjusted operating margin decreased 230 basis points to 8.1% from 10.4% in the previous -- in the quarter of 2013. This margin decline is primarily the result of 140 basis point increase in advertising and promotion spending as a percentage of net revenues to support our brands and increasing emerging market investments, in line with our strategy and our commitment to long-term growth.

As far as cost containment measures are concerned, we are proceeding as planned with our productivity program. We continue to expect to see annual savings of over $25 million by the end of this fiscal year, reaching $45 million in savings by the end of FY15 and $60 million by the end of FY16. To further build on this momentum, we are currently evaluating our operating model to identify additional areas for simplification and standardization.

Let us now look at our performance by segments. Fragrances revenue grew 6% like-for-like, including 7% volume growth, partially offset by negative 1% price mix. The negative price mix reflected a higher proportion of mass and prestige fragrance this quarter.

Adjusted operating income for fragrances decreased 2% to $54.3 million, while the adjusted operating margin declined 70 basis points to 10.7%. This decline reflects lower gross margin, in part reflecting negative foreign exchange, the negative impact of ceased activities in the prior year, and some [profitable] mix shifts as well as investment in emerging markets.

In color cosmetics, revenue declined 6% like-for-like with a 5% volume decline coupled with a negative 1% price mix. Adjusted operating income decreased to $36.7 million, with the operating margin down 310 basis points to 10.6%. While maintaining the gross margin for this segment at the same level despite the sales decline, we meaningfully ramped up marketing support to the segment to regain traction in the coming quarters.

For the skin and body care segments, revenues grew 8% like-for-like, including 4% volume growth and 4% positive price mix. The positive price mix reflected the mix shift in the quarter to our prestige brands, philosophy, and Lancaster.

Adjusted operating loss for the segment increased to $9.6 million, from $2.2 million in the prior year, as we have ramped up advertising and promotions spending behind the brands to accelerate the momentum of the segment. Going forward, our operating income in the segment should benefit from the $8.3 million reduction in annual amortization expenses following the recent asset impairment.

Our adjusted effective tax rate was negative 40.9%, compared to 6.9% in the prior year period. This was due to a one-off commission of tax benefits upon settlement of certain foreign annuities, totaling $38.1 million, compared to a one-time tax benefit of $23.8 million in the prior year period related to the extension of 954(6)(c), resulting in a $14.3 million increase in one-time tax benefits. The settlement of the foreign audits should also provide an ongoing incremental benefit to our book tax rate of approximately 100 basis points.

As the result of the above, our adjusted net income increased by 27% to $86.7 million. This drove adjusted EPS of $0.22, up from $0.17 in the prior year period.

Net cash used by operating activities totaled $4.2 million in the quarter and was a source of cash of $443.1 million in the last nine months. And after capital expenditure, our free cash flow was $247.9 million in the last nine months.

Let me now offer an update of our SAP rollouts which has contributed to our continued operating efficiencies. We advanced our SAP rollout program with the increased first launch of SAP in our largest manufacturing plant, located in Sanford, North Carolina. The system and process ramp up period is underway and we continue to focus on changed management throughout the facility.

With this implementation, we plan to exit FY14 with over 70% SAP global coverage in both commercial and manufacturing. The SAP rollout program is expected to continue in FY15.

Finally, we have been actively deploying capital in the public markets as part of the $200 million share repurchase program we announced in our last earnings call. During the third quarter, we repurchased approximately 4.5 million shares of our class A common stock for $67.6 million and I am pleased to say that the total amount of cash deployed for repurchase to date has reached $100 million. We believe this speaks to our commitment to driving shareholder value and our view on the value we continue to see in our shares.

With that, I will turn the call back to the operator for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Bill Schmitz, Deutsche Bank.

Bill Schmitz - *Deutsche Bank - Analyst*

Can I just ask you, one question is just a housekeeping question, not a real question, what do you think the tax rate is going to be for the fourth quarter? And then that $8.3 million of amortization that's going away, is that pre or post tax? And am I right to say that it doesn't have any impact on cash flow, so it comes out both sides?

Patrice de Talhouet - *Coty Inc. - CFO*

So Bill, thanks for your question. So of the second part of the question, the $8.3 million is pretax. As far as the fourth quarter and the full year guidance, so we don't modify our current guidance which is that the effective tax rate should be in the range of 25% to 28% going forward.

Bill Schmitz - *Deutsche Bank - Analyst*

Okay. Great. Thank you. And then when you think about what's going on in the mass challenge, have you guys done any work to figure out why the decline has been so substantial in such a short period of time? I know there's some destocking but if you look at some of the sell through numbers in Nielsen, it looks equally bad, so do you guys have any sort of conclusions as to why it happened so abruptly and then maybe what it is going to take to get it to accelerate again?

Michele Scannavini - *Coty Inc. - CEO*

Bill, this is a one million question and we have debated about that several times with you and we've updated on the industry. Clearly there are some explanations related to some, let me say, external happening like extreme weather conditions that have impacted clearly the beginning of quarter 3, particularly January and February. But we are seeing the slowdown coming even before and we remember perfectly well that the Christmas season in the mass channel has been particularly soft.

It looks like low income consumer are purchasing less. They are going less in the store. And to this the environment is very promotional, this is something that we see clearly in United States. But we have seen this movement also in Europe.

Now, on the positive side, let's say Europe has started seeing some sign of improvement. Particularly in central Europe. I've not seen yet sign of improvement in the US.

Now, how this can change, difficult to say. How we can contribute to try to change this, is try to bring innovation, testing and exciting to the market and increase our investment behind our brand, hoping in this way to create more traffic and more purchase. But I was following very, very attentively -- carefully, all the release of all the players in the mass market and I can say that although everybody is in agreement that there has been this strong slowdown, try to relate one specific reason why is very difficult.

Operator

John Faucher, JPMorgan.

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

As we look at the T Joy write-down contrasted by the philosophy results, your skin care business seems to be heading a little bit in two different directions and there has been some discussion in the market in terms of your willingness to go out and potentially do an acquisition in skin care going forward. So can you talk about where this divergence in performance leaves you in terms of looking at your skin care portfolio and whether you should be adding to it, is it a sector where you need to raise your focus?

And then sort of going along with that, if you look at the change in your outlook on T Joy, you had talked about using that as a distribution platform for other products. Has the write-down or the need for the write-down rather led you to any sort of different decision in terms of whether or not that's possible going forward? Thank you.

Michele Scannavini - *Coty Inc. - CEO*

Okay. So let's start with the first part of the question that is explaining a bit our skin care dynamic and the limits of the two different dynamics. So when you look at our business and our portfolio, I'm going to say that actually the vast majority of our portfolio now is tuned in a positive direction.

Start talking of philosophy, we have discussed several times the issue that we faced at the beginning and basically we related to two main things. The fact that we have a delay our informational development because of the time required to reformulate product and to register in new countries this product. And the low impact of the innovation plan.

Now, we worked intensively on both and we see that the situation now in philosophy is getting progressively better. Up to the point that now we have four quarters in a row of growth that is both in the United States and the international market.

So I think that through the period we also strengthened our capabilities. We brought at the new management team in the philosophy team with stronger expectations of skin care. And apart from philosophy, I would say that this is an important step overall for our ability to manage successfully the skin care segment.

Then we have Lancaster, that is a smaller brand, but strong in sum, but is developing actually very nicely in China. Particularly in the sun segment.

And then we have adidas that as we discussed before supported by developing in emerging markets and the sporting event is also having a positive growth. So in this context these are the positive we have, the exception of T Joy.

Now, the refinance is clearly due to the fact that as you know with T Joy, we had some issues in finding a management team that was competent, loyal, and reliable. In the meantime, the brand lost momentum and the activity that we tried to do in the brand so far didn't payout.

We also have to say that the stage of T Joy is a very small brand in a very, very big competitive mass market in China. So it's particularly difficult to have a grip with consumer when you don't have critical mass enough to have a big impact on the market.

So I should say that all in all, as we discussed a few times, we are on a learning curve on our management of the skin and body care category that basically we have created two or years ago. I must say that all in all the signs are positive, the, let me say, trend is positive. We need just to fix the T Joy issue as it was mentioned before, we are looking to alternatives to fix it and to benefit the total skin and body care category profitably.

Operator

Olivia Tong, Bank of America.

Olivia Tong - *BofA Merrill Lynch - Analyst*

First I just want to follow-up on the T Joy question. So I guess -- what is sort of your plan going forward, and in terms of priorities, where does Chinese mass skin care fall?

And then the real question I wanted to ask is, with half the June quarter now in the books, can you talk about what you're seeing now that the weather has turned in the US? It sounds like mass is still sluggish but it also sounds like some of your competitors are seeing some green shouts in prestige overall, so just curious on what you're thinking in terms of that. Thanks.

Michele Scannavini - *Coty Inc. - CEO*

Okay. First question on China. So let me remind a bit what is our business in China today.

So the biggest part of our business in China is prestige business, specifically prestige fragrances, today is more than 50% of our business in China. This part of the business is growing very nicely, both in terms of revenues and in terms of profit.

And we see that we are going from strength to strength with our brand, particularly Calvin Klein, that is the number three brand in the market, Chloe, Marc Jacobs and other brands of our portfolio. So this is a very healthy growing part of our business in China.

Then we have skin care, Lancaster, and adidas, both are growing very nicely, adidas in the last quarter had a stronger double-digit growth. So also there we see a number that is positive. And then we have T Joy, where the real issue is.

Now, as I said before, we have not ready yet to talk about our plan on how we are going to reorganize our business in the mass market and mass channel in China. But it's important for everybody to remember that the vast majority of our business in China is doing well, and actually, as I said before in the quarter, we had a mid single digit increase despite the very poor performance of T Joy.

In terms of the trend -- the market trend in the US, so while have seen in the quarter 3, at least in the segment where we compete, a situation which mass was difficult and still declining, but even the prestige business, in this case particularly prestige fragrances was overall flat. When adjusted for the calendar shift you know that this year is counted one week less than last year. But when you try to put a number like-to-like, like-for-like, sorry, it is overall flat.

So it's not an empty situation in prestige as well. I have no visibility on April number yet so I cannot say if the trend is continuing April, but all in all the situation in the US market in that moment is rather static if not declining.

Operator

Chris Ferrara, Wells Fargo.

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

Just a question on the Avon deal and then on A&P. So I guess first on Avon, can you just confirm what the structure of the deal is? Will you be manufacturing fragrance in the market through the same third-party manufacturer you had been using? And then booking revenue on your sales to Avon?

And then the second question, just on A&P, this 140 basis point increase, can you talk a little bit about where you are on A&P spend relative to where you want to be? Do think the company is spending at appropriate levels and is this a shift from promo? How do you think that line will trend as we move into FY15?

Michele Scannavini - *Coty Inc. - CEO*

Okay. Let's start with Avon. So as a whole I want to restate I'm very happy and very excited about this deal because I believe it's going to really give us now penetration with our fragrances in the most important market in the world for fragrances. So we see this as a very important deal for our business in the future.

Said that, the structure is a distribution agreement. So Avon will distribute and sell through their beauty representatives our products and we will manufacture product through third-party manufacturer locally.

Because obviously to be competitive in the market, you need to have a local production. So we are going to have the scheme and we can say it's a very normal distribution agreement.

As far A&P, we are planning to increase our investment. As you might remember, we said that we have been historically between 23% to 24% of our investment. We are planning to progress it to grow to a higher part of these gap, these interval -- sorry -- because we see that the market is very competitive, and particularly when the market trend is a little bit soft, as you have seen in the last month, particularly in the countries -- the developed countries, it is important to put fuel behind your power brand.

So we are -- so the fact that we see increased advertising investment in this quarter, is not an exception. It's going to be a trend that we will see for the future because we believe in the potential of our brand but we need to be sure that we have enough investment to stand out in a very competitive and crowded environment.

On top of that, obviously, our increased penetration in the emerging markets, so having more position with our brands will bring investment to support our brands. So all in all, we have defined clearly and strategically that we need to invest more behind our brand in order to ensure to get sooner to our long-term growth objective of growing in line or faster than the market in segments where we compete.

Operator

Neely Tamminga, Piper Jaffray.

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

Can we talk a little bit about the nail category and maybe this is revisiting the core of Bill's question around mass. If we were to kind of look at nail as being a little bit of a microcosm across the broader distribution networks? You've got mass all the way up to prestige.

What are you seeing within the nail category as it relates to the mass versus prestige? Said another way, is OPI actually more stable or even positive, and Sally Hansen just hasn't caught up to that innovation level yet? Or is OPI actually still negative and Sally Hansen just more negative? Thanks.

Michele Scannavini - *Coty Inc. - CEO*

Okay. So talking of the nail category, trying to clarify a little bit the different segments of our nail category.

So first of all, it is important to understand that we see a very strong declining trend today in the US. It is not the case in the rest of the world.

So in Europe, for instance, the nail segment has been growing high single digit. So it really today, North America, specifically US.

Number two when you look at the overall nail business, the vast majority of the business is mass. So clearly the impact on the total nail segment is driven very strongly by the trends in the mass channel and when the trend in the mass channel is bad, total nail segment is suffering.

Now, referring to OPI, again, OPI in Europe has a distribution that is professional and start having some distribution is doing very nicely. It is growing and is growing from strength to strength.

In the US, OPI is mostly distributed in salon, and the salon business, let me say is overall around flattish with nail that is suffering a bit also. Not as much as we see in retail.

But I believe that one of the cause that I was mentioning related to the decline of that category that is a huge in-house inventory of nail product by consumer and other states is impacting, maybe not the service part of the salon, but for sure the selling, product selling part of the salon as well. So also in salon, nail salon category, we see a decline, not strong as we see in the retail environment.

Operator

Wendy Nicholson, BCTI Research.

Wendy Nicholson - *BCTI Research - Analyst*

A couple things. First on the SAP initiative, have you quantified what benefits you think you'll see from that either on the income statement or the balance sheet and over what time frame?

Patrice de Talhouet - *Coty Inc. - CFO*

So in terms of SAP rollout, clearly, this is helping us in driving efficiencies so this is something that will bring some more standardized and simplified ways of operating and will help us in our productivity program, so this is embedded into the productivity program and this is an enabler for the productivity program to happen.

Wendy Nicholson - *BCTI Research - Analyst*

Got it. Okay. Terrific. And then on the share repo, the $100 million has happened faster than I would have expected, is there a plan to re-up the authorization, it sounds like you are halfway done already. Do you have a longer-term plan or an annual target in terms of the number or amount of shares you want to buy back?

Patrice de Talhouet - *Coty Inc. - CFO*

So on this one, as you know, so the board has approved a $200 million program so we have already executed the first $100 million so there is no reason why we will not pursue the second portion of this approved $200 million program. And we will revisit going forward on a regular basis what is the best way for us to return cash to shareholders.

Operator

Mark Astrachan, Stifel.

Mark Astrachan - *Stifel Nicolaus - Analyst*

I wanted to ask about M&A, just get some updated thoughts on your views of acquiring scale versus going after new categories and geographies. And then just a second sort of a follow-up to some of the other questions around A&P spend, can you talk maybe a bit about any change in how you're managing mass versus prestige brand spend given what we're seeing from a divergence in category growth and just sort of how you are thinking about it. So incremental spend, but is it in a different way then you envisioned maybe 6 or 12 months ago?

Michele Scannavini - *Coty Inc. - CEO*

Okay. So first part on our M&A strategy. So we are looking for a deal that can have a strategic feet with our growth objectives and that are financially accretive. This is the important things to keep in mind.

As you know, as we have discussed, our growth road map includes to get a stronger -- even a stronger leadership in the segment where we are already covering a good position, like fragrance and color. And to strengthen the scope of our business in skin care.

We are looking for targets that can give a significant contribution to strengthen our competitive position, adding certain segment, or in certain areas, particularly in emerging markets. But one thing that is important is that we want to see something that is on top of being strategically right or financially accretive for us.

In terms of A&P, so we are really driving our A&P decision based on the strategy that we have for our brands. So it's not very much driven by the let me say short-term trends of the channel. It's more driven by what is our assumption in growth potential related to our power brands.

For instance, just to be specific, when we look at fragrance, clearly we have a stronger business and more power brands in prestige so we are going to invest more in brands in that prestige channel than in mass. Where we look at the total segment, our power brands are in mass, particularly Rimmel and Sally Hansen and OPIs in locations, and because of this, we will invest more in mass than in prestige. So again, it is driven by growth potential related to our power brands.

Operator

(Operator Instructions)

Linda Bolton Weiser, B. Riley.

Linda Bolton Weiser - *B. Riley & Co. - Analyst*

Could you give just a little bit more color on the agreement with Avon in terms of the distribution of the fragrances in Brazil, specifically I think you have some other agreements, joint ventures and agreements with other distribution partners in the market, so how will you kind of divide up the brands? Are certain brands going to be distributed through Avon and other ones through other channels? Or exactly what are the details of the distribution? Thank you.

Michele Scannavini - *Coty Inc. - CEO*

That's a question because given the opportunity to clarify what is going to be going forward, our situation in Brazil. As of today, we have a joint venture with Frajo that is a company owned by Boticario that take care of distributing and selling our brands in the retail brick-and-mortar mass environment. And here we are going to progressively distribute all our brands in the different categories.

Then we have now the agreement with Avon door-to-door. As you might remember, we have today an agreement with another door-to-door company that is called Jequiti.

This agreement will expire in the moment in which we are going to start working with Avon. So Avon will have the exclusivity of disturbing our door-to-door -- our fragrance brand door-to-door.

Then the fragrance brand that we will distribute door-to-door, or to better say the fragrance product, will be exclusive to door-to-door. That means that we're going to have also some fragrances that will be distributed in a brick-and-mortar but will not be the same. So we will avoid to have the same SKU, the same product in the two channels. Is it clear?

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 appreciate 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 again.

Michele Scannavini - *Coty Inc. - CEO*

Thank you.

Patrice de Talhouet - *Coty Inc. - CFO*

Thank you.

Operator

Thank you. Ladies and gentlemen, this concludes your presentation today. Thank you everybody for participating and you may now disconnect.

Michele Scannavini - *Coty Inc. - CEO*

Thank you very much.

Patrice de Talhouet - *Coty Inc. - CFO*

Thank you and goodbye.

Michele Scannavini - *Coty Inc. - CEO*

Goodbye everybody.

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