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COTY - Q1 2015 Coty Inc Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. My name is Tracy and I will be your conference operator today. At this time I'd like to welcome everyone to Coty's first-quarter FY15 results conference call.

(Operator Instructions)

As a reminder this conference is being recorded today, Thursday, November 6. 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. Thank you.

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

Good morning and thank you for joining us. On today's call are Bart Becht, Chairman and Interim CEO, 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. You can find the bridge from reported to adjusted results in the reconciliation tables in the earnings release. I will now turn the call over to Bart.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Thank you, Kevin, and good morning, everybody to Coty's first-quarter results conference call. This morning we'll take you through a summary of today's announcements and then Patrice and I will be pleased to take your questions.

Q1 was a quarter of good strategic progress but mix financial results. Our strategy of focusing on our power brands showed good progress, as power brands net revenue grew mid-single digits on a like-for-like basis behind exciting innovations.

We are particularly happy with the growth contribution from Sally Hansen Miracle Gel which not only allowed the Company to regain market share in the US nail market, but managed to restart that category growth where Coty is the clear market leader. Other noteworthy first-quarter growth contributors were Rimmel, helped by its Wonder'full mascara product, and the new Marc Jacobs Daisy Dream fragrance.

With regard to our financial results, while power brands representing 70% of sales grew strongly, the revenues of the remaining 30% of our brand portfolio materially declined resulting in a 1% like-for-like growth rate for the total Company. Consistent with Coty's strategy, we increased the level of advertising and consumer promotion spend compared to the prior year, reaching 22% of net revenues with the increase very much focused on power brands and supporting innovations.

The productivity of our increased spend is to us clearly a concern, and we will be looking at how to improve productivity in this area going forward. As a result of the materially higher support levels behind an overall revenue growth of 1%, operating income declined which in turn contributed to an adjusted net income drop of 5% to $103 million.

In contrast, adjusted EPS remained flat compared to the prior year thanks to Coty's share repurchase program which we commenced in FY14. In conclusion, while we continue to expect market dynamics to remain quite challenging, we are targeting to gradually return Coty to profitable growth.

We believe that the focus on our power brands combined with the savings generated by our global efficiency plan should help us make progress against these targets over time. On a different subject, we recently announced our offer to acquire the Bourjois cosmetics brand from its parent company, Chanel.

This transaction, which is expected to close in the second half of our fiscal year, we believe is a great addition to our existing portfolio because it strengthens our global market position in color and provides further critical mass to our French operations. We clearly also look forward to welcoming Chanel as a shareholder of Coty. I will now hand over the call to Patrice who will provide a few comments on the financials and the progress of the global efficiency plan.

Patrice de Talhouet - *Coty Inc. - CFO*

Thank you, Bart, and good morning everyone. I will comment on the overall P&L and then give you some perspective on our global efficiency plan and our capital structure.

First the P&L. As Bart already mentioned net revenues growth of 1% like for like was supported by our power brands, giving mid-single digit growth in the quarter and comprising over 70% of net revenues.

This good performance, reflecting a focused strategy behind our programs, was however partially offset by a decline on the rest of our portfolio. The 1% like-for-like growth was the combination of a good volume growth of 4% partially offset by a negative 3% price mix impact due to higher promotional activity in the market and growth from lower priced product in emerging markets.

In the quarter, given the competitive trade environment, adjusted gross margin declined to 59.6% from 59.9% from prior year with a negative impact of higher customer discounts and allowances partially offset thanks to the ongoing supply chain initiatives. The advertising and consumer promotion line has increased by $15 million in Q1 FY15 versus the prior year, with the bulk of investment behind some of our key launches reflecting our focused strategy on fueling our power brands.

The tight management of our cost structure is paying off with administrative costs flat versus prior year. After the earlier July announcement, we have started to implement the new organizational redesign and booked $40.5 million of restructuring charge this quarter.

As a result our reported operating income margin has decreased to 10.2% in the quarter. Our adjusted operating margin decreased from 15.8% in the prior year period to 14.1% in the first quarter of FY15, reflecting the increased investment to properly support the brands.

Our profitability by segment has shown contrasted evolution. On the one hand, we have seen an increase in skin and body care with the TJoy discontinuation yielding some positive effects resulting in an increase to the adjusted operating margin of 100 basis points, and an increase in color cosmetic adjusted operating margin of 20 basis points.

On the other hand, we have seen fragrances adjusted operating income profitability decrease as a result of a tough retail environment coupled with increased brand support. Reported net income decreased to $10.6 million in the quarter from [$93.5 million] (corrected by company after the call) in the prior year primarily reflecting lower operating income and expense on early retirement of debt.

On an adjusted basis net income declined 5% to $103 million from $108.3 million reflecting lower adjusted operating income partially offset by lower tax expense. Our adjusted effective tax rate was 24.9% for the quarter, and we would at this stage anticipate approximately 25% to be a good estimate for adjusted effective tax rate for the remainder of the fiscal year.

Turning now to our global efficiency plan, as discussed on our last call we have targeted combined annual savings of over $200 million within the next three fiscal years, and anticipate associated costs for this savings will total $250 million to $300 million. As a reminder, the global efficiency plan also includes a previously announced productivity program which will drive over $60 million in annual savings, and the China mass business organization which will drive over $20 million of savings.

As previously mentioned, in the quarter we have recorded more than $40 million in costs associated with the plan, bringing the total cost recorded to date for the global efficiency plan of $130 million, which is halfway toward the expected total. On the savings front, we are very confident towards our goal of $200 million knowing that with the actions in place we already more than halfway towards our goal targets.

Let me now spend a minute on the capital structure. Consistent with our discussion on the last call, we continued to strive to improve our capital structure with the goal of enhancing financial flexibility in support of our growth and restructuring initiatives.

During the quarter we successfully prepaid our private placement notes issued in 2010 and replaced the debt with a bank term loan. We also amended certain covenants in our existing $3 billion credit facility to provide flexibility for these growth and restructuring initiatives.

Our net debt increased by $180 million compared to June 30, primarily driven by the payment of the early termination fee associated with the prepayment of the notes. Net cash provided by operating activities in the quarter was $26.2 million, which is lower than last year mainly due to the cash earnings gap compared to prior year.

Let me say that we are clearly committed toward a zero working capital journey over long term, and we are confident that the current momentum will help us achieve these goals. Consistent with our focus on enhancing shareholder value, in October we distributed more than $70 million of cash to our shareholders to pay our annual dividends of $0.20 per share.

As Bart mentioned, now that our very exciting offer for Bourjois is public we intend to continue with our share repurchase program based on the current $300 million authorization we have available. As a wrap up, while market dynamics remain challenging, our objective is to return sustainable profitable growth and drive long-term shareholder value.

Thank you. We will now open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

John Faucher, JPMorgan.

John Faucher - *JPMorgan - Analyst*

Thank you, good morning. I wanted to talk a little bit about your comments about the non-power brands and can you go a little bit into that in terms of saying is this a question of whether or not you guys are providing the levels of support?

Obviously you're spending less on those brands versus your core brands. Or is it something where you just think the retailer is moving away to a lower number of SKUs that they're promoting, et cetera?

So some further on color on that would be helpful. Thank you.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

I don't think it is an issue of support levels, but like you said the support levels clearly are not at the same level as the power brands. There is in detail in particular on the fragrance side, there is a long list of celebrity fragrances.

Some of which are gradually fading away. So there are a number of brands which have -- are late in their lifecycle and are gradually losing their position.

As we are focusing harder and harder on the power brands, this issue should gradually go away over time. But it will be a very gradual process. It is not something which is going to happen within a couple of quarters.

John Faucher - *JPMorgan - Analyst*

Okay. And if I could follow up on that. You talked about the celebrity fragrance issue.

As you look at the problems in fragrance, do you see that going from celebrities to designers? Or do you think it's purely a celebrity issue at this point just because the market is oversaturated?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

I would say it's not just celebrity, it's much more of a mass fragrance issue. So it is both celebrity fragrances and other brands which are in the mass fragrance area where there is some market weakness. You are absolutely right that on the prestige side there are better market dynamics, and this is also where we have a harder focus from our power brand point of view.

John Faucher - *JPMorgan - Analyst*

Okay. Thank you very much.

Operator

Dara Mohsenian, Morgan Stanley.

Dara Mohsenian - *Morgan Stanley - Analyst*

Good morning. Bart, I was hoping you could discuss your cash flow priorities here, particularly in terms of share repurchases versus acquisitions. Do you think you're ready to do more acquisitions post Bourjois or given the restructuring in Bourjois might you take a bit of a pause here to make sure you execute well in both those areas?

And then on the repurchase front, obviously there will be higher shares with the issuance for Bourjois. Do you anticipate repurchasing shares to offset that impact this upcoming year, and would you go beyond that also? Thanks.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

I will have Patrice answer the second point. On the first point in terms of acquisitions, clearly we do want to become a much stronger leader in the global beauty industry over time through a combination of organic growth and inquisitive growth.

So will we do further acquisitions? Yes, we will continue to look at that.

Are we in the best position today to do acquisitions? No, because clearly we have more work to do from a business point of view.

And we also have to absorb the Bourjois transaction. But if you look at the longer term, yes we will continue to be on the acquisition front.

Patrice de Talhouet - *Coty Inc. - CFO*

Good morning, Dara, so on your second questions. Key to the share repurchase program we have a $300 million authorization for the time being.

This will roughly offset the issuance of shares for the Bourjois acquisition. Now when it come to the next step, first we need to execute the first $300 million and then on next steps this is something that we'll reevaluate going forward.

What is the right way to return cash to the shareholders? So it's a question of market dynamics and discussion with our shareholders as well as with the Board.

Dara Mohsenian - *Morgan Stanley - Analyst*

Okay. Thanks.

Operator

Bill Schmitz, Deutsche Bank.

Bill Schmitz - *Deutsche Bank - Analyst*

Bart, a question for you. What do you think the big differences are between running a beauty company and running a household products company?

So what's the same and what's different, and maybe how you would change your management style versus your previous gig? And then my follow-up question is just on the sustainability of growth in the nail care category.

Because obviously it's been fits and starts recently, but we've had this great period last couple months where the category has been very strong. So I'm just wondering how long you think that good tailwind lasts?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Beauty versus health is an interesting question. Clearly the categories are different.

Having said that, I've worked in many different categories even within Reckitt Benckiser because we had everything from food to household to personal care. So each one of those have their own consumer dynamics and competitive dynamics, and you really need to dig into that in order to be successful at them.

Clearly there is one thing which is substantially different in the beauty industry versus the household business industry which is called licenses. In particular in the prestige fragrances, you're working with licensors and that relationship is quite important in order to be successful.

So I would say that's probably, other than understanding the dynamics of the individual categories, that is a substantial difference versus other consumer goods companies. I would say the other thing in beauty, I think it is, innovations can have quite a big impact.

And in that respect it is somewhat similar to household, but less similar to let's say healthcare or a food category. In beauty innovations can like in households can have a quite dramatic impact on the top line.

In terms of the nail category, I can't really comment in terms of sustainability or growth. We have seen the nail category grow very, very nicely over the last 5 to 10 years.

Sally Hansen as well as Rimmel have been very nicely positioned in that OPI. They have all been very nicely positioned in those categories.

We are clearly the global leader in the nail category and we'll do everything possible to make sure not only that we have good share positions, but that we target growth in this category. Or target growth for the category over time.

Bill Schmitz - *Deutsche Bank - Analyst*

Great. Thank you very much.

Operator

Olivia Tong, Bank of America.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Thank you. Good morning. You had alluded to the productivity of advertising spend in your prepared remarks.

I'm curious, do you believe that ad spend as a percentage of revenue, that's the right number? Or is it more a function of getting productivity? And is it a function of getting productivity out of that number, or do you think that number is too high?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

So I don't think that the media investment is too high. I do think I would agree with you that productivity of media investment could improve.

But clearly in addition to media investment you have substantial other A&P spending levels sitting in the number. And personally I believe we can do much better by switching some of those lines into media, into real media investment.

So what I'm looking for is to take what we would call nonworking dollars, which are really dollars in the lines where -- that the consumer never sees. I'll give you an example. It's the production of a print ad.

So it's the development of packaging, and there are many other lines like that which sits in the A&P budget. And I believe we can optimize those and invest them in efforts which the consumer actually does see.

And within the working part I think we can get a better return on investment. And this is not just something which could improve our top line, but clearly also improves the bottom line. And like we said already in the press release, we are targeting to return to profit growth, and this effort is one of the efforts for us to get us there.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Got it. And then just following up on that. Your comment about gradually returning to profitable growth.

How gradual? Because on the one hand your comps not that difficult Q2, and track channel trends are starting to look at little bit better in a handful of categories.

But obviously emerging markets growth had slowed a bit and the dollar is stronger, and there's obviously concerns around the productivity over your spend. Thanks, Bart.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Yes. In terms of the market role that we're facing, so clearly we have a different geographic and category mix than some other companies in the beauty industry. And if I look at the market roles that Coty is exposed to, we're talking 1% plus at the moment.

So we're not looking at very strong market dynamics. Granted the color category has seen a rebound in the US.

But we have other segments. For instance like mass fragrances where the dynamics are not very good as we already discussed.

So I think the way you got to take a look at this is that we're looking at a return to profit growth over time. And I think a big contributor to that could be the return on investment that we discussed as well as the cost efficiency programs we're putting in place. So even in an environment where we might be facing headwinds from a top line point of view, I still believe that there is a possibility to return Coty to profit growth over time.

Operator

Chris Ferrara, Wells Fargo.

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

Thanks. Bart, I guess since you've taken over as Chairman you've now had a couple of CEO changes, CFO change, changes of head in supply chain, change in head of business development. I guess the question is, can you talk about what's going on internally culturally maybe at a higher level?

Is the message changing internally? What's going on with all the change and how is the employee base responding to this stuff?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Clearly we have a number of changes. We believe that the leadership changes are there to strengthen the team, and to make the team and the whole business more professional.

And we should not forget we've gone from being a private company to a public company and that requires a more disciplined approach. We are also in the midst of changing the organizational structure.

We were a business which was managed by the vision, and now we have much more of a classical matrix structure like most consumer goods companies have. One of global categories, countries, and functions.

And that also requires a different leadership style and different competencies. So net net we believe that the leadership changes are the right ones and are there to strengthen the team.

If you ask me how employees are feeling at the moment? Clearly there's a level of uncertainty because the one Coty project is not fully implemented yet.

And we clearly need to work through this period of uncertainty so we can get back to business. And that's exactly what we're focused on.

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

Great. And just as a follow-up to that, along with those changes in leadership are there also greater incentives to deliver targets and hit certain bogies from a growth perspective?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

We have a very established program in place from a remuneration point of view which consists of base salary, annual bonus, and long-term incentives. On the annual bonus side we're very much incentivizing people to drive top line growth, bottom line growth, and cash efficiency in the business.

We're very much focused on net working capital, as Patrice highlighted before. So there is a clear incentive scheme in place to deliver targets. To balance short and long term, in addition to the annual bonus programs we have long-term incentives to make sure that people don't just optimize the end-year results but also the long-term results.

Clearly from a JV point of view we are very much interested in a steady improvement year after year to make this much more of a successful global beauty company, and we do believe that our incentive targets are aligned to that. Having said that, we review this literally every 12 months in depth to make sure that that's the case, and we will have another review on this in the next couple of months.

Operator

Wendy Nicholson, Citi.

Wendy Nicholson - *Citi Investment Research - Analyst*

Hello. Two questions. My first is with regard to the 30% of the business that's the non-power brands.

Is there value to keeping that in the portfolio? Or do you think it might make sense to adopt a more aggressive strategy with just shutting down some of those brands?

Because it seems to be costing you a lot terms of your reported results. So views on that would be helpful.

And then second of all, could you talk a little bit about the Avon partnership? I know you called it out in the press release as contributing to your fragrance business, but order of magnitude how big was that in the first quarter?

What's your expectation there? And can you just remind us of how that works?

Are you shipping a whole bunch of stuff and then they work through the inventory? Or is there a just-in-time inventory replenishment?

I'm just trying to forecast how big a contributor that's got to be to your business maybe in the December quarter. Thanks.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

So first in terms of the portfolio strategy, clearly which is squarely focused on our power brands. So I would say I was very pleasantly surprised with the growth rate on the power brands in the quarter which was quite strong compared to what's happening out there in particular when you look at some of the growth rate of many other CPG companies.

Clearly I was not very happy with the growth levels on the non-power brands. Having said that, I have zero interest clearly in terms of allocating substantial resources to non-power brands or the bottom end of the portfolio.

That clearly immediately raises the question should we discontinue or divest it? Divesting is going to be challenging because some of those are licensed brands and it's not that straightforward.

Discontinuing is in a lot of cases not super interesting because while they might be declining, they're still contributing substantial levels of profitability. So just to take them out is not super interesting because we don't do a lot of work on them, but they still make money.

So as we harden our focus on the power brands, over time the portfolio should shift. But as you all know, this will be a gradual process.

And so we're going to have to live with the 30% decline -- the 30% of the business continuing to decline for some time. Which is a drag on growth clearly.

In terms of the Avon partnership, it is progressing very well. It is quite encouraging.

We're not going to discuss specific financials on the Avon partnership. Having said that, it is providing huge growth in Brazil but from a very low base.

And it is not going to make a massive dent in the total Americas number. In terms of distribution, the products are being shipped to Avon and then they essentially ship them to their sales representatives.

Wendy Nicholson - *Citi Investment Research - Analyst*

And in terms of expanding potentially beyond Latin America, is that something you would consider doing with Avon?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

I think the first thing is to make -- as you all know normally when you look at Latin America, Brazil represents 50% of Latin America. If we can make Brazil highly successful, I would be very, very happy. And that is the first port of call.

Operator

Steph Wissink, Piper Jaffray.

Steph Wissink - *Piper Jaffray - Analyst*

Thank you. Good morning, everyone. Just a couple of follow ups on the advertising and promotional expense.

Guys, could you just talk a little bit about how much of that in the quarter was related to recapturing some placement that you may have lost versus some of the conversion drivers or some of the supported discounts that you offered to the retailers? And then just secondly maybe more of a lever high-level question around that spend.

You implied that productivity was below your goals, but your power brands did grow mid-single digits, which was quite a bit better than the industry growth. So maybe give us some sense of the productivity hurdle rates that you'd like to see to satisfy your expectations?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

I can tell you what I would like to see and then the question is how we get there, clearly. So I would like to see when I invest more money, that I have a growth rate which generates more profit. (laughter)

It's very straightforward. So we're going to have to manage that to get there. So the question really is how we get there.

And like I said, the way we should get there is take a lot of nonworking dollars in A&CP either out and put them on the bottom line, or reinvest them in working dollars which produce results. And that's what we're working on internally in terms to improve the productivity.

The fact that the tail of the business is declining and therefore is depressing the overall growth of the Company cannot be enough of an excuse to sit there and it's like okay, behind increased investment we're going to always have reduced profit. This cannot do, it's just not good enough.

So we're going to have to work on that. In terms of recapturing placement, I assume you are assuming lost distribution of brands?

Steph Wissink - *Piper Jaffray - Analyst*

Correct.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Okay. So I don't really have a good answer on that. What I can tell you that in clearly the biggest hit that we had last year was from Sally Hansen.

And there we didn't really lose distribution, the whole category came down. And there was a huge amount of traders talking associated with that. So I don't think it was really a distribution question, it was much more all the category momentum and market share issued than anything else.

Steph Wissink - *Piper Jaffray - Analyst*

So just maybe a clarification. So are you finding that your spend this quarter helps you regain maybe some of that trade distribution? Not additional doors, but just expanded within the doors that you already had?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

The Sally Hansen success on Miracle Gel really is an innovation success. So clearly we got distribution on the Miracle Gel.

Some of that was on top of the SKU distribution that we had and that very much drove the market share and drove the category, which was very exciting. While one can be disappointed with the overall 1%, I would say we should be very happy with the power brand growth.

Within that there's some very good success stories. Sally Hansen is one of them.

Rimmel is another clear success story. Daisy Dream is a clear success story. There are some brands which are doing extremely well within the Coty portfolio.

Operator

Mike Moodie, RBC Capital Markets.

Mike Moodie - *RBC Capital Markets - Analyst*

Thanks, good morning, everyone. Bart, just a question on Chris Ferrara's question. When we think about you as Interim CEO, just curious if you have an update for us of how we should be thinking about a permanent replacement?

Or have you -- plan on being the permanent replacement? And then the second broader question is, a lot of consumer companies this quarter have talked about the US improving. And so I just wanted to get your state of the union on the US consumer?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

So there is not much to comment in terms of replacement CEO. Clearly we are working on a replacement.

I'm very comfortable with the idea that we will have a top-quality CEO in place sometime next year. Who that will be and on what exact timing is really premature and I don't really want to speculate on that.

In terms of the US, the US consumer improving, yes in some category we see some improvement, but the growth overall in the US across our categories is still very anemic and is quite frankly not much better than Europe, which has always been considered as a very anemic growth market. The US across the various segment is not much better.

Mike Moodie - *RBC Capital Markets - Analyst*

Thank you.

Operator

Connie Maneaty, BMO Capital.

Connie Maneaty - *BMO Capital Markets - Analyst*

I was hoping you could talk a little about some of the joint ventures you've signed in the last year for emerging markets? And in particular how is the new arrangement going in China?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

It's very early days.

Patrice de Talhouet - *Coty Inc. - CFO*

Yes, it's very early days. We just signed this agreement with Li & Fung on the mass side of the business, so I think it's really early stage.

As I mentioned in my script, what we can share is that the discontinuation of the TJoy brand is producing the results that we expected in terms of bottom line, so that's a positive sign. In terms of traction on the business, it's just a month after the signature.

So it's far too early to assess the performance so far. So we'll come back on that in the coming quarters.

Connie Maneaty - *BMO Capital Markets - Analyst*

So then the growth of the emerging markets businesses you have is more organic rather than based on these newer relationships? Is that the right way to look at it?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Yes. That's correct.

Connie Maneaty - *BMO Capital Markets - Analyst*

Okay.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Emerging market growth was quite strong. Remember it was around --

Patrice de Talhouet - *Coty Inc. - CFO*

So the growth in emerging market was 10% which is quite good. And that represent now 28% of our overall top line.

So we are happy with the progress we're making. This is above what we had in Q1 last year at 25%.

So for the time being we are happy with that. The only thing I would mention is that in one of our market we had a change of business model which has impact the performance comparison. But in a nutshell, the 10% is true organic growth.

Connie Maneaty - *BMO Capital Markets - Analyst*

Okay. Is Sally Hansen Miracle Gel patented? Because Revlon's got a gel-like formula, but L'Oreal so far does not as far as I can tell.

So what kind of protection do you think you've got on Miracle Gel? Because I'm not expecting L'Oreal to lag in this development.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Even if there were to be protection on it, in consumer goods there's nothing really protected. [Adjusted the gross to clear].

If you're asking me, we have a head start. This is the way you've got to look at that on Miracle Gel.

And we've done a phenomenal job in terms of the market to product. So, plus we have the market-leading brand in this category.

So you have a market-leading brand with a market-leading innovation which is well communicated. But it is going to be copied. We should count on that.

That is going to happen. There is not enough protection around that is going to stop competition from coming up with similar products.

Operator

Lauren Lieberman, Barclays.

Lauren Lieberman - *Barclays Capital - Analyst*

Thanks, good morning. I was hoping you just could talk a little bit more about the promotional environment? Because obviously the commentary in the press release and the impact on gross margins was pretty clear.

So it sounds like it's -- fragrance is worse than color. And if you could talk a little bit about regions and what you see as the path to slowing that down.

I feel like we've been in a heightened promotional environment in mass fragrance now for 12 to 24 months. And it's awfully tough to get out of that cycle.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

There continues to be both in Europe but also to some extent in the US still an increase in discounts and allowances in the categories. And this is not just limited to fragrances.

This is also in other categories. I mentioned earlier that we are looking at return investment of our A&P budget.

But quite frankly we'll also be taking a look at is there anything that can be done in this area? Clearly we don't want to become uncompetitive.

At the same time, just like you said, we have now seen a sustained period of increased discounts. And the question is if that should remain, yes or no.

We're in the process of looking at that. But the promotional environment we saw again in Q1 furthered growth to net deterioration because of increased discounts.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay, so it's the mass color business as well?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

There is some in the mass color business for a very simple reason, the category went down last year. In particular in the US discounts increased and they have not come out. You still have a year-on-year impact.

Operator

Javier Escalante, Consumer Edge Research.

Javier Escalante - *Consumer Edge Research - Analyst*

Hello, good morning, everyone. I have a follow up on that Brazil. My understanding is that prior to this joint venture with Avon you had a distribution agreement with Jequiti, which is another direct seller.

So if you can tell us based on the experience that you have with Jequiti how that informed the brand selection, the price points, the kind of categories that you are doing with Avon? That would be my first question.

The second would be more about OPI. Earlier this year we heard of this expansion in Sally Beauty, 2,700 I believe.

And since then we haven't heard anything about it. How that is doing, to what extent there is any channel conflict with the [breaksist] in distributors, and if you can tell us how the OPI is doing in the US on a like-for like-basis? Thank you.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

On P&L, I have been here three weeks so I'm not going to claim I'm an expert on every single SKU that was launched in Avon and Jequiti. What I can tell you is that clearly Avon is a much bigger operation than Jequiti in Brazil in terms -- from a coverage point of view there is no comparison between the two.

So clearly you have Natura being number one, Avon number two, and Jequiti being a distant number three in terms of sales representatives coverage. We are clearly launching on Avon a lot more mass brands with price points.

We're not launching prestige brands through Avon. These are very much mass brands that we're launching.

Some of them are our power brands, some of them are celebrity fragrances. It is substantially bigger to results from a revenue point of view on Avon clearly than on Jequiti, which is simply a function of the type of brands we've launched as well as the fact that Avon has much better coverage.

OPI was launched in Sally Beauty. It is not having any negative impact on the salon business that we can tell. OPI continues to do fine.

In the US we have seen on OPI we actually -- we saw some diversion of OPI into the mass trade in particular which we're trying to reduce, so that's had a negative impact on sales. And secondly we had Nicole by OPI, which was launched a number of years ago, which is in our mind a mistake.

Which also is gradually coming down. If you take the effect of Nicole by OPI and the diversion in the lower end of the tray, OPI is doing quite well.

But short term we're going to see a little bit of a negative impact on OPI. But overall the brand health is still very, very good.

Operator

Mark Astrachan, Stifel.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Thanks and good morning, everybody. I wanted to ask about the Chanel partnership. Does the future stake that they're going to have essentially lead to the opportunity for additional partnerships with other beauty brands?

And then more broadly thinking about the structure of the business, Bart, I'm curious from your standpoint how JAB thinks about the Coty business? And sort of more broadly what benefit does Coty get from being a public company considering that the JAB has a lot of access to capital markets?

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

So on the Chanel partnership, just to be clear. So far what we've announced is an offer to part of the Bourjois business, so this deal is not closed yet.

To have a discussion about anything which might be an opportunity after, the first focus is to actually close the Bourjois deal. Clearly we're very happy about this acquisition.

And we're also very happy that Chanel is taking Coty shares for this because we both see this very much as a partnership. Will this result in anything else beyond this?

There's been no discussions on that. We are very much focused on closing the transaction.

In terms of JAB thoughts on the Coty business, for us it's very simple, what we want Coty to be. We want Coty to be a strong, global leader in the beauty industry and get there through a combination of organic and inquisitive growth.

So what does Coty get from JAB as a public company? Access to being a public company provides two key benefits from a JAB point of view.

First it puts more discipline in the business being subject to public scrutiny, which we think is very, very good. Second, it gives us access to capital markets.

And even in small transaction of Bourjois we use shares as Coty's part of the transaction. So there is clearly a benefit of having shares as currency.

And that is much better handled at the Coty level than at the JAB level. Is not as JAB we couldn't raise the money, but at the Coty level it is much, much better to have it there than at the JAB level.

At the same time, clearly our view as JAB in the Coty business, we're interested in a well-performing business year after year after year, not quarter after quarter. Our focus will not be on quarters, our focus should be on years. Did I answer your question?

Mark Astrachan - *Stifel Nicolaus - Analyst*

You did. That's definitely helpful. Thank you.

Operator

Lauren Lieberman, Barclays

Lauren Lieberman - *Barclays Capital - Analyst*

(Technical difficulty) and Adidas. Because those were two power brands that my recollection has had pretty meaningful launches this quarter and neither were called out. So just any feedback on what maybe didn't go so well with those launches would be great. Thanks.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Which brands? Sorry, we missed that.

Lauren Lieberman - *Barclays Capital - Analyst*

With Chloe. I think Chloe Love Story, was that the one that launched this quarter? And then there was an Adidas launch as well.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

The Chloe Love Story is just being launched as we speak. So it's just too early to comment on that.

And the Adidas launch what did we refer to? It's the same.

Patrice de Talhouet - *Coty Inc. - CFO*

The Adidas launch -- so Chloe was launched, Love Story was launched only in France so far and was launched end of August, early September. So I think it's too early to assess.

But the current feedback we have from Love Story is very positive. So we're very happy with the launch.

And it's the same story for Adidas. It's far too early.

The first signs that we get from the Champions League are pretty positive. So that's a very nice start, but once again it's only a couple of weeks.

So I think we need to wait before we draw a conclusion out of this. But so far so good.

Lauren Lieberman - *Barclays Capital - Analyst*

Thanks so much.

Operator

I would now like to turn the call over to Kevin Monaco for closing remarks. Please proceed. Thank you.

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

Thank you all for joining us here on the call today. If you have any other follow-up questions please don't hesitate to call us here in the investor relations department. Thank you very much.

Bart Becht - *Coty Inc. - Chairman & Interim CEO*

Thank you.

Patrice de Talhouet - *Coty Inc. - CFO*

Thank you.

Operator

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