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COTY - Q3 2015 Coty Inc Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. My name is Howard, and I will be your conference operator today. At this time, I would like to welcome everyone to Coty's third-quarter FY15 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 call is being recorded today, Thursday, May 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 Bart Becht, Chairman and Interim CEO; and Patrice De Talhouet, Executive Vice President and 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. In addition, except where noted, the discussion of our financial results and 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 welcome, everybody, to Coty's third-quarter results conference call. This morning, we'll take you through a summary of today's information, and then Patrice and I will be pleased to take your questions.

Q3 was our second consecutive quarter behind our new strategy of investing in and fueling growth of power brands and driving strong profit growth behind efficiency programs. We clearly have made excellent progress in driving growth behind our efficiency programs as shown by the 24% growth in Q3 adjusted operating profits. Patrice will detail our strong progress against Coty's $200 million efficiency program in a minute, but the savings are very much driven by headcount reductions, procurement savings, and restructuring of our China mass business.

Due to our strong performance in this area, we will be looking to increase the $200 million target for our global efficiency program in the months to come. We'll come back to this subject and our revised target as part of our full-year 2015 results discussion. Power brands and overall growth, on the other hand, is still muted for the quarter, and year-to-date despite some clear bright spots. The bright spots for the year are Sally Hansen, Rimmel, Chloe, philosophy, and Marc Jacobs. All of which continue to perform extremely well thanks to innovations such as Sally Hansen Miracle Gel, Marc Jacobs Daisy Dream, Chloe Love Story, and philosophy's Renewed Hope in a Jar.

We are particularly proud to report that the robust appeal of the Miracle Gel line has allowed Sally Hansen to reach its highest US market share level since our IPO. This success extends beyond the US with Sally Hansen now achieving the number one nail brand position in several European markets such as the UK, the Netherlands, and the Czech Republic. While we already have several bright spots in the portfolio, more is to be done. And, now that we have created more space in the P&L through our efficiency programs, our objective is reinvest part of these savings to steadily improve our growth track record across all our power brands, and as a consequence, on the total Coty business.

In this respect, we're also pleased to have announced the recruitment of Elio Leoni Sceti as CEO and Camillo Pane as EVP of Category Development effective July 1. Both of them have a proven track record of building successful global brands in a variety of consumer-oriented businesses. I look forward to working closely with them and the Coty Executive team in my role as Chairman. We are also excited to have closed the Bourjois transaction on April 1 with the Bourjois brand joining our portfolio and Chanel becoming a Coty shareholder. We view the Bourjois brand as very complementary to our portfolio, further strengthening Coty's position in the global color cosmetics market.

Looking forward, we remain optimistic about Coty's future and its ability to make steady progress under its new strategy. Year-to-date, adjusted EPS has grown by 17%, driven by renewed operating profit growth, a lower tax rate, as well as a lower share count due to an aggressive share buyback program. FY15 adjusted earnings per diluted share, including the negative impact of foreign currency translation and the impact of the Bourjois acquisition, are projected to be between $0.95 and $0.98 per share, reflecting a year-on-year growth between 17% and 21%. The achievement of this would mark a substantial turnaround in Coty's financial performance and put it on a much better platform for success going forward.

I will now hand over to -- 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 our overall financial position.

First, the P&L. Total net revenues were flat, like-for-like, in the third quarter. Our adjusted gross margin of 61.6% was in line with the prior-year quarter. The Company's cost structure continued to improve as we saw solid reduction in our fixed costs. As we discussed in the last earnings call, we have set a savings target for our global efficiency plan of $200 million by FY16 -- FY17, sorry. If you remember, this $200 million is split into three buckets. The China business reorganization for $20 million, the productivity program that we have launched a couple of years ago for $60 million, and the remaining amount of $120 million for the [One] Coty reorganization.

The actions we have taken to date will bring us approximately 70% towards our FY17 savings goal of $200 million compared to the halfway mark we discussed on the last earnings call. As a result, we are on track to see savings north of $80 million in this FY15, which is incremental to the $25 million in savings last year. And, with the One Coty program and the China reorganization last -- at the start of this fiscal year and the quality program progressing, we see meaningful opportunity for further cost reduction beyond FY15. In light of our strong savings performance, we expect upside to our targeted total savings of $200 million for the Global Efficiency Plan, and we'll be ready to share our updated targets on the next earnings call.

As a result of these factors, our adjusted operating income grew 24% in the quarter with the margin expanding 280 basis points to 10.9% versus 8.1% in the prior-year period. For the second consecutive quarter, we saw margin improvement in each of our segments with fragrance up a strong 230 basis points to 13.7%, color up 110 basis points to 11.7%, and skin and body care up 670 basis points to 1.5%. It is worth noting that despite the minus 7% FX impact to our top line in the quarter, the natural hedge built into our operating model, which includes having 25% of our total cost base in euro limited the negative FX impact to our adjusted operating income to only 1% negative.

Moving down the P&L, our adjusted effective tax rate for the quarter was 16.1%, compared to a negative 40.9% in the prior year due to a $38.1 million favorable foreign tax settlement. And, we continue to expect an adjusted effective tax rate of 16% in FY15. Looking beyond FY15, we expect our adjusted effective tax rate to be approximately 25% with potential for variability depending on the mix of profits by region. All of these encouraging results illustrate that we are building a better business and on our way to become a stronger leader in the global beauty industry.

Fiscal year-to-date adjusted EPS of $0.91 reflects a strong 17% growth. We continue generating strong free cash flow totaling $223 million fiscal year-to-date, reflecting our continued effort to drive profitable growth. We also continued our share buyback program in the quarter as we repurchased 5.8 million shares in the open market during Q3 for $114 million, and year-to-date 13.4 million shares at a cost of $263 million. Turning now to the capital structure. During the quarter, we successfully syndicated an [$800] million loan that matures in 2018. We applied the proceeds against debt that was maturing later this year as well as next year. By extending our debt maturities, more than 90% of our debts will not mature until calendar 2018.

Finally, with the Bourjois acquisition now complete, let me now offer a few points on this transaction. First, Coty's foreign subsidiaries purchased approximately 15.4 million of class A shares for Coty Inc. for $373.5 million in available cash, and subsequently, exchanged these shares with Chanel for Bourjois shares. Coty Inc. used the cash proceeds from its foreign subsidiary to repay debt, reducing total gross debt from $3.6 billion as of March 31 to $3.2 billion.

Second, let me provide an update on the anticipated impact of the Bourjois transaction to our P&L. We anticipate this transaction will add approximately $185 million to annual net revenues based on today's exchange rate with a balanced quarterly cadence. In FY15, we expect Bourjois to have very limited impact on our adjusted annual EPS. FY16 will be a transition year as we integrate Bourjois and optimize the operating model. Looking to FY17, we expect Bourjois to be accretive to our Color Cosmetic earnings profile.

Thank you. Now, I will now open the call for any questions you may have.

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

May we have the first question, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question or comment comes from the line of John Faucher from JPMorgan. Your line is open.

John Faucher - *JPMorgan - Analyst*

Hello? Can you hear me?

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

Yes, now we can.

John Faucher - *JPMorgan - Analyst*

Okay. Thank you. I want to talk a little bit about the difference between the power brands and the non-power brands, and as you look at this, how long does it take to get the non-power brands down to a level where they're no longer going to be a material drag on overall organic sales growth? How long does that process take, do you think?

Jules Kaufman - *Coty Inc - SVP, General Counsel & Secretary*

That's a good question. So, what we're seeing year-to-date is power brands are still showing growth, and non-power brands clearly have a drag on the business. Within the non-power brands, however, there are some good brands, and then there's a set which I would call celebrity Fragrances which is largely a phenomenon which is dying out. And, that is the part which is posing the biggest issue from a drag point of view. It's not so much the smaller -- basically, brands we have which have a good following and loyalty. It's hard to say, but if you look at the celebrity Fragrances part, it has a substantial drag because in a number of cases, we're seeing double-digit declines in some of these brands. It will work its way through the system.

Going forward, from a growth point of view, what needs to be done is not just to worry about that is to very much look at how we're going to accelerate growth across all our power brands. I think we're in a much better position to do that going forward then where we were six months ago for a very simple reason. We've created a substantial amount of space in the P&L, which will allow us to achieve our strategy of both driving growth behind increasing investment and basically still driving profit growth by dropping some of the cost savings into the bottom line.

And, that's what really needs to be done is now that we have created substantial, basically, room in the P&L, we need to increasingly focus at reinvesting some of the monies that we're saving into the business, and in particular, in the power brands. To answer your question, the drag will continue on the bottom end of the portfolio, but we need to accelerate the growth at the top end. That ultimately is going to gradually improve the overall performance of the Company. This will clearly take some time, but that's what we'll be focusing on going forward.

John Faucher - *JPMorgan - Analyst*

Got it. If I can just ask a follow-up on that. As you look at the incremental investment on the power brands, how much of that is -- you've talked about the reallocation of trade spending -- so which is more short-term. How would you assess the balance of shorter term versus longer term investments as you look at the power brands going forward?

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

If you look at what has happened on a year-to-date basis to our advertising and promotional budget, you will see that in terms of absolute spend, there is not a lot changed. However, in terms of allocation, it substantially changed. So, we have substantially increased already the working media budget on our power brands. We have rationalized spending on nonworking dollars, and we have rationalized spending on the bottom end of the portfolio. You can see that in the success of some of the brands -- some power brands already.

When I mention bright spots, all the bright spots which I have mentioned have seen substantial increases in investments, and that needs to gradually happen across the entire power brand portfolio. In terms of trade spend, the promotional situation is what it is. I believe there is opportunity for improvement. But, quite frankly, in the short-term, short- to medium-term, rationalizing non-strategic spend, which is completely under our control, is a much better source of cost savings and opportunity to reallocate it to our power brands.

John Faucher - *JPMorgan - Analyst*

Great, thank you.

Operator

Our next question or comment comes from the line of Jason Gere from Key Bank Capital. Your line is open.

Jason Gere - *KeyBanc Capital Markets - Analyst*

Thanks. I guess just a follow-up on John's question. If we could think about the reinvestment rate for the next wave of cost savings, can you compare how you look at it versus when you came out with the efficiency program back a couple years ago and what you were planning on spending? Is there a meaningful step-up? Or, is it really more or less the same, but as you just said, more shifting? And then, I have another question.

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

Yes, I think it is more shifting of the spend. I would say, we're going to stick with our strategy of trying to gradually step up the growth pattern behind our power brands in the total Company while continuing to show basically strong profit growth at the same time. So, we have to do both. It's much more a question of shifting monies within the A&P budget, within the total P&L from non-strategic spend to strategic spend. If you were to look at our full-year A&P spend as a percentage of net revenue, you'll not see that much happening. But, if you look at how the monies are shifted within the P&L, you already see a substantial shift out of non-strategic spend of nonworking dollars into working dollars and out of the bottom end of the portfolio into the top end of the portfolio. I think that pattern you will continue to see going forward.

Jason Gere - *KeyBanc Capital Markets - Analyst*

Okay. Great. Thank you. Then, the other question I have is just on the Fragrance business. I was wondering, we've had a couple of quarters in a row of negative like-for-like sales. I guess your view on how you're going to revitalize the Fragrance business -- getting it back to growth maybe by the fourth quarter into next year? If you could talk in that context about how much the mass channel is weighing you down. And then, just with that, the margins were really good, again. I'm just wondering how we should think about that going forward? Is this a business where we're really going to need to see more scale to drive margin upside? Or, will the global efficiency programs be able to do that on its own without acquisition? Thank you for taking questions.

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

Yes. So, on Fragrance, I would say the net revenue indicator of minus 2% is not -- is picturing a more negative situation than it is in reality. Because Fragrances is showing substantial volume growth, but at the same time, has a negative price mix, which takes it to minus 2%. That already tells you that from a promotional investment point of view, we have optimization possibilities. And, that is also something which needs to happen. I think we have good initiatives on our plate going forward.

We have the opportunity to invest where it counts in the brand equities of the brands, and we gradually need to basically release the tension on the trade spend without clearly impacting the volumes. So, that's going to be a fine balance of shifting from -- let's call it a more sell-in to a more sell-out approach where you invest more in brand equity and less in trade spend. Underlying, you need to know that volume growth on Fragrances is very good. There is really no issue from a volume point of view. There is an issue from a net revenue point of view, which is also ultimately having a negative impact clearly on margins which we're offsetting with cost optimization. Does that answer your question?

Jason Gere - *KeyBanc Capital Markets - Analyst*

Yes, thank you.

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

Okay.

Operator

Our next question comes from Bill Schmitz from Deutsche Bank. Your line is open.

Bill Schmitz - *Deutsche Bank - Analyst*

Good morning. Can you talk about the list of power brands, and if you thought about maybe culling the list? How you define a power brand and what makes a brand become a power brand? And then, what makes a brand fall out of that set? I have a follow-up as well?

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

Right, so you know for us, what is a power brand. First, it's a brand which has either a certain amount of scale or has the potential to achieve that scale. It has good growth opportunities within the markets in which it operates. It has a margin structure which we believe is attractive, and it is in a category and in a situation where we believe we have the capability to grow it. So, clearly this is -- this set of power brands, the 10 power brands we have at least once a year is up for review to make sure that this is the right list of brands. We will go through this review once a year, and I'm sure with the new CEO, Elio, we will have another discussion if this is the right list for us, yes or no -- or not. I would say at this point in time, there is very little reason to believe -- I would say to cull the list and to basically change the list. We still have some brands where we don't -- where we're not happy in terms of our growth profile, but there are initiatives now being developed to address these problems. For the time being, the list is the list.

Bill Schmitz - *Deutsche Bank - Analyst*

Great, thanks. Then, are you still looking at M&A? And, I was also wondering how important is scale in Fragrances broadly? Are there huge advantages from adding incremental brands into the existing infrastructure?

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

I would not necessarily say that scale is the only reason for success in Fragrance, color, or any of our categories. It does help clearly from a cost optimization point of view, but there is other factors which play a role than just scale.

Bill Schmitz - *Deutsche Bank - Analyst*

Okay. And, are you still looking at acquisitions? I know there's a lot of internal stuff going on, and you just raised the savings target. So, I'm curious if there's enough bandwidth to pursue inorganic means to grow?

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

As you can imagine, we're not going to comment on any M&A speculation, so I'm afraid I'm going to not answer this one.

Bill Schmitz - *Deutsche Bank - Analyst*

It was worth a try. Thank you. (laughter)

Operator

Our next question or comment comes from the line of Chris Ferrara from Wells Fargo. Your line is open.

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

Thanks. I wanted to talk about cost savings, I guess, more in general. So, your Fragrance margins are well above industry average, maybe best-in-class, yet across the organization, your savings are coming through very nice obviously and net of any reinvestment so far. In Fragrance in particular, when you benchmark where your margins are, is the composition of the P&L maybe different than other best-in-class competitors, you think? Or, do you think that you can actually just widen the margin or the gap between you and second best-in-class, or industry average on margins?

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

Okay, maybe because I've not worked in the cosmetics industry for this long, but I am personally I think some of the margins in a lot of these categories are substandard compared to the broader consumer goods industry. And, in particular, when you're sitting on very high gross margins in many of these categories to work with operating margins at this level, that would be -- they're just low. I know relative to some of the other industry players, they might be higher. I guess what I'm telling you is depends on what you take as a starting point.

Patrice de Talhouet - *Coty Inc. - CFO*

Chris, to build on what Bart has just said, it's fair to say that the last two quarters give you an evidence that even if you are best-in-class in terms of profitability on the fragrance segment, keep on increasing that. I think that's -- gives you the answer.

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

Great, thanks. Just a couple housekeeping ones. Can you comment on how big the contribution was from the Avon Fragrances? And then, also the skin and body margin improvement, is that -- do you think that's a step-up? Or, is there any fluctuation, volatility in the air? Do you think you've cracked the code where the margins are going to be better from here?

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

I would say the cooperation with Avon is a good one. It is contributing to the net revenue performance of the Company, but it is not like huge. So, we're not going to disclose specific numbers on this, but it's a nice contribution but it is not huge. In terms of skin, Skin and Body in particular. Skin and Body profitability improvement -- clearly, part of that is because of the China situation which has been addressed. And, that has very substantial impact from a P&L point of view, and this is also part of the global efficiency program. I'm not sure you want to comment anything on it?

Patrice de Talhouet - *Coty Inc. - CFO*

Chris, we said in one of our previous calls that the objective on the skin and body care segment was to target profitability which was mid-single digits -- low to mid-single digits, and I think we're going there. This is quite sustainable. The actions that are taking in place are fundamental actions to drive some sustainable growth.

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

Got it. Thank you.

Operator

Our next question or comment comes from the line of Lauren Lieberman from Barclays. Your line is open.

Lauren Lieberman - *Barclays Capital - Analyst*

Good morning. I had a question on the Sally -- the Miracle Gel in the US? First was, I actually heard that there was some sellout situations. I was wondering if there was sales strength was possible to be even greater in coming periods, if that was in fact what had happened? And then, also, that there have been started to already be some value entries for these faster gel products? And, if that's happening a bit more quickly maybe than you had anticipated? And then, I do have a second question. Thanks.

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

Can you repeat the last part?

Lauren Lieberman - *Barclays Capital - Analyst*

Yes, just that I was saying that there have been some value price entries to mimic the Miracle Gel formulation, and maybe this is getting too granular. But, I was curious about the technology catching up from lower-price players more quickly than expected?

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

So, I can comment on that. In terms Of Miracle Gel clearly is a phenomenal success. The market share on Miracle Gel in the US -- correct me if I'm wrong -- I think is about 19% on Miracle Gel only, and it might even be higher in the most recent readings. And, clearly has had a huge impact on the overall Sally Hansen market share in North America.

From a sellout point of view, it's doing extremely well. There are some competitors which are either in the market or coming into the market. It's not very clear that they provide the same product benefit as Sally Hansen provides at this stage, so we will continue to support clearly Miracle Gel. Aggressively support it also going forward for a very simple reason, the penetration and the trial levels on this product are still relatively low, and so there's still substantial opportunity for growth here.

Lauren Lieberman - *Barclays Capital - Analyst*

And then, the first part of the question also I meant rather than sellout, sell-through, literally the product being sold out of stores. So, the capacity issue, if that's actually been the case. Sales were even constrained in this period because of supply.

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

So, I would say that from a capacity point of view, that we clearly are favoring the US market at the moment because it's the first market where we've launched. We do not have capacity issues to deliver the product any more in North America. Having said that, there are still basically out-of-stock situations at retail level simply because we are not necessarily always getting the right amount of space for the product. So, the stuff is sold out, in particular on weekends in certain key retailers at times.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. Then, because of that -- so it sounds like you maybe delayed some international markets, or no? I know you said -- UK sounded like it was very strong. But, was there any delayed international [sales]?

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

There are other markets where the product is being delivered. But, it is -- we still are to some extent capacity-constrained.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. Great. Thank you. The other thing, just I know it's very small. But, curious on how the Chloe skin care launch had done, and just your general interest in really that level of perceived skin care?

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

I don't think we have Chloe skin care. At least not -- .

Lauren Lieberman - *Barclays Capital - Analyst*

Launched in Asia. I read about it a couple months ago.

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

Yes, but it is puny. It's less than puny.

Operator

Our next question or comment comes from Olivia Tong from Bank of America Merrill Lynch.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Thank you. Two questions. First on the -- I appreciate all the comments around strategic versus non-strategic spend and the shifting there, but we haven't yet seen a lift in overall like-for-like growth. Can you help us understand the moves you're making and the confidence in the moves that you're making, and how they will ultimately result in top line improvement? And then, on the cost savings progress, just do you consider this new -- this SG&A run rate that you had this quarter the new run rate? Or, was there something substantially contributing to Q3? Thanks.

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

So, let me start with the like-for-like, and I'll leave the SG&A one to Patrice. In terms of like-for-like growth, the key initiatives that need to be taken. What we did is we clearly have a strategy of two legs. One is to drive growth in the power brands and overall Company on a like-for-like basis, and the other one is to improve fundamentally the margin situation on the business. So, we have started with the first one. We have instigated a substantial program of cutting non-strategic spend across all lines of the P&L in order to drive profit growth and create space for reinvestment. I would say the first phase is not completed, but it is well in motion and we now have capability in the Company to continue that. So, that is a very good start.

Now clearly, we need to move and also start implementing step number two, which is to reinvest some of these monies back in the business in our power brands on key initiatives, and that is now gradually starting to get done. Some clear examples are some of the brands, which I've call the bright spots, where we already have increased investment behind good initiatives. Sally Hansen Miracle Gel being probably the most prominent example, but we will be gradually expanding this to more brands. Once, we get that up and running completely, we should see gradual improvement in the like-for-like growth rate of the power brands, as well as the total Company. But, clearly, this will take a little bit of time in order to do that. I would say, we are well on the way on the efficiency programs in building a better business. Now, we need to translate that into a better like-for-like growth rate.

Patrice de Talhouet - *Coty Inc. - CFO*

Olivia, on your question regarding the SG&A run rates. I think it's fair to say that out of the $80 million that we have generated in FY15 -- or, that we're about to generate in FY15 -- one-third of that is sitting in the A&CP line and this is really about indirect procurement and making sure that we spend our money wisely. And, two-thirds of that is to be attributed to the cost structure. All this is clearly recurring. So, these are not one-offs, and you should see the benefit of all this in FY16.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Great. Thank you. And then, if I could follow up on two more. First, what was the actual growth of the power brands? And then, one housekeeping thing. What share count are you using, given the Bourjois deal, for Q4? Thanks a bunch.

Patrice de Talhouet - *Coty Inc. - CFO*

Can you repeat the second question?

Olivia Tong - *BofA Merrill Lynch - Analyst*

Sure. It was what share count are you using given the Bourjois deal for Q4?

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

Right. So, our power brand growth was low single digits. And, clearly, very much split on a by-brand basis as I already highlighted before. So, in terms of Bourjois?

Patrice de Talhouet - *Coty Inc. - CFO*

[370 million].

Olivia Tong - *BofA Merrill Lynch - Analyst*

Thank you very much.

Operator

Our next question or comment comes from the line of Steph Wissink from Piper Jaffray. Your line is open.

Steph Wissink - *Piper Jaffray - Analyst*

Hi. Good morning, everyone. It's Steph Wissink. Just two questions. The first related to the celebrity Fragrance trend. Can you talk about some of the contractual obligations you have within those agreements? Is there an opportunity to step down some of the cost outlay based on the decelerating performance? And then, separately, I think you talked just moments ago about the proportionality in the savings, two-thirds to go to gross margin line and one third to SG&A. As you reinvest the dollars, should we think about that proportionality staying similar in terms of adding back some of the costs saves of going forward? Thank you.

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

Yes, on celebrity -- first on celebrity, before I mislead you, it's not like every celebrity Fragrance is doing poorly. There are some which are doing fine and there are some which are not doing fine and just fading away, as you would expect. Like some celebrities fade away, and therefore, the Fragrance fades away with them. In other cases, the celebrity Fragrances are still doing fine. Overall, as a category segment, it's not doing that well. In terms of cost structure, like I already mentioned earlier, we have cuts [poured] at the bottom end of the portfolio to reallocate monies to the top end of the portfolio. Clearly, on celebrity Fragrances in some cases we've cut support levels. There's no question. But, that doesn't mean we've cut it on all celebrity Fragrances. We've only cut it on certain brands at the bottom end of the portfolio.

Patrice de Talhouet - *Coty Inc. - CFO*

On your second question, let me slightly amend what you have just rephrased which is the cost structure -- the global efficiency plan, sorry, of $80 million is split one-third of the savings is in the A&CP line and two-thirds of the savings is in the fixed cost structure line. In terms of reinvestment, as Bart is saying, clearly our top priority for the time being after building a better business is to be the bigger business, so we need to reinvest some of these savings opportunistically into our programs and to shift some more money into working dollars. That's what we are going to do in the coming quarters.

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

I think when you think about investment levels on the total Company in terms of A&P for the full year, I don't think you are going to see a huge difference in terms of percentage of a net revenue spend. So, you should not be concerned that we are going to reduce investment in the business. We are simply reallocating monies within the A&P line from the bottom end to the top end of the portfolio and from nonworking to working.

Steph Wissink - *Piper Jaffray - Analyst*

Thank you.

Operator

Our next question or comment comes from the line of Mark Astrachan from Stifel.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Bart, I'm just curious, holistically, does JB view themselves or need to be a controlling shareholder of Coty?

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

Yes.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Under all circumstances, they want to have control?

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

Well, we -- with all our consumer goods Companies, we like to have control, yes, that is our central premise. And then, we're going have a debate on how you define control, but we like to be a controlling shareholder. We invest in Companies where there are premium brands, which have strong growth opportunities, and where we can clearly see profit and cash benefits. We like to control the shape of events behind these Companies. So, the answer is over time, we like to make sure that where we invest, we have control over the future path of the Company.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Got it. Okay. So, that might be subject to interpretation. I guess we could discuss that in some other capacity. Also curious what made Bourjois an attractive asset to Coty?

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

It's an attractive asset to us for a very simple reason. It's a very strong brand. It sits more at the premium end of the color category compared to the existing portfolio. It has strong positions in a number of European markets and in the Middle East. It's a great addition, as a result, to our portfolio. We know how to manage this category. It has still has good growth opportunity and good profit opportunity in our mind. And, clearly, it also improves our overall ranking in color on a global basis, but I would say that's more of a secondary benefit. The clear reason why we're buying this is because we believe this is a good brand which has opportunity for growth in margin, cash, and, therefore, good from a shareholder point of view.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Got it. And, just related to some of the other questions on spending, is that a brand as you think about redeploying cash that you think perhaps the trajectory of growth can change with selected and more effective reinvestment?

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

Potentially, yes, it's a bit early for that to make that assessment. We just basically bought the business so we're not that arrogant to sit here and say we know everything about the brand. Our first job is to actually really understand this business on detail and as part of that understanding, if we have flexibility within the P&L to further support it because we see fantastic growth opportunities -- I'm sure we will act on it. First step is for us really to understand it, welcome these people into our organization, and to make sure that we work with them in order to make this a better business.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Perfect. Okay. Thank you.

Operator

Our next question or comment comes from the line of Javier Escalante from Consumer Edge Research.

Javier Escalante - *Consumer Edge Research - Analyst*

I have a question with regards to the power brands that are a drag. If I have the list correctly, Adidas is one of them. The other is Playboy. At some point in time the strategy of these two brands were very related to China, and to the extent that China has been folded to what extent that's what is the drag? And, what other emerging markets these two brands do you think have opportunity? And, the second question has to do also with OPI, which is the other brand that doesn't seem to be doing well even though it had been a rollout to the Sally Beauty Shops. If you can help us understand what is happening with OPI, and why is it not contributing to growth?

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

Let's start with OPI, and then we'll come to Adidas and Playboy. OPI is a fantastic brand. It doesn't matter what type of consumer research you do in the US or outside, you will find that this is one of the top-ranked basically cosmetics brands, and in my mind, has a huge basically opportunity for growth going forward. There have been a number of issues on the business, largely related to transition from previous management into current management, and so there has been a number of managerial issues on this business, which are in the process of being fixed. I am very optimistic that OPI going forward will start to see growth. So, I think it's an amazing brand with amazing potential. There will be absolutely no doubt in my mind that this is a power brand, and there simply is -- executionally, we need to fix a number of things in order to do well on this business.

On Adidas and Playboy, I would say on both of these brands -- Adidas, clearly, the fact that the brand is not doing that well from a reporting point of view in part is because we've changed all structure in China. We've seen a substantial negative impact from going from owned business to a distributor business. In addition to that, there has been in the past some cutbacks in support, and there has been a lack of initiatives. That is being addressed.

So, also there, I would say how much opportunity there is behind Playboy remains to be seen, but I think a lot can be done on this brand and should be done. On Playboy, I would say we've lost a little bit of our way. This brand was nicely positioned a number of years ago. I think we deviated from that path in terms of brand positioning. Also, there are a number of remedies which are being looked at, and we will see in due time if they will fix the situation. Having said that, like I already outlined before, we will have annually once a year review what should be in the power brand list and what should not. And so, there is a review process of that. I think I've just given you some background on the three brands.

Operator

Our question or comment is a follow-up from Bill Schmitz from Deutsche Bank. Your line is open.

Bill Schmitz - *Deutsche Bank - Analyst*

Europe, very quickly, because it seems like L'Oreal and Estee had really good results in the region, and yours was a little worse. Now, you cited southern Europe. Is that a function of inventory destocking? Or, why do you think the industry seems to be accelerating, and you are lagging a little bit?

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

I don't want to be going to the same as argument of trade destocking, which is a phenomenon which the trade tries to do every single year. So, I think fundamentally, we still have some issues to address on a few of the power brands, like I just outlined. And, I think if we have the right initiatives with the right brand positioning and investments, we should be able to address that over time and that should be gradually increasing the growth rate of total Company.

I would like to highlight one point, though, is that the geographical exposure of Coty from a market growth point of view, the market growth underlying where Coty is, is less than 2%. Which is not necessarily the case where some of our competitors. Our exposure from a market growth point of view is a little bit less than some of our competitors. Having said that, there's no question in my mind that over time, we should be able to address the growth basically situation of the Company.

Bill Schmitz - *Deutsche Bank - Analyst*

Okay, great. Thanks. That's very helpful.

Operator

Our next question or comment comes from the line of Lauren Lieberman from Barclays. Your line is open.

Lauren Lieberman - *Barclays Capital - Analyst*

Follow-up on Bourjois. Because Bart, I was a bit surprised by the answer on we're not sure if we can accelerate growth on this business. Candidly, why would you buy it then? Isn't that the point?

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

I didn't say that.

Lauren Lieberman - *Barclays Capital - Analyst*

Well, it was -- I felt like well we're going to integrate it and we'll see, I'm not sure we can change the growth trajectory. No one doubts the cost savings ability.

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

I did not say that at all. What I said basically is that we first need to understand the brand before we decide if we're going to put substantial extra investments in that. There's no question that it has a good growth trajectory already on the brands in a number of markets. The only question is for us to understand exactly the brand positioning before we decide to increase the investments on the business. That's what I said.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. It's more of a timing issue than a -- ?

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

Correct.

Lauren Lieberman - *Barclays Capital - Analyst*

Whether we will or won't.

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

Yes. Correct.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. Thanks. Then also, just while I have you on the promotional spending, I was curious if it's heavily skewed towards certain brands? Like is Calvin Klein and perhaps Marc Jacobs more of a challenge on that front than the Chloes or the OPIs in the portfolio?

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

There is a difference in promotional spend between the brands. But, quite frankly, I don't think that is really the fundamental issue or opportunity on these brands. It really is a question of having the right initiatives, the right positioning of the brands and increasing the investment levels on these businesses in order to accelerate growth. And, that's what we will be doing going forward.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. Thanks so much.

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

Okay, there are no further questions on the list, so can I just thank all of you for attending the call. We'll see you in three months. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect. Everyone have a wonderful day.
