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COTY - Q4 2017 Coty Inc Earnings Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. My name is Nicole, and I'll be your conference operator today. At this time, I would like to welcome everyone to Coty's Fiscal Fourth Quarter and 2017 Full Year Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded today, Tuesday, August 22. 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 of IR and Treasurer*

Good morning, and thank you for joining us. On today's call are Camillo Pane, Chief Executive Officer; and Patrice de Talhouet, Executive Vice President and Global Chief Financial Officer.

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 we list factors that could cause actual results to differ materially from these forward-looking statements. All commentary on organic net revenues reflect the comparison of Legacy-Coty and the P&G Beauty Business on a combined net revenue basis at constant currency in both the current and prior year periods, excluding the impact of acquisitions, other than the acquisition of the P&G Beauty Business.

In addition, except where noted, the discussion of our financial results and our expectations reflect certain adjustments as specified in the Non-GAAP Financial Measures section of our earnings release. You can find the bridge from GAAP to non-GAAP results in the reconciliation tables in the earnings release.

I will now turn the call over to Camillo.

Camillo Pane - *Coty Inc. - CEO & Director*

Thank you, Kevin, and welcome, everybody, to Coty's Fiscal 2017 Fourth Quarter and Full Year Conference Call. Fiscal '17 was a transformational year for Coty. First, we completed an incredibly complicated acquisition of the P&G Beauty Business, dealing with the complexities of both a carve-out and a RMT structure. Second, we fully reorganized into a product and customer-focused organizational structure centered on 3 vertically integrated divisions. Third, we reached significant milestones in our integration efforts. And fourth, we strengthened our portfolio through the additions of Younique, ghd and the pending acquisition of the Burberry Beauty license.

I'm particularly proud of the culture we are building within the new Coty, where we embrace the diversity of consumer's beauty, focus on disruption, think like a startup and welcome the challenge of an increasingly complex beauty industry. Equally important, we believe the strategy we outlined earlier in the year, which focuses on strengthening our global brands, shifting more resources to fuel the growth of the brands with high growth potential, stabilizing the remaining brands and continuing to expand the geographic reach of our portfolio, is beginning to bear fruit, as demonstrated by the improvement in the net revenue trends in the second half of the fiscal year.

So let's begin with our performance at a high level. In Q4, organic net revenues, excluding acquisitions, declined 3% in constant currency, which includes a 1% benefit as a result of pre-shipments to customers in advance of exiting the Transitional Service Agreement with P&G for Europe, which occurred on July 1. Q4 reflects a much improved and very good growth in both Luxury and Professional Beauty, but continued weakness in Consumer Beauty, which is a key priority for us to address. Including the ghd and Younique acquisitions, our Q4 net revenues grew 5%. Fiscal 2017 organic net revenues declined 5%, with flat performance in Professional Beauty, a slight decline in Luxury and pressure in Consumer Beauty. Including ghd, Younique and a full year of Hypermarcas Brands, net revenue in constant currency grew 1% versus the combined net revenues of the prior year.

From a profit perspective, our Q4 adjusted operating income reflected the materially higher level of investment in marketing to support the momentum in our business and to achieve flawless execution at retail for launches like Hugo Boss Tonic, Gucci Bloom, Tiffany's debut fragrance, CK Obsessed, as well as the COVERGIRL PDA campaign and the Clairol Color Crave launch, all of which I will elaborate on later. Profit was also impacted by a higher combined fixed cost base, which I'm not happy about. While some of the cost increase was a result of operating under the TSA with Procter & Gamble, where we had limited visibility and control over certain areas of fixed costs, our cost base is not where it should be. And we are rapidly working to address this issue as part of our synergy program and organic efficiency initiatives. Patrice will elaborate more on this point, and we will get back to you on this topic in the coming quarters with specific actions. For the year, our adjusted operating income grew 24%, with a margin of approximately 10%.

Looking at revenue dynamics by division. Momentum at the Luxury division continued to improve as we progress through the year, from a mid-single-digit decline in the first half to low single-digit growth in the second half. For the quarter, Luxury revenues increased organically by 5%, while for the year, organic net revenues declined a moderate 1%.

By brand, we have continued to see strong momentum across Hugo Boss, Gucci, Chloe and philosophy, as well as several of our ultra-premium fragrances, such as Bottega Veneta, Miu Miu and Alexander McQueen. For Hugo Boss, we recently launched Boss Bottled Tonic and announced Chris Hemsworth as the new face of the brand. The strength of the key Hugo Boss fragrance pillars have driven share gains for Hugo Boss across a number of key countries, including Germany, the U.K., France and Italy. Our momentum in philosophy, with strong net revenue growth in both the quarter and the year, has resulted in the brand continuing to gain share in the U.S. philosophy's e-commerce presence, already strong in the U.S., should be bolstered by the recent opening of an online store on China TMall website, aimed at engaging young Chinese consumers. As we look to maintain Luxury momentum into FY '18, we are excited by the brand execution plans we have in place behind our inaugural Tiffany's fragrance and the launches of Gucci Bloom and CK Obsessed that I mentioned earlier. While it's still early days, all 3 launches are off to a good start, with sell-through exceeding our expectations.

Professional Beauty organic net revenues grew a healthy 3% in Q4. I'm pleased to report that in addition to the continued success of our salon hair brands, we have recently seen a significant improvement in OPI revenue trends. In salon hair, Wella maintained its strong momentum behind its Contouring Collection, the Oil Reflections launch, and recent launch of Wella Professionals Fusion, while System Professional continued progressing on its global rollout.

On OPI, following several quarters of sales decline, Q4 net revenues were down modestly on a global basis but resumed growth in North America. As we look to FY '18, we expect further improvement in OPI trends, driven in part by the launch of the OPI Gel ProHealth system, which began to roll out on August 1. OPI's new gel can be removed 50% faster and without damage, which means healthy-looking nails after removal, addressing a key barrier to consumer gel use. Additionally, new Coty gel colors will come in shade-matched bottles to improve shopability. We're very excited about the prospects for OPI's new gel system, targeting a fast-growing segment of the salon nail category.

Turning to Consumer Beauty, division organic net revenue declined 10% both in Q4 and for the year. As context, the global consumer beauty industry began to decline modestly at the end of calendar 2016 in the categories and countries in which we compete. It weakened further in the latest quarter to a low single-digit decline. As we focus on returning the Consumer Beauty division to growth over time, we are working on the significant relaunch and restage of a number of our major brands to better connect them with the changing consumer. We're actively engaging with our traditional retail customers to amplify the in-store shop experience to drive category growth. Additionally, we continue to focus on key specialty customers as well as driving our e-commerce footprint.

Against this weak market backdrop, Coty Consumer Beauty net revenue are being furthered pressured by shelf space losses in the U.S. and Europe, as discussed on the last earnings call. Nevertheless, in the quarter, we are seeing strong performance in a number of our key emerging markets, such as Brazil, Mexico and the Middle East. In Brazil, the acquired Hypermarcas Brands are growing at double digits with our Brazil business overall outperforming the underlying market. In Mexico, we have seen steady share gains in retail hair, supported by improved in-store execution and stronger support plans. As for the Middle East and Africa, we saw double-digit net revenue growth in the quarter, supported by market share gains across many of our brands. Bourjois remains a highlight in the Consumer Beauty portfolio, with solid growth in the quarter and full year, and strengthening its position in a number of fast-growing markets. Finally, adidas performance improved, with brand growth in Q4 in key emerging markets, such as China and Brazil.

Our solid Consumer Beauty brand initiatives pipeline for the first half 2018 includes Clairol's Color Crave line of hair makeup and COVERGIRL Total Tease Mascara, both of which are now hitting the shelves. And while the brand relaunch for COVERGIRL will not fully begin until winter 2018, our Project PDA campaign offers a glimpse of the new COVERGIRL positioning, centered on confidence and empowerment. The campaign's digital engagement results significantly exceeded our expectations, with 6.4 million video views and 375 million impressions in the first 2 weeks from launch and some uplift in our in-market performance for the brand.

Shifting to digital, I would like to share some of the continued success that we're having both on our digital communication and e-commerce expansion. As I discussed earlier, in Consumer Beauty, we saw strong digital engagement in connection with COVERGIRL PDA campaign, which in turn benefited the brand's in-market performance. In Luxury, the Marc Jacobs Daisy Anniversary digital campaign reached 2.8 million young women, with engagement rates in the mid-teens percentage and highly attractive cost per view. The recent launch for Miu Miu L'Eau Bleue, via digital-only campaign, featured a shoppable Instagram Story, resulting in orders more than doubling on Sephora.com.

On the M&A front, the combined impact of the Hypermarcas Brands, ghd and Younique now represents a material addition to Coty's results and I'm pleased with the contribution of these businesses. Speaking about Younique, I'm happy to report that it continues to outperform in both net revenues and recruitment of active presenters. Also, we are prepared and looking forward to welcoming the Burberry license in October.

The recent improvement in top line trends is an early confirmation that our strategy to strengthen and grow our key brands, stabilize the remaining brands and expand our geographic footprint, is beginning to yield results. From a profit point of view, we still have work to do, and it's a key priority for us. In summary, we are proud of the progress that we have made in 2017, a challenging transitional year, but one that we believe has set the stage for Coty to be a global leader and challenger in beauty.

I will now turn it over to Patrice.

Patrice de Talhouet - *Coty Inc. - CFO*

Thank you, Camillo, and good morning, everyone. I'd like to begin by emphasizing that we see Coty's transformation as a 3-part journey. The first step is integration of the businesses, a step which I believe is well underway and on track with the successful exits of the TSAs in both North America and Europe. While there is clearly more work to do on a full integration of the businesses, we are now focusing on Phase 2, which entails the stabilization of our business, coupled with the realization of synergies. The third step is top line growth acceleration and we believe that our actions to date position us well for success.

To reflect a bit on where we've been and where we are going, as you know, it has now been nearly a year since we closed the P&G transaction and reorganized into a new focused divisional structure, combining talented executives from Coty, the P&G Beauty Business and other leading companies. Given the complexity of the Reverse Morris Trust carve-out merger with P&G, I am pleased with the progress that we have made to date in creating a new global leader and challenger in beauty. With that said, I will give a brief update on the progress that has been made in the first leg of our journey.

As of early July, we have successfully completed the first 2 parts of the 3-stage exit from the Transition Service Agreement with P&G. As you recall, North America was completed on May 1 and we successfully exited the Europe TSA on July 1, which together account for over 70% of our net revenues. We remain on track to exit ALMEA in September. Regarding the exit of the European TSA, I would like to provide you with a few numbers to help put the enormity of this endeavor into context.

The process involved 6 factories, 16 distribution centers, roughly 1,700 team members, 570 system designs, 60,000 testers and roughly 1,000 training sessions before go-live on July 1. We are happy to report that we are now manufacturing the combined portfolio without constraint on Coty's systems. In addition, the entire order-to-cash cycle, which includes order processing, fulfilling, shipping, invoicing and accepting payments, is now entirely controlled by Coty, quite an achievement. By controlling the entire order-to-cash process in Europe and the U.S., we will now have an opportunity to lower the underlying operating cost, with ALMEA to follow soon.

As for the second phase of our journey, stabilization of the business and the realization of synergies, we have seen stabilization in top line trends in the second half of the year and we are well on our way to realize synergies in line with the phasing we outlined several quarters ago. As part of our synergy program, in Q4, we booked an additional $200 million in restructuring costs. In fiscal '17, we recorded approximately $700 million one-time operating expense, bringing the total recorded to date to $850 million. As for one-time capital expenditure, we spent $200 million in fiscal '17, bringing the total spend to date to approximately $250 million.

And a quick comment on our portfolio rationalization. As stated previously, in the spirit of focusing the organization on step-changing the revenue growth trajectory of the new Coty, we are planning to rationalize a component of our brand portfolio and will consider the divestiture or discontinuation of brands that, in total, constitute 6% to 8% of the combined portfolio net revenues. We are progressing with the process and are evaluating a number of alternatives and will expect to conclude the process during the course of the current fiscal year '18.

I would like now to discuss our Q4 and fiscal '17 performance. I am pleased to report that our Q4 net revenues of $2.2 billion grew 5% year-over-year on a combined company constant currency basis and declined 3% organically, including a 1% benefit from the Europe TSA exit. Fiscal '17 revenues of $7.7 billion grew 1% on a combined company constant currency basis, reflecting a 5% organic sales decline for the year, offset by the sales contribution from the acquisitions. We are very pleased to see Coty's underlying business trends beginning to show signs of stabilization, as our revenues improved from a high single-digit decline in the first half of the year to a low single-digit decline in the second half.

Moving on down the P&L. In Q4, our adjusted gross margin expanded 420 basis points year-over-year to 62.1% compared to Legacy-Coty, while our fiscal '17 adjusted gross margin increased 200 basis points to 62.4%, benefiting from the higher-margin P&G and Younique businesses and incremental improvement in our cost of goods sold. Our Q4 adjusted operating income was $90.1 million, with a margin of 4%, with the year-over-year decline driven by a material increase in marketing spend as well as higher fixed costs.

In Q4, we took the opportunity to increase marketing investment to drive further revenue momentum, particularly around key launches, as Camillo discussed. That said, it is important to note that while we increased our support in Q4, our full year marketing spend was around 25% of net revenues, consistent with the prior year level for the combined company and in line with our commentary at the beginning of the year. The increase in fixed cost for the quarter is partially driven by a higher fixed cost base.

It is important to remember that operating under the TSAs with P&G during fiscal '17 significantly limited our visibility into and control over our fixed costs. The increase also, in part, reflected an acceleration in the changes we have previously communicated in our go-to-market structure in various emerging markets, specifically where we are converting existing distributors to Coty affiliates. I want to assure you that fixed cost is an area on which we are extremely focused. And we will come back to you with an update with more specifics in the coming quarters.

We remain committed to our previously communicated synergy phasing. But it is important to emphasize that due to the time it takes to realize the benefits of supply chain savings and SG&A reductions, fiscal '18 synergies and other cost initiatives will be more heavily weighted to the second half of the year, which will weigh on our first half profitability.

Our full year fiscal '17 adjusted operating income of $772.8 million grew 24% compared to Coty legacy in the prior year. The full year adjusted operating margin of 10.1% compared to the 11% pro forma adjusted operating margin for Coty and P&G Beauty combined in fiscal '16, as disclosed in our January 8-K. From a segment perspective now, in fiscal '17, Luxury reported an adjusted operating margin of 11%, Consumer Beauty of 9.6% and Professional Beauty of 9.6%. Our adjusted diluted EPS for fiscal '17 was $0.63.

Now turning to our cash profile, we had a great year and generated $758 million in operating cash flow despite the acquisition and restructuring costs incurred during fiscal '17. I am also happy to report that we exited the year with negative adjusted working capital, reflecting the substantial improvements we have made on the acquired P&G Beauty Business. Our balance sheet remains strong, with $535 million cash and $6.7 billion in net debt, and we paid another quarterly shareholder dividend.

To wrap things up, I would just again like to emphasize that Coty's journey towards growth is well underway. Our financial flexibility, the strength of our new organizational structure and seasoned leadership team positions us well to become new global leader and challenger in beauty.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Dara Mohsenian of Morgan Stanley.

Dara Warren Mohsenian - *Morgan Stanley, Research Division - MD*

So just around the SG&A fixed cost issue in the quarter, clearly, it's worse than previously expected. You ran through some of the reasons behind that. I guess, how quickly can you solve that issue? Why do you still have confidence in the longer-term targeted synergy potential, given the issue? And then can you just detail the range of solutions you're looking at and potential magnitude of those solutions in terms of profit impact?

Patrice de Talhouet - *Coty Inc. - CFO*

So Dara, thanks for the questions. As you said, first, we remain very committed on our overall synergy target of $750 million and the phasing that we have outlined before. So there is no change on that. Second, what we have said is that we are very committed about addressing this issue and come back in the coming quarters with answers. I think we will come back with [clear] action plans. We are -- it's a key priority to us. And the measures that we are going to take are already now starting to be decided and will yield some results in the course of the year.

Dara Warren Mohsenian - *Morgan Stanley, Research Division - MD*

Okay. And does it -- is it sort of sequentially, it builds throughout the year? Is it a pretty substantial fix versus what you realized in Q4? And just given the magnitude of the issue in Q4, I just want to get a sense of how it progresses sequentially throughout the upcoming fiscal year.

Patrice de Talhouet - *Coty Inc. - CFO*

No, I think what we have already pointed out is the fact that when it comes to synergies, the synergies is mainly weighted on the first -- on the second half of the year, which will, as a result of that, impact the first half of the year profitability. Now the measures that we are currently taking will yield some results sequentially in the coming quarters.

Operator

Our next question comes from the line of Faiza Alwy of Deutsche Bank.

Faiza Alwy - *Deutsche Bank AG, Research Division - Research Analyst*

So just to follow up on the SG&A comment, could you try and just quantify for us what the fixed cost impacts were? I think you mentioned sort of some of the go-to-market, higher expenses in some markets. And I'm just having a difficult time conceptually trying to figure out what you're talking about as it relates to the TSA with P&G. So if you could just expand on some of the commentary around there.

Patrice de Talhouet - *Coty Inc. - CFO*

So first, I think it's important to remind that when we comment on the lower profitability in Q4, what we said is that it's the result of 2 things. First, a material improvement -- increase in the investment in order to support, [to fuel] momentum that we have in a variety of brands, so that's the first one. The second one is, indeed, is a higher fixed cost base. And as we said, this is, first, the reflection of our new divisional structure; second, the fact that we had limited visibility with the TSA exit. And now that we are wrapping things up and exiting the TSA in North America, in Europe and then in ALMEA, we will have everything under our belt and we'll be able to address these costs very rapidly. So once again, we will come back in the coming quarters with some specific answers. We remain committed on our synergies of $750 million and on the phasing that have outlined before.

Faiza Alwy - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. And then just if I could follow up, any comment on how you think organic growth will trend in fiscal '18? I think I heard you say some improvement, but if you could just expand a little bit on that.

Camillo Pane - *Coty Inc. - CEO & Director*

So we're not going to comment on specific guidance. We want -- we expect clearly to see momentum in the Luxury and Professional Beauty to continue. And regarding Consumer Beauty, this is more of a longer term, as we discussed, it's a journey. But we are on the right path. We are really working on the relaunch of several brands or most brands in Consumer Beauty, we already discussed this in the past. We are receiving very strong positive feedback from the retailers on all of the relaunches. And so we expect the overall momentum to continue for the 2 divisions. But we're not going to give you guidance for the overall company.

Operator

Our next question comes from the line of Joe Lachky of Wells Fargo Securities.

Joseph Bernard Lachky - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

So I just wanted to get back to the organic sales outlook. And I guess, specifically, it took a lot of marketing support, obviously behind new innovation, to show the stabilization in the top line that you've seen. How -- can you talk a little bit about what sort of reinvestment behind A&P you think you'll need going forward in '18 to continue to improve on the top line?

Camillo Pane - *Coty Inc. - CEO & Director*

We believe that we have the right level of investments behind our brands in our 2018 plan. What you have seen in Q4 is clearly a material increase in the investments because we have certain launches that we believe are very important for us and they're going to yield some results. And this is why you've seen material increase behind launches like Hugo Boss Tonic but also the preparation of Gucci Bloom and the Tiffany new fragrance that we just launched, but also the launch of CK Obsessed and a couple of launches or campaigns in Consumer Beauty, like the COVERGIRL PDA campaign or the Clairol Color Crave launch. Early reaction on the Gucci Bloom has been very favorable among consumers and retail partners. We had the prelaunch in Harrods in the month of August. And the results are actually very promising, that they are above our expectations. And the same is for the Tiffany launch, which we just did in Bloomingdale's. Again, it's exclusive in the month of August and is also overachieving versus our expectations.

Patrice de Talhouet - *Coty Inc. - CFO*

This being said, it's also important to know that when you look at our long-term trends, the level of marketing spend that we have is really in line with what we have communicated at the beginning of the year, which is around 25%. So it's not like we are changing drastically here. There was a seasonal effect in Q4. But at the end of the day, when you look at the trend, we are still at 25%, which is exactly what we said at the beginning of the year.

Joseph Bernard Lachky - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Okay. And then maybe if you could talk about your long-term EPS target, the $1.53 you laid out by fiscal '20. And obviously, you had some unforeseen struggles here in fiscal '17. And I would imagine, need to see some pretty material underlying improvement in the business. But also if you could talk about how aggressive you plan on being. Well, first off, if you reiterate that target, and then also how aggressive you plan on being to reach it via M&A or other balance sheet activities like that?

Patrice de Talhouet - *Coty Inc. - CFO*

So first, we remain committed on the $1.53, as we said already on the last call. So this is not changing. What we also said, that this is a long-term journey. So I don't think we should draw a conclusion out of 1 quarter. This is a long-term journey. We are very committed to the $1.53 by 2020, as you rightly pointed out. We are not going to comment on the M&A and the way we are going to get there. As we said previously, there are many ways to get there and we can use some of our balance sheet to be able to get there. But we are not going to give you any angle on the way to get there.

Operator

(Operator Instructions) Our next question comes from the line of Steph Wissink of Jefferies.

Stephanie Marie Schiller Wissink - *Jefferies LLC, Research Division - Equity Analyst*

Just a couple of follow-ups, the first on A&P on the Consumer segment. I'm wondering if you can talk a little bit about the rate change that you expect to see in retail sales from some of the initiatives around both COVERGIRL and then some of your other color cosmetics brands. And then secondly, just with respect to follow-up on the targets, I'm curious if you can just help us understand what the underlying business run rate would need to be to achieve that target $1.53 in fiscal '20. What kind of step-up would we need to see in '18, '19 and '20 to get to that level, on the underlying organic run rate?

Camillo Pane - *Coty Inc. - CEO & Director*

So regarding some of the launches or relaunches, I believe you have asked your question about Consumer Beauty, am I right?

Stephanie Marie Schiller Wissink - *Jefferies LLC, Research Division - Equity Analyst*

Yes, please.

Camillo Pane - *Coty Inc. - CEO & Director*

Okay. So the plan to relaunch COVERGIRL is in second half of fiscal '18. And this, as we discussed last time, includes new positioning, new creative, new packaging and new store appearance. And as I said, the retailer feedback on our plan has been very positive so far. We've been working also with a new creative agency, Droga5, which is one of the best agencies in the world, to build on an already strong brand equity. Recently, we have seen a research coming from the outside, from an external market research company, which highlighted that actually, COVERGIRL is the #1 cosmetic brand in the U.S., with the most loyal consumer base, especially amongst millennials. So clearly, when we see this, this was not done by us, this research, it gives us quite a lot of confidence about the relaunch that we are preparing. And we have done a campaign called Project PDA, Public Display of Application, which actually received a lot of positive feedback from consumers but also retailers. And again, it's all around empowerment of women and the ability of self-expression because we encourage women to actually apply makeup in public, which is quite a strong stand that we have taken with COVERGIRL, and we're fully behind this. The new launch of COVERGIRL Total Tease Mascara has been a great success in Canada and is being now rolled out in the U.S. But as I said, it's going to be a gradual improvement of the performance, because the full relaunch will happen for COVERGIRL in the second half of 2018. When I look at some of the other brands, we're also working quite hard on the relaunch of Clairol. And we have quite big initiatives coming, again, in the second half of 2018. We need to remember also that most of the U.S. retailers, they have their shelf reset in the second half of '18 or beginning of calendar '18. And so it's important that all our plans will be all perfectly set and in tune with the trade windows that are prepared by the retailers, but also quite confident on Clairol. And in the meantime, while we prepare for the full relaunch with this big innovation, we have launched Color Crave, which is a lineup of hair makeup, which again, goes into the direction of transforming Clairol from a very functional brand into a beauty brand, which is one of the key objectives that we have for the brand in the future. Color Crave started quite well, although we're quite at the beginning, so it's still early results. And above and beyond these 2 brands, we're also working on other relaunches, and Sally Hansen is another brand that we are working on it for 2018. And in the meantime, I can tell you that the launch of Color Therapy in Sally Hansen is already 5%, 6% market share of the nail market, plus we are focusing again on developing collections for the Sally Hansen brand. Again, in the attempt of ensuring that this category, which is more of an impulse category, gets fueled by new innovation and new ideas on a regular basis for our consumers and our retailers.

Patrice de Talhouet - *Coty Inc. - CFO*

On your second part of your question about the $1.53 by 2020, so we expect to achieve this through the use of different levers, including, one, the achievement of our targeted synergies and ongoing efficiency initiatives. So on our targeted synergies, I remind you that the phasing that we have was 20% this year, 50% in fiscal '18, 80% in fiscal '19, and then the full 100% by 2020. So that gives you a hint on the phasing. And of course, by the growth program, and you see already that 2 out of our 3 legs start to have some growth momentum. And of course, the strategic use of our balance sheet for M&A, and you start to see that our recent acquisitions, Hypermarcas, ghd, Younique, start to have a material impact on our growth profile, which is in line with our overall strategy.

Operator

Our next question comes from the line of Andrea Teixeira of JPMorgan.

Andrea Faria Teixeira - *JP Morgan Chase & Co, Research Division - MD*

I just wanted to clarify a little bit on the $750 million. You just discussed some of the phasing and I wanted to find out if actually the phasing of the synergies, if you can put a bridge on the synergies and how much it would flow into the bottom line or if we should be thinking of flowing it more into fiscal year '20, given your investments in COVERGIRL and new launches and all of that?

Patrice de Talhouet - *Coty Inc. - CFO*

The synergies are really net of any potential reinvestment, et cetera. So what we mentioned is that we are going to generate the $750 million. And as part of our investment thesis, this $750 million would fall bottom line to achieve the $1.53 of EPS. So this is net of any reinvestment and of any support that we would need to fuel the growth momentum. And so once again, the phasing of this -- the impact of the P&L, this $750 million, is 20% this year. Then you have 50% that will be achieved in fiscal '18, impacting the P&L in fiscal '18, 80% impacting the P&L in fiscal '19 and then the full $750 million impacting the P&L in fiscal '20.

Andrea Faria Teixeira - *JP Morgan Chase & Co, Research Division - MD*

So what you're saying, fiscal year '17, we already have some impact of the synergies. Can you quantify? You said it was 18%.

Patrice de Talhouet - *Coty Inc. - CFO*

20% of $750 million.

Andrea Faria Teixeira - *JP Morgan Chase & Co, Research Division - MD*

So the reason why we didn't see it is the TSA expenses and all those, everything else that was hard for us to see, because what we -- what I wanted to figure out is like what is the earnings power? So you just reiterated the $1.53. But as the cadence of the top line, what is behind the top line that will get you to $1.53? Because that's obviously -- your $750 million depends on progression of top line, right?

Patrice de Talhouet - *Coty Inc. - CFO*

Sure, but we still -- we start to see some growth momentum in 2 out of our 3 legs. And this is going to continue to progress in the coming years, point one. Point two, you also have a material impact of the acquisition that we have made, ghd, Hypermarcas and Younique, which are growing quite substantially, and as a result of that, will weight even more on our growth profile going forward.

Operator

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

Mark S. Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

Wanted to talk about the sales expectations. So appreciate not wanting to get into specifics from a guidance standpoint, but I guess, maybe looking at it differently. What's a realistic rate of growth for the business now as you think about it from a longer-term standpoint? Or in a different way, what is the growth that you benchmark yours against relative to the categories in which you're competing? I think Bart had said on the roadshow a year ago, call it, very low single digits. Is that still something that you're benchmarking yourself against today?

Camillo Pane - *Coty Inc. - CEO & Director*

Yes, I believe that's the right benchmark because of the way, the composition of our portfolio, both from a brands point of view, channels point of view and markets point of view. So I confirm what Bart said in the roadshow. In terms of sales expectations, as we said, the path to recovery will not be a straight line. However, over the last couple of quarters, we have now reported gradual improvement in our underlying net revenue trends. Before, we had high single-digit decline in the first half, now we are in low to mid-single-digit decline in the second half. We have 2 divisions, which are confirming a strong positive momentum. And overall, what I can tell you is that we expect the strategic efforts that we are taking to continue to bear fruit in fiscal '18.

Mark S. Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

Okay. And then shifting a bit to cost and free cash flow, so fixed costs are what they are, I guess, in the period that just ended. So curious, how do you think about the total cost structure of this business today versus what you thought going in when you did the deal or even when the deal closed in October? And then sort of related to that, you outperformed free cash flow outlook in fiscal '17 relative to those going-in expectations. So thoughts on fiscal '18, including CapEx and what you're going to do with the cash in terms of debt paydown or M&A or sort of both. Obviously, there's a dividend as well. So anything there would be helpful.

Patrice de Talhouet - *Coty Inc. - CFO*

Sure. So on the cash, we never -- we are going to generate cash in line with the progression of our EBIT. And we're going to keep on working on the working capital. We still have some investments in terms of CapEx to do in the coming year to finish and to wrap up the integration. So there is still some one-off CapEx to be done. This being said, as I've outlined in my script, we now have a negative working capital for the combined company, which is quite an achievement. So how we'll return cash to the shareholders depends a little bit, so we will -- it's either, of course, via dividend or to further fuel the top line with additional M&A. This will be discussed in due time. Now in terms of cost structure, do we have any expectation? Once again, what we said is that we have designed a divisional structure, which is a focused organization, which is probably slightly more expensive than a mutualized organization. But we have done that on purpose to be able to have more focus on the growth agenda. So it's a slightly more expensive structure than others, but in order, once again, to have some more momentum on the top line. So I think that's what we can say today.

Operator

Our next question comes from the line of Jason Gere of KeyBanc Capital Markets.

Jason Matthew Gere - *KeyBanc Capital Markets Inc., Research Division - MD and Equity Research Analyst*

Just 2 questions, I guess more or less follow-ups on previous questions. But the first one, when you factor in some of the shelf space losses in '18 that you'll lap, and then the contribution of acquisitions, do you think the momentum of Luxury and Professional can offset, I guess, the kind of weakness in Consumer Beauty in the first half of the year? So that's the first question. And then the second question is really just on e-commerce. I know you're talking about a bunch of these relaunches. And I'm just kind of curious about, I think one of your tenets is really kind of managing some of the in-store execution at your bigger retailers. But just the balance with the shift that we're seeing to online, which segments are you seeing more of that growth coming into? Do you have the right capabilities in there to kind of manage this? So any perspective on those 2 questions would be great.

Camillo Pane - *Coty Inc. - CEO & Director*

I'll start with your second question. And so in terms of balance of e-commerce and work on retailers, what I can tell you is that we are working quite hard on revamping our store execution. This one of our key pillars of growth of our strategy. And so we are making choices of shifting money to invest in the key stores. And of course, we are working with our key partners, retailers, to improve the partnership, to bring more value to them and of course, to step up the omni-channel. And of course, we're working on the relaunches of the brand, which will hit the store in the second half of 2018. Now that said, e-commerce is a big priority for us. And I have already mentioned and announced a new structure with a new head of e-commerce, a new structure which has higher accountability on that. It's important to say that our agency, Beamly, which we acquired around 1.5 years ago, is now fully focused on helping us on the e-commerce effort. And we are working with key customers also in stepping up the e-tailing business, or the e-retailer business, which is clearly a channel that can react much faster to our program. So we're seeing good results there. And let's also not forget that Younique, the business that we bought just recently in February, is a full e-commerce business, 100% D2C, where we have over 250,000 brand ambassadors, presenters, who every day are out there selling cosmetics under the Younique brand via the web, via the social media. So it's a clear testament also to our new focus on e-commerce, which is not done only through the acquisition of Younique, but also internally, organically. And the team is making big progress on this area. Now your first question was about Luxury and Professional Beauty offsetting the Consumer Beauty pressure. What I can tell you is that, of course, we expect the momentum of Luxury and Professional Beauty to continue in 2018. And on Consumer Beauty, what I can tell you is that the shelf space that has impacted us in 2017, truly only now in a certain way is having an impact, because the shelf reset from the key retailers, it does happen around the March-April of each year, let's say. So we expect this headwinds on shelf space losses to actually last and continue until Q3, Q4 of 2018, when we will start to lap the current shelf space losses. Now what's happening is clearly, at the moment, we are working with the retailers and presenting all our plans to ensure that we don't see any more impact, let's say, post the new reset that will happen at the beginning of calendar 2018, in the second half of fiscal '18. And I have strong confidence that we will not see any more impact, because of the great conversations we're having with the retailers and the positive feedback on our plans.

Operator

Our next question comes from the line of Rosie Edwards of Berenberg.

Rosie Edwards - *Berenberg, Research Division - Analyst*

Just a couple of questions. Firstly, if I use the prior year EBIT margins of 11% as a starting point and then add back synergies of $150 million, it implies there was a sort of drag on costs of over $200 million from weaker top line and also the extra fixed costs that you're talking about in the fourth quarter. And that $200 million, is that sort of a balance you see -- you'll be able to sort of claw back, if you like? Or is that a sort of earnings shortfall? And in terms of like clawing it back, so either through your own efficiencies or through kind of M&A, as you've kind of previously alluded to?

Patrice de Talhouet - *Coty Inc. - CFO*

So I think when you start from 2016 with 11% blurred margin of the combined business, you add back the synergies, the contribution of Younique, some of the acquisition. What you also need to deduct is, first, the contraction of the business that we've seen, which has been substantial. And yes, a cost structure, a step-up in the cost structure, especially on the carve-out business, to be able to handle a business of twice the size. So I think that's the way you should see it. It's not only due to the cost structure, it's also due to the fact that we had a contraction of the business versus the fiscal '16. This being said, now we have a synergy program, an ongoing productivity program in place, that we are actively working on. And that will deliver synergies, that would be able -- that will be one of the elements that will be able to deliver the $1.53, combined with: One, use of the balance sheet to do M&A; and second, to return to -- to go back to a growth momentum at one point in time.

Rosie Edwards - *Berenberg, Research Division - Analyst*

Okay. And then just on Consumer Beauty, focusing more on the U.S., I just wondered, do your relaunches sort of include any channel shifts or expansion of distribution points? Because I'm assuming at the moment the brands would be sort of more weighted to sort of modern trade as opposed to, for example, specialty, multi and things like that?

Camillo Pane - *Coty Inc. - CEO & Director*

Yes, no doubt that our strategy has a channel mix, and specialty beauty, which you're alluding to, you're mentioning, is clearly a very important part of our channel mix. So we are focused on that quite a lot. And the e-commerce, what I discussed before, so working with our partner retailers and working on the e-tailing business, the e-retailing business is also a big focus. It's no doubt that the consumers are shifting their behavior. And it's also important that we do deploy strategy that are also in line with this shift in consumer behavior. So absolutely working with the brick-and-mortar retailers, specialty beauty and e-commerce, truly the 3 key areas of focus for all the relaunches that I mentioned before.

Operator

And I'm showing no further questions at this time. I'd like to hand the call back over to Camillo Pane for any closing remarks.

Camillo Pane - *Coty Inc. - CEO & Director*

So I would like to thank all of you for the attention and for the questions. And I wish you a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. That does conclude today's program. You may all disconnect. Everyone, have a great day.
