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COTY - Q2 2019 Coty Inc Earnings Call

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OVERVIEW:

Co. reported 2Q19 like-for-like revenue growth of 0.7%, adjusted net income of $181.9m and adjusted EPS of $0.24.

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PRESENTATION

Operator

Good morning, ladies and gentlemen. My name is Maria, and I'll be your conference operator today. At this time, I would like to welcome everyone to Coty's Fiscal Second Quarter 2019 Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded today, February 8, 2019.

On today's call are Pierre Laubies, Chief Executive Officer; Pierre-André Terisse, Chief Financial Officer; and Ayesha Zafar, Group Controller.

I would like to remind you that many of the comments today may contain forward-looking statements. Please refer to Coty's earnings release and the reports filed with the SEC where the company list factors that could cause actual results to differ materially from these forward-looking statements. All commentary on organic net revenue reflect the comparison of the business at constant currency in the current and prior year period, excluding the impact of acquisitions and divestitures. 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 Mr. Laubies.

Pierre Laubies - *Coty Inc. - CEO & Director*

Thank you, Maria, and welcome, everybody, to Coty's fiscal 2019 Second Quarter Conference Call. I'm very happy to be participating on my first earnings call since joining Coty. Actually, it's my first-ever earnings call since I've been working private businesses all my life. I'm also very pleased to have Pierre-André Terisse here with us as our newly appointed Chief Financial Officer. And Pierre-André and I will walk you through the second quarter financials and I will [be able] to take questions. We also have with us on the call Ayesha Zafar, who has served us as our Interim CFO over the past 5 months.

Before diving into the details of our business, let me just acknowledge that I've been with Coty for fewer than 3 months and Pierre-André has been with us for 1 week, so therefore, we are very much still in the learning phase about our business. We will do our best to answer all of your questions on the call today, I would expect to do so on the future ones. Today is clearly a bit of an unusual situation and there may be questions that we will need the Investor Relations team to get back to you on as appropriate.

Since I joined the company, I've been discovering each part of our business, aiming to assess what is and what is not working and where the opportunities lie. As a result, I have not yet had the chance to speak to many of you directly, but I look forward to doing so as we conclude our assessment and finalize our strategic plan.

Before we get into the substance of our last quarter, I thought that it would be appropriate for me to share a bit of my background as some -- as well some introductory remarks and initial observations about Coty. As you may know, I spent most of my career at Mars, where I started in finance and later became General Manager, Regional President and then Divisional President. I acquired extensive experience across the world as I operated in France, Russia, Latin America, border Europe and eventually globally as I became Global Pet Care President of Mars. I left Mars to become CEO of Douwe Egberts, which became later JDE after a merger with the Mondelez coffee business and which also required a substantial strategic reconfiguration.

My first experience of business transformation occurred in Russia 23 years ago, and it feels like I have been doing little else since then -- since that time, sorry. I derived from these experiences, a few core beliefs. I believe that there is no shortcut to greatness, that persistence and consistency are key elements of any successful turnaround plan. I believe that my job, together with my leadership team, is to lead our organization to mastery, therefore freeing space for creativity and innovation so that we can generate lasting growth.

If you examine my practicum elsewhere, while exact financial figures are private, you will find that with the teams I had the privilege to lead, we systematically created value by deploying the same business philosophy that we intend to be applying at Coty. I'm also particularly proud to say that each time I moved on to a new challenge, I left a very skilled and highly engaged team, and the business continued to grow and perform for the years that followed.

Our approach to Coty will be no different. To turn around our business means rapidly refocusing Coty on the fundamentals. My observation is that we can unlock significant value at Coty by running our company better. This will give us the headroom that we need to address the most strategic issue that we face and capture the opportunity that we see. I must stress to you that, while we are confident we can return Coty to a path for growth, we are also realistic that it will take some time. Our Luxury and Professional Beauty businesses are growing reasonably well, but they cannot compensate completely for the difficult trajectory of our Consumer Beauty division.

In Consumer Beauty, we will need to earn our right to grow again. In that respect, a personal experience has led me to conclude that the path to building a bigger business is always to build a better one. That means, producing better products, better [advertisement], better store execution, better pricing, less complexity, lower cost, more engaged people, simpler organizational design, flatter structures and so on.

So we will just do that. We will focus on doing quality business and will not be obsessed by market share at any cost. We will refocus our portfolio and make sure that we advertise our core brands at scale. We will strike the right balance between advertising and promotion. We will ensure that our media choices deliver the right amount of reach and frequency. We will create advertising, which cuts through and consistently build our brand assets. We will make sure that our product range provides the velocity that our retailer partners expects from us. And we will rightsize our innovation pipeline to deliver fewer yet bigger projects. We already execute on these fundamentals well in our Luxury and our Professional Beauty division, but we need to do that in all our categories, all our markets, all of the time.

From a financial standpoint, we will be gross margin obsessed. We clearly understand that gross margin is the lifeblood of the business and that we have a gap here versus our beauty peers that we must close over time. That means: Managing revenue and cost, improving product mix and range, simplifying our portfolio and formulation and systematically deploying lean-inspired methodologies in our manufacturing and logistics operation. We will depart from having an experimental culture to one that embraces a disciplined approach grounded in logic, playbook, standardization and prioritization.

I have observed over time that while there are many ways to kill a brand, there is truly one way to be the great one. In marketing and selling, like in all other functions, our objective will lead to -- will be to lead our organization to mastery, we will become experts at what we do, and we'll aim to make sure that all our people clearly know what is expected of them and that they have the tools and methodologies to excel in their job.

I want to stress that I do not see any contradiction between discipline and innovation. On the contrary, I'm quite convinced that discipline enables innovation and maximizes the chance of success. This is very purposely an ambitious agenda. We will deploy these principles whenever possible during the remainder of fiscal 2019, although our main objective is to finalize the strategic plan which will define our agenda for the medium term. I have a great deal of confidence that the management team that we have now put in place is the right one to develop this plan. We will leverage the power of all and the capabilities of each. We will make sure that we have true alignment within our leadership team, and of course, the organization on our road map and our way of doing things.

I am personally very confident that we can do this, yet I am also conscious that we need to earn back the trust of our investors. To achieve this, we will need to build a believable plan, which will be shared with you over the next few months and to be also tactical of delivery in the quarters to come. In the meantime, we intend to carry on and deliver profit trend recovery in the second half.

Now let me turn things over to Pierre-André, who brings a deep [practical]. He comes to us with the nearly 30 years of public company finance experience, including nearly 7 years as the CFO of Danone. We are delighted to have him join Coty as this important yet exciting junction for our company.

Pierre-André Terisse - *Coty Inc. - CFO*

Thank you, Pierre, and good morning, everyone. And I am excited, too, to join the company where the potential for value creation with so many [fuel], combining challenges, strong brands and teams and opportunities for improvement. And this will obviously be a long journey. But every day since I joined is confirming this impression, and I look forward very much to contributing to the new management team and building together in the coming months a strong plans and execution.

So on to our second quarter result. In general, I think it's important to say that the quarterly results show continued difficulty, first. But at the same time, they also show some progress in strengthening our control over the business. We had a number of positive developments in the quarter, including improved visibility and progress on supply chain issues, strong Luxury results and improved dynamics in Professional Beauty.

On a like-for-like basis, second quarter revenue increased by 0.7%, and this show of sequential improvement in the like-for-like performance was connected to several temporary factors: The action of Burberry; the positive impact from the mandatory change in the revenue recognition policy; the shift of some Luxury shipments from the first quarter into the second quarter as a result of U.S. Hurricane Florence; and last, supply chain-related headwinds. We estimate these factors cumulatively benefited our like-for-like revenue growth rate by approximately 2%, which imply a modest underlying second quarter like-for-like decline of minus 1.1% for the total company, adjusting for all one-off factors we experienced in the quarter. Year-to-date, like-for-like revenues were down 3.2%. But again, on an underlying basis, we estimate that the like-for-like revenues declined approximately 2% in the first half.

Let me get now into a bit more detail on the highlights of the quarter. I'll start with the supply chain disruption, which in November -- which we were talking in November, with 4 major issues which drove the business disruption across the 3 divisions. We now have significantly more visibility around these issues, and we can confirm that the nearly $150 million of less net revenues in the first half of full year '19 represent the majority of the impact we expect for the year.

We've made significant progress in resolving the issues in our Luxury warehouse in Germany, such that shipment backlogs have been cleared and capacity constraints are effectively resolved. We do not anticipate any further impacts connected to this warehouse during the second half of fiscal 2019.

The disruption that we experienced during the ramp-up of the Consumer Beauty planning hub and manufacturing plant in the U.K. has also been steadily improving, and service levels for the color cosmetic portfolio are nearly in normalized levels. We expect only minor residual impact on third quarter results as these Consumer Beauty supply chain disruption is getting fully resolved.

However, we still have progress to make on the consolidations of the Professional Beauty distribution center in the U.S. which continues to negatively impact customer service, particularly for the OPI nail brands. We expect to stabilize OPI's service level during the second half. And the teams are working very hard on this, as we speak, with the progress.

You will also recall that there were 2 external factors that quarter that mainly affected the Luxury division. As a result of shortages from component and pump suppliers, we continued to experience a deficit of pumps in certain glass bottles and expect this to be an ongoing issue during the second half. We've been assured though by our supplier that Coty's order are being prioritized a very strong capacity in their own plans and we expect to see here, again, progress.

We firmly believe altogether that we have resolved the most critical supply chain integration issues and we are confident that the disruption, which will be solved by year end, with a much more moderate expected in the second half.

So that's for supply chain. I'll now move to Luxury. With the division, we've returned to strong 10.8% like-for-like net revenue growth in the second quarter. The supply chain issues, of course, continued to be a sizeable headwind, but this was more than offset by strong growth in the Burberry in light of very depressed prior year comps as well as the U.S. hurricane-related impact previously mentioned. On an underlying basis, Luxury was still strong, growing approximately 5% in both the quarter and the first half, which is consistent with historical trends.

We continue to see strong growth across many of our core brands, including Gucci, Calvin Klein, Marc Jacobs and Chloe, supported by robust innovation and execution. Looking at the details for some of them. In Gucci, we have continued to expand the Bloom [keynote]. And as we entered the second half, key launches include the ultra premium Alchemist's Garden collection, Gucci Guilty Revolution, and a select relaunch of items in the Gucci color cosmetic line. In Burberry, the launch of Her is off to a strong start, driving improved share trends, particularly in the U.S., U.K. and Germany. Daisy Love continued to expand the Daisy Marc Jacobs franchise. And while Hugo Boss has been impacted by the supply chain disruptions, the brand remains a core focus, with a key launch slated from second half.

We continue to see strong e-commerce momentum in the division with online growth well ahead of overall divisional growth, fueled by both traditional retailers and e-commerce pure players. And from a profitability standpoint, Luxury continues to drive exceptional financial performance with 41% adjusted operating income growth in the second quarter and 29% in the first half, contributing to a 15.4% adjusted operating margin in the first half. This continues therefore to be a very strong business for us.

Professional Beauty, next. Second quarter like-for-like trends improved sequentially through a decline of 0.8%, including the negative effect of supply chain disruptions. These disruptions are impacting our hair color business, including Wella; that have disproportionately impacted our OPI brands as already mentioned, disrupting shipments of the brands both in North America and internationally. Adjusting for the supply chain disruptions, underlying Professional Beauty like-for-like revenues remained consistent at plus 1.5%. On the profit side, strong improvement in delivering gross margin, supported by product mix and accretive innovation, together with fixed cost control, drove a 1% increase in the second quarter adjusted operating income, resulting in a 17.3% adjusted margin for the quarter and 12.3% adjusted margin for the first half.

From a brand perspective, Wella continued to benefit from a steady increase in [completing sell-out growth] to the Wella Koleston Perfect with [healthy growth] line. We continue to see growth, strong momentum in ghd across nearly all countries, fueled by the combination of our platinum+ styler launch, a new brand campaign and growing distribution.

Before I move ahead with consumer, I would like to outline here that together, Luxury and Professional Beauty represents 60% of the portfolio, and that this 60% of the portfolio are showing steady to strong performance.

Let me now focus on the 40% of the business which is still facing difficulties. Consumer Beauty second quarter like-for-like results are negative 7.3%, improved meaningfully from the 14% decline in first quarter as well as nonetheless weak results, indicating that we still have much work to do to achieve stabilization. On an underlying basis, second quarter like-for-like was a negative 7.8%, with Younique contributing to the decline. During the second quarter, the performance was broadly in line with set out trends as our brands were pressured by continued weakness in the mass beauty category, particularly in the U.S. and Europe. Still, our trends have shown a moderation in the pace of our share losses.

From a category and brand perspective, so color cosmetic declined mid-single digits with COVERGIRL and Sally Hansen benefiting from easy comps in the prior year ahead of their brand relaunches, while Wella and Max Factor were weighed down by the supply chain disruptions.

In retail hair, Wella sell-out trends remained positive with Wella steadily gaining share of the rest, helped by innovation. Sell-out trends at Clairol remain pressured, while net revenues benefited from low cost ahead of Luxury lines and media relaunch. In body care, [ads of villa] continued their momentum with strong revenue growth and [shining].

E-commerce was a bright spot in Consumer Beauty, which strong growth in the quarter and year-to-date and share gains on that as well across a number of category and in our core Consumer Beauty categories.

During the second quarter '19, Younique revenue and profit remained pressured due to a decline in product sales and presenter sponsorship. We continue to refine our product offering and compensation plan structure to drive improvements in presence and sales activity, recruitment and retention. And from a profit standpoint,

Consumer Beauty second quarter adjusted operating margin performed 5.6% as top line pressure and the last profit contribution from the divested brand more than offset solid fixed cost reduction.

Our expectation in second half of fiscal 2019 is for growth and moderation in supply chain disruptions, as already said, and a more disciplined strategic approach to our investments above and beyond net revenues, which should translate into an improved profit picture in the second half.

Connected to the continued pressure we have seen in the Consumer Beauty division, let me briefly touch on the $965 million non-cash impairment charge that we are taking this quarter primarily connected with the Consumer Beauty division and selected brand trademarks. The Consumer Beauty division has experienced increased competitive and market pressure throughout the first half of fiscal '19, which has resulted in weaker-than-expected revenue and earnings. Additionally, the [difference] rate associated with the division has also increased in the quarter.

Based on these 2 adverse factors, management determined that they were indications that the goodwill of this division as well as certain trademarks, intangible asset may be impaired. And accordingly, an interim goodwill impairment test was performed as of December 31, 2018. The charge announced today reflect noncash impairment charge of $832 million for the Consumer Beauty goodwill and $97.8 million for the trademarks of COVERGIRL, Clairol and 2 small regional brands. While this charge clearly had a material impact on reported operating profit, our adjusted operating income excludes this charge, of course.

Second quarter adjusted operating income of $322.3 million declined by 7% from the prior year with a margin of 12.8%, bringing first half adjusted operating income to $463 million and an adjusted margin of 10.2%.

In the first half, the adjusted operating income was adversely impacted by temporary factors of approximately $48 million, including over $90 million from the supply chain disruption. Excluding these temporary impacts, the first half underlying adjusted operating income would have declined about 6% year-over-year with an operating margin of approximately 11%. We anticipate profit trend recovery in the second half compared with the first half.

Our second quarter adjusted net income, $181.9 million, declined 23% over the prior year, primarily due to a $41.8 million positive foreign tax settlement in the prior year, which we don't have this year, of course. Interest expense was modestly higher than last year as a result of our higher debt balance. While net income attributable to minority interests was declining due to the decrease in Younique's profitability fiscal '18. As a result of all these, adjusted EPS for the quarter was $0.24 per share.

I'll now comment on the improvement in our net debt during the quarter. Debt decreased in the second quarter due to approximately $320 million of operating cash flow and $195 million of free cash flow generated during the quarter as we drove strong progression of operating income into operating cash flow, supported by working capital improvements. Our team remained focus on free cash flow as deleveraging is a strong priority for Coty and the most important lever for value creation for both equity and debt holders in the short term.

Like Pierre, I believe that the more disciplined and [pillar] focus on cash will meaningfully [add in] for cash flow in the medium term. This, in turn, will free up resources to both invest behind our brands and to expand our profits.

Net debt of $7,489,000,000 on December 31, 2018, decreased $173 million from the balance of $7,662,000,000 on September 31, 2018, resulting in the last 12 months net debt to adjusted EBITDA ratio of 5.85. The reduction in net debt reflects positive free cash flow, the payment of $94 million dividend and a positive foreign exchange impact relating to the part of our net debt which is in euro.

Our covenant-adjusted net leverage ratio remains, as a result of all these, below our penalty threshold, and we ample liquidity available under our revolver with no significant debt maturities until 2022.

Let me, to finish, offer some final color on our fiscal 2019 outlook. As we focus on building a healthier business model, we anticipate profit trend recovering in the second half of full year 2019. We expect that full year 2019 constant currency adjusted operating income will be moderately below last year adjusted operating income of $1 billion. And we continue to expect positive free cash flow for full year 2019 and for the rest of the year.

Before wrapping up, let me key quickly review my idea of key priorities for the remainder of the year. The first, of course, is to fully resolve the supply chain issues. And on this one, we are making very good progress, which we will need to be carefully monitored in the third quarter. Collectively, as a team, we will work towards delivering the profit target I just mentioned. My own core focus as a CFO will be on improving free cash flow generation as part of our commitment to deleveraging. And finally, as mentioned several times by Pierre, we will lean into quality, and under his leadership, we will spend the next few months assessing the risks and opportunities of the business and building medium-term plans with a focus on gross margin, adjusted operating income and free cash flow.

That's what I wanted to tell you as a comment for this second quarter. And with that, let's move to Q&A. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Nik Modi of RBC Capital Markets and.

Sunil Harshad Modi - *RBC Capital Markets, LLC, Research Division - MD of Tobacco, Household Products and Beverages*

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Pierre, maybe you can just -- I know it's still early, but as you've come in and looked at the businesses, just wanted to get your assessment on the consumer insights capabilities at Coty today. And maybe on a scale of 1 to 10, where would you rank it? Obviously, 10 being the best. And just from a -- from the COVERGIRL perspective. Obviously, it was relaunched. It looked like it had some early success. Just wanted to get the state of the union on how that relaunch is progressing.

Pierre Laubies - *Coty Inc. - CEO & Director*

Nik, thank you very much for this question. So when it comes to consumer insight capabilities, I think that we have -- based on my superficial assessment and I'm being very cautious about what I say, I think our assessment of where the market is going, where -- what are the consumer trends and that is it, that we need to do, is probably reasonably good. So I give it 6 or 7, I mean, if I wanted to rank it. I do happen to believe that where our opportunities lie is how to transform this insight into a consistent marketing strategy; a disciplined approach to brand building, a disciplined approach to portfolio management; and I would say -- yes, and a disciplined media approach overall. So that's kind of what I think. I think the opportunity is not left in discovering the insight, but how we transform them into concrete action.

When it comes to COVERGIRL, I have to say I think this is an amazing brand and this is a brand with a lot of scale, a lot of opportunities, not only in the U.S. market. But I'm talking from intuition here, and so I'll accept that this is a sort of answer-first answer. I think that brand has really a lot of potential. It is very distinctive. It has really strong international expansion capabilities, so I think that we have a very strong asset here. When it comes to the relaunch, I think the -- I would say that the assessment is a bit less clear at this stage. We are not happy with the development of the brand. I know distribution plays into that, but I think that there are also some issues with the way the market the brand from a structural standpoint. Again, you come back to the same conversation we had, media choices, building or not on the distinctive asset of the brand and velocity of our shares and complexity of our range. So we are taking stock of that, but again, I think the team is quite conscious of some of the trajectory that we have with that brand. We really believe it deserves better, and we will work strongly to turn it around.

Operator

Our next question comes from the line of Shannon Coyne of BMO Capital Market.

Shannon Elizabeth Coyne - *BMO Capital Markets Equity Research - Analyst*

Pierre, could -- you talked about introducing playbooks in a more standardized, disciplined approach to the business. Can you give more details on what that means? And maybe talk about how that marries up with being in beauty, which is often a changing and a dynamic industry.

Pierre Laubies - *Coty Inc. - CEO & Director*

Actually, thank you, Shannon for this very good question. Playbooks talks of the way we -- on how we do business, nothing else. Beauty is a creative world, and so is music, right? And nobody can play in to a philharmonic orchestra without mastering music, right, or the theory of music and learning music. That is a bit the same analogy. What we need to do is to have strong standard ways of doing things, organization at facing which matters: The why, the how and the what. The why is very clear, why we are in the business, why does the company exist? In general, it's relatively easy to answer this question. That what is what makes the difference? If I want to sell more COVERGIRL, I need to do something with the range, we need to do something with the price, we need to do something with the distribution and we need to do something with the recipes. That's the what, and that's where we spend most of our -- we must spend most of our time. Large organization face complexity. Complexity is the ransom of success. And with complexity, comes complexity of the businesses, complexity of processes and complexity of organization. And that's the way of the how operates. What we don't want is to have people who [discover] on how they have to perform their job. We want them to really master that by giving them the marketing philosophy or selling philosophy, a manufacturing philosophy or a finance philosophy for wherever it counts, all right? And so that's what we are going to do in this company. We need to invest a bit at the initial phase, but it will free up a lot of time and a lot energy so we can focus on selling more beauty.

Shannon Elizabeth Coyne - *BMO Capital Markets Equity Research - Analyst*

That's helpful. And just go quick, can you give us some sense on how -- based on the guidance you gave today, how Q3 and Q4 plays out?

Pierre-André Terisse - *Coty Inc. - CFO*

I'll take that. It's going to be skewed towards Q4, clearly. There are different reasons for that, one of them being the supply chain resolution, which is obviously going to improve. There will be some impact as well at revenue recognition because a change of norm is going to have different impact throughout the quarters as we are normalizing this, and some cost saving as well. Yes, that's it.

Operator

Our next question comes from the line of Lauren Lieberman of Barclays.

Lauren Rae Lieberman - *Barclays Bank PLC, Research Division - MD & Senior Research Analyst*

Pierre-André, I know you've been there only a week, as you pointed out, but a couple of questions for you. First, just thoughts on capital allocation, sort of where does the dividend fit in on your priority list? Also, I noticed in the release, the net debt-to-EBITDA target that's been there in the past was not that mentioned. So is there is any change to that? And then also just that you were willing to step up and kind of -- you adjusted the full year guidance a little lower, but like you said, there's an implied significant acceleration. So why do that at this point? You're very new, you didn't have to. So maybe just talk of your level of conviction, the drivers that really kind of get you to be comfortable giving an outlook at this point in time.

Pierre-André Terisse - *Coty Inc. - CFO*

Thank you, Lauren. So I'll start -- it's a complete kind of question, actually. I'll start with the last one. It's true I've been here for a week, but the company has not started working for a week only. And Pierre, by the way, joined 3 months ago. And from that 3 months, there's been a lot of things happening, in particular, in reassessing the short-term performance of the business, getting a more realistic view of what we are [destined] and putting in place plans to support the profitability and the profit delivery and to support as well the delivery of cash flow. For the past 1 week, and I must say, a bit more than a week, to be fully frank. I've been wrapping up on that work, meeting many people and getting to the conclusion that we have a very solid plans. And this is the reason why we feel comfortable in saying what we have been saying about -- around the profit delivery, which means $950 million to $1 billion operating income target for the year, and indeed, an improvement in the second half. But it's pretty logical and very easy. You see that Consumer Beauty in Q2 is already improving versus Q1. You see that as we move forward, we are getting less impact from the supply chain issues, and as a result of that, I mean, you can see what the trend is going to be in the second half. So this is why we are comfortable reassuring the market on that, and somehow, confirming the resilience of the business, which we have seen in the second quarter.

On your other question which are a bit more long term. So on capital allocation and dividends, there is simply no intention to touch the dividend. My -- sorry, in the financial [policy] and capital allocation, the return to shareholders is a very important matter, and we take it very seriously, as we take very seriously, deleveraging. And today, I have no reason to question what is put in place. We are focusing on free cash flow generation to match these 2 objectives of the financial policy.

On the net debt target change, I believe you're talking of the medium-term guidance. As mentioned by Pierre, we are going to make a strategic assessment of the company in the coming month. And as we see, this will result in conclusion in the cash flow generation and what we want to do with it. And therefore, I don't want to confirm before we have made this plan, whatever the target, medium-term, will be. I just want -- I simply want to note that we'll have a set of targets from a covenant perspective, which anyway, leads us to a net debt-to-EBITDA ratio which are gradually going down as we move in time. So that remains in place, of course. I hope I have covered your question with my answer.

Operator

Our next question comes from the line of Wendy Nicholson of Citi.

Wendy Caroline Nicholson - *Citigroup Inc, Research Division - MD and Head of Global Consumer Staples Research*

Could you talk about your initial sense for the portfolio of brands? Do you have a feel for whether you just have too many brands to manage, too many different lines of business? And I'm particularly curious if you have an initial take on the hair coloring business because that seems to be particularly challenged and maybe particularly a competitive category where it might be difficult to regain some momentum.

Pierre Laubies - *Coty Inc. - CEO & Director*

Okay. Thank you, Wendy, for this question. I think it is -- we -- indeed, as you have said, we don't suffer from a lack of brands at Coty. But probably, we do suffer from a lack of portfolio structure. So I think this is what we are going to assess during the strategic plan. I believe that if you want to manage or to achieve a solid market share at any given market, yes, you do need to have brands, but you do need to have a well-structured portfolio of brands aligning with the price tiering of the marketplaces. And unfortunately, I think that over the year, this has not been the strategy that Coty has followed. Some of competitors have definitely followed this strategy because it is a good one. All right. So I think that this is something that we need to work on. We will definitely come back to you when we evaluate our strategy and share our strategy with that way of looking at the market. And I do happen to believe that, in that case, Coty is very well placed. We have a few hidden gems into the organization or into the business that we can capitalize on and to build, I would call it, a structured portfolio which has the capability to become global, providing we give it the focus that it deserves. But I will be -- that is my answer, first, to your question.

And I understand also that there are set of brands that we have which are probably nonstrategic. In this type of situation, I think you have to be pragmatic, right? You've got this defined generic cash flow, so we will need that cash flow, so we will continue to manage them. Some of these brand are also going to be -- are strong, but are local. I don't mind that at all. I think you can have also a set of local brand, providing they are well managed and you manage them not as global brands, but you manage them as you would manage a global brand at the local level, right? And again, this is what the value of a playbook give, which gives people proven methodologies and way of doing things which are actually, whatever you apply it, on the COVERGIRL brand, on the Max Factor brand, you could apply it over to Banani in Germany. And so that's my approach to this sort of problem. And I think that was your first question.

On hair coloring, it's -- yes, we clearly -- we had a great idea in the U.S. market, definitely with the Clairol move, where I think, typically, our execution has been a bit challenging. And we have -- unfortunately, we have, in the case of Clairol particularly in the U.S. market, we have gained penetration with the relaunch of Clairol, but we have upset some traditional users of the main partition of the market, as I call it, and we have lost business. It is a great example of why your playbook matters and then you avoid this sort of problem. I think it is a category where we have a right to win. We have capabilities, we have competencies and we have potentially -- we have, I would call it, local brand with Clairol in the U.K. and in the U.S. I don't see any reason why we can't beat a global portfolio on this category. Taking into consideration our success in Professional hair color, I am absolutely convinced that we can take this to the mass market. And again, it would be clearly part of our strategy. I again, see that as a great opportunity in terms of growth.

Operator

Our next question comes from the line of William Reuter of Bank of America.

William Michael Reuter - *BofA Merrill Lynch, Research Division - MD*

Earlier, you chose not to talk about a medium-term leverage target. Maybe you can even longer term than that. Philosophically, where do you believe this company should be levered? And then, I guess, if I could just get an update on the P&G integration. We were expecting $225 million of savings in '19. Do you know what was achieved in the first half, and therefore, what we might expect to see in the second half?

Pierre-André Terisse - *Coty Inc. - CFO*

Just on the first part of your question, and I will let Ayesha answer your second part about synergy. I have no philosophy. I mean, it basically depends on the business and it's ability to deliver cash flow. So entering the problem or the question with [surgical] conviction, to me, doesn't make sense. I want first to go through what is the ability of this business to deliver free cash flow? What is the need for investment? What is the ability to deliver [systemic income] growth? And then depending on the outcome, we need to define what is the right level of leverage we want to put in place and what we can state from a realistic standpoint. So that's why I'm not willing to go much further than that. And I mean -- and we'll give you that once we have numbers.

Ayesha, you want to answer on?

Ayesha Zafar - *Coty Inc. - Senior VP & Group Controller*

Yes. So just the answer around synergies. We were expecting about $225 million for the year. And we are on track, so I would say roughly half, but that's just to give you a sense. That's how we were expecting it to work out.

Operator

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

Mark Stiefel Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

I wanted to ask about the gross margin focus. So that suggests perhaps freeing some funds up for flexibility in the business, including reinvestment, whether it's incremental or just a continuation. I guess, I'm curious, if that's reasonable, if that's kind of how you view the business, and if so, or even if not, how do you think about the EBIT margin longer term? Because I think your predecessors seemed to have what, I think in the industry, was viewed as a bit of unrealistic expectations about high-single digit EBIT margins. Do you think that, that is still the right number? Sort of directional, not looking specifics. But what is the right level of margin for the business? What's the right level of reinvestment for the business? That would be helpful.

Pierre-André Terisse - *Coty Inc. - CFO*

Yes, thanks. And I'll take the first part of your question and then I will let Pierre elaborate on gross margin and the engine. But again, I don't want to make the answer before we have entered the extraction exercise. But what we are all clear about is that we think there is meaningful -- there is room for meaningful improvement of the operating margin. And this is our goal, actually. We want to take this company at the level of EBIT margin which is going to be meaningfully higher than the one we have today. And a substantial part of that is going to come from gross margin, another part of that is going to come from the simplification of the cost, basically and from fixed cost and from fixed cost leverage, by the way, as I've done. For gross margin, my only comment, and Pierre will add a bit more, is that if we want to be on the business of quality, we need to have the ability to invest in R&D. And if we want to have the ability to invest in R&D, we need to have a level of gross margin which is higher. And that's as simple as that. So the question is only answered is we have to see that happen.

Pierre Laubies - *Coty Inc. - CEO & Director*

Exactly, Pierre-André. And Mark, thanks for the question. It's almost a point -- a strong point of view that I have developed over the year, is that -- and reinforcing to this category. Looking at this category in detail, beauty is an expensive business from an A&CP standpoint. You need to be able to compete in this area. It doesn't mean that you need to waste, and we don't need them to, we don't intend to. But clearly, we need to strengthen our ability to talk to our consumers or to build our brand with our consumers, and in that respect, delivering sustained gross margin and ever-improving gross margin. I mean, it is -- we need to make a [step-up] rapidly. And also, that go to through a strategy of continuous improvement through many levers, being strategic [portfolio] management, costing, simplification of our recipes, simplification of our organization, reduction of our cost. I mean, we have to -- in a strategy like that, you don't leave any stone unturned, and we will just do that. But clearly, we are in the business of brand building. And as Pierre-André said, that takes money. And at the same time, we also want to deliver to our company, pay dividends and improve our profitability. So again, I see that as the place to go to, and we will do that in a relatively not-too-distant future.

Operator

Our next question comes from the line of Robert Ottenstein of Evercore.

Robert Edward Ottenstein - *Evercore ISI Institutional Equities, Research Division - Senior MD & Head of Global Beverages Research*

And you kind of touched on my question just now, but maybe let me try to ask it again, and knowing it's early days. So again, philosophically speaking, you made a couple of key big picture comments before the Q&A section. One, you want to earn the right to grow in consumer business; two, you're not obsessed with market share; and three, you are obsessed with gross margin. And I guess, what I'm struggling with a little bit, and again, you touched on it here, is what do you mean in terms of right to grow in consumer business? Does it mean that you have the brands that the consumers want? Or does it mean that you have the profitability first? Just kind of a chicken and egg situation there. And if you stand back and look at some of those comments, you're not obsessed with market share but you are obsessed with gross margin. Does that mean that you want to be more aggressive, perhaps, in terms of pricing? So again, I know you touched on it a little bit before, but if you could just kind of help us think through those bilious objectives, particularly in the short term. I understand long term, you want to drive the gross margin long term. But over the next 12 months, how are those different priorities fitting together, please?

Pierre Laubies - *Coty Inc. - CEO & Director*

Thank you very much, Robert, for this question. When I say I'm not obsessed with market share is I mean by that, that I'm obsessed with quality business, all right? And there are good business. We all know that, in life, there are good business and very bad business. What we are going to do, we'll need to focus on getting good business and we are going to forfeit very, very bad business and we are going to limit that business, right? So I think we need to be pragmatic on this dimension, but as we [reveal the degree], the direction that we give to our people. I actually don't see any compatibility between doing that and having market -- and having gross margin. Actually, I think it is the lifeblood of gross margin, too. And gross margin is, in turn, the lifeblood of building brands, right, or building portfolios. So I see that philosophically sort of 2-times, all right, if I may say so, or 3-times strategy. Clearly, spend the next 6 months assessing our point of departure market-by-market, assessing our portfolio market-by-market, where is the space to grow, where are the opportunities? Immediately, at the same time, but that will take another a couple of years, I would say, focus on the quality of the business with the portfolio that we have today and optimizing its performance in term of quality market share and not only in terms of total market share. I mean, mostly in that case, I mean the market share of the base business, and that should be incremental one. And at the same time, once we have done all the CP, really beefed an innovation program or transformation program from a portfolio standpoint, that we'll able -- will we be able to deploy in a period of time or starting from, I would say, 18 months to the next -- through the rest of our life, right? Or 18 months to 2 years, to the rest of our lives. It goes again, this is you need the expertise and consistency over that. We have too many markets where we only have one brand. And we can't fight competitors who have 2 or 3 brands with 1 one brand, that's not going to work. And so we will need to beat those opposition in the marketplace. And again, you don't move -- COVERGIRL is a brand which has 17% penetration in the U.S. market. It was launched 78 years ago, if I do remember well, all right? So I think that takes time, right? And of course, I do not intend to wait that long and -- to see success. But clearly, I do see that is a series of events, and we all -- which all work concomitantly with different parts of the organization working on each specific agenda item.

Operator

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

Pierre-André Terisse - *Coty Inc. - CFO*

And that will be the last question, by the way.

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

So Pierre, we seem to be hearing 2 things. So on the one hand, it seems that you want to invest to help build a better company, and some of that can likely be sourced by lean initiative. But given where you stand now versus competition, especially in Consumer Beauty, it also seems that, that would require a good deal of upfront investment and I think that's implied by the lower operating profit outlook today. So I guess the first question is do you agree with that assessment? And the second question is, how do you balance that desire to improve and the potential need to invest against your deleveraging priorities? And to what extent is elevated debt sort of constraining what you otherwise like to do? And how do you sort of break through those constraints?

Pierre-André Terisse - *Coty Inc. - CFO*

Yes, and maybe -- Pierre-André, I will take the question first. I don't think the investments has anything to do with the -- with our profitability, as you mentioned. The profitability incorporates a very important factor, which is the supply chain issues, so I think that's the main reason for the profitability of this year being higher than the profitability of last year.

On the constraints, well, that's basically what we have on the agenda. How we have a strong commitment on the deleveraging standpoint. We have ambition from the profitability of this company, and we know that we need to find ways to, at the same time invest and deliver and do anything in a balanced manner. So this is very much what we are going to try and work in the coming weeks and months. And we are going to try and incorporate in the strategic review. We are using those constraints for our business, and we intend that debt servicing front, and because that would be taking too much risk. You need to do it in a gradual manner. And then we'll deliver it [added income]. So maybe, Pierre, you want to complement on that?

Pierre Laubies - *Coty Inc. - CEO & Director*

Faiza, a good question. I think that I allude to what I have said earlier in my initial statement. We have space to improve the performance of our business by working differently, right? In our A&CP budget, yes, we are not short of A&CP. Yes, we could have more. I mean, that's not a problem. I mean, who doesn't want more A&CP? But our balance between working media and nonworking media has to be improved. Our balance between reach and frequency has to be improved. Our balance between the different type of media can be improved. So we have space in our P&L and we have space in our execution, right? We will save that space -- those spaces. And I think it will free up not only cash, to be honest with you -- or money to be spent, but also, it will save us from a lot of waste, all right? And I think with waste comes fatigue, and with fatigue comes lower performance. And our objective is actually to fundamentally eliminate waste, and hence, refocusing our organization and our people to what -- really what makes a difference.

Pierre-André Terisse - *Coty Inc. - CFO*

Okay. With that, we thank you, all. And we'll see you on the road. Thank you. Bye-bye.

Pierre Laubies - *Coty Inc. - CEO & Director*

Thank you so much, all, for your time.

Operator

Thank you, ladies and gentlemen. This does conclude today's conference call. You may now disconnect and have a wonderful day.