THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

COTY - Q4 2018 Coty Inc Earnings Call

EVENT DATE/TIME: AUGUST 21, 2018 / 12:00PM GMT

OVERVIEW:

Co. reported FY18 adjusted EPS of $0.69. 4Q18 adjusted EPS was $0.14.

CORPORATE PARTICIPANTS

Camillo Pane *Coty Inc. - CEO & Director*

Patrice de Talhouët *Coty Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Christina Marie Brathwaite *JP Morgan Chase & Co, Research Division - Analyst*

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

Jonathan Patrick Feeney *Consumer Edge Research, LLC - Senior Analyst of Food & HPC and Managing Partner*

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

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

Linda Ann Bolton-Weiser *D.A. Davidson & Co., Research Division - Senior Research Analyst*

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

Olivia Tong *BofA Merrill Lynch, Research Division - Director*

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

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

PRESENTATION

Operator

Good morning, ladies and gentlemen. My name is Candice, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Coty's Fiscal Fourth Quarter and 2018 Full Year Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded today, Tuesday, August 21.

On the call today are Camillo Pane, Chief Executive Officer; and Patrice de Talhouët, Executive Vice President and Global Chief Financial Officer. Also joining the call is Christina Frank, who recently joined Coty as the Head of Investor Relations. I would like to remind you that many of the comments today may contain forward-looking statements. Please refer to Coty's press release and the reports filed with the SEC, where the company lists factors that could cause actual results to differ materially from these forward looking statements. All commentary on organic net revenue reflect a comparison of Legacy-Coty and the P&G Beauty Business on a combined net revenue basis at constant currency, in the current and prior year period, excluding the impact of acquisitions and divestitures 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 Mr. Pane.

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

Thank you, Candice, and welcome, everybody, to Coty Fiscal 2018 Fourth Quarter and Full Year Conference Call. 2018 was a year of good progress for Coty, as we stabilized the overall business and continued with our ambitious integration agenda. We have delivered our target of modest organic revenue growth and a very healthy improvement in the adjusted operating margin the second half of the year.

Nevertheless, much remains to be done, and I would like to use this call as an opportunity to not just review the results but also remind you of our earnings model and the strategic framework that will guide us going forward.

The Luxury division fired on all cylinders in fiscal '18 had a great year with 6% like-for-like growth, driven by strength in all regions and travel retail.

The division's growth was fuel by the Gucci Bloom and Tiffany launches, strong performance by the Calvin Klein and philosophy brands, and excellent innovation and recent share gains with the launch of Chloe Nomade and Marc Jacobs' Daisy Love. We're particularly excited about the growth in ALMEA, with terrific performances in China and Latin America.

As you know, we added Burberry to the Luxury portfolio this year, and we're very pleased with the progress to date and confident about the brand's future. Less than 9 months after the acquisition of the license, we're launching Burberry Her, a great new fragrance centered on the London vibe. We've also made significant progress in bringing the Burberry distribution in-house and fiscal 2019 will be a year of continuing to normalize customer inventories while aiming at strong growth in emerging markets.

Fiscal '18 was a solid year for the Professional Beauty division with like-for-like growth of 1.7%, including very strong momentum in the ALMEA region and with key brands like Wella and OPI, despite the disruption in one of our North American warehouses.

OPI growth was driven by a very strong performance by Gel Color, while Wella was fueled by the continued strength of our Color portfolio and by the Wellaplex launch.

In fiscal '18, our Consumer Beauty revenues declined 4% on a like-for-like basis, an improvement from negative 10% in fiscal '17.

Consumer Beauty Europe and North America regions declined mid- to high single digits, against the backdrop of low single-digit declines in the mass beauty category in these regions, aggressive competitive activity and supply chain disruption due to the consolidation of the planning center at the end of Q4 2018.

The ALMEA region was stable, as strong high single-digit to double-digit revenue growth in most markets was offset by a decline in Brazil due to our intervention on inventory pricing as well as the recent trucker strike.

Brazil continues to show share gains and is growing at more than double the industry rate, and this continues even in the second half of fiscal '18 following our price increases.

Overall, I remain unsatisfied with the current performance of the Consumer Beauty division and this will remain one of my key priorities.

Now let's turn to the future. As described in our press release, we're now focused on enhancing operating profit growth by delivering the remaining cost synergies and returning the business to low single-digit like-for-like net revenue growth.

This level of top line growth, combined with our ongoing focus on reducing costs even after the synergies are fully delivered, underpins our medium-term target of achieving a high teens adjusted operating margin over the next 5 years.

We believe that each of our divisions plays a unique role in helping us to deliver this margin structure and profit growth. Specifically, we look for Luxury to sustain its above-market top line expansion, fueled by our strong innovation capabilities, geographic expansion, and ongoing development of our prestige skincare and color cosmetics offerings.

In Professional Beauty, we look to accelerate our growth by maximizing the untapped potential of OPI and ghd, while capitalizing on Wella's market-leading position.

In Consumer Beauty, we aim to stabilize the division's top line and improve the bottom line, and I will get into further details shortly.

Against this backdrop, we view fiscal '19 as an important step in the right direction to achieve our medium-term ambitions.

For fiscal '19, we're targeting well over 100 basis points of operating margin expansion, which, combined with our target of flat to modest like-for-like net revenue growth, would deliver mid-teens adjusted operating income growth and a fiscal '19 adjusted EPS target of $0.74 to $0.78.

We believe key drivers to achieve these targets are the delivery of the announced cost synergies, continued strong growth in Luxury and Professional Beauty, and progress towards the stabilization of Consumer Beauty.

I will now outline the strategic framework that will drive our top line performance, and Patrice will discuss the synergies and profit in more details in his section.

Our strategy to drive growth is focused on 4 distinct pillars, which are all equally relevant for all the 3 divisions.

It includes focusing on brands which matter and have potential, on driving innovation and in-store execution much harder, on digital transformation and on rapid expansion in the emerging ALMEA markets.

On the first point, we will continue to drive the potential and longevity of our global, iconic brands such as COVERGIRL, Wella, Clairol and Rimmel in Consumer Beauty. Wella Professionals in Professional Beauty; and Gucci, Calvin Klein, Burberry and Hugo Boss in Luxury.

In addition, we will focus on driving brands that we believe have high growth potential, including Bourjois and Younique in Consumer Beauty; OPI and ghd in Professional Beauty; and Chloe, Marc Jacobs Bottega Veneta and Tiffany in Luxury.

We're pleased to say that the strength of these brands, coupled with our disproportionate investment behind them, has enabled this group to outperform and our target is to further enhance this outperformance.

We have improved, and will continue to improve our innovation pipeline and make progress with our in-store execution strategy. Key examples are the partnership with third-parties to shorten our time to market on innovation, especially in countries like China, where localization is a key priority, and the launch of a highly select number of flagship brand stores for Bourjois, philosophy and Gucci beauty, where consumers can connect with our brands' DNA and products. Our recently improved in-store execution of COVERGIRL in the U.S. is another example.

Alongside our plans to rejuvenate our core business, we're equally focused on our digital transformation and I'm pleased to confirm that we're making great progress towards our goals. In fiscal year 2018, e-commerce accounted for approximately 10% of our total net revenues, including Younique. Excluding Younique, which is an entirely e-commerce driven business, e-commerce net revenue grew more than 50% year-over-year.

I'm very pleased that this change in focus has fueled strong e-commerce results, which are well ahead of the market across all 3 divisions. We will continue to disproportionately invest in this growing channel, including further talent acquisition, data and product management systems and in-house content creation capabilities, and expect e-commerce to make an increasing contribution to Coty's growth rate over time.

Finally, one of the most important areas for amplifying our growth potential is the work that we're doing to fuel momentum across all divisions in ALMEA. I already mentioned Brazil, so let me focus for a moment on China, which is a key area of opportunity for us. Our China presence is small today, but we have the right iconic brands for this market, and our double-digit growth across all 3 divisions in fiscal '18 reinforces our ability to win in China. Fiscal '18 gave us clear confidence in ALMEA's role in our earnings model, and we believe going forward ALMEA will be an increasing growth contributor.

Within the context of this framework, let me talk about how we're going to achieve our medium-term objective of stabilizing Consumer Beauty. We recognize that Western Europe and North America will continue to be under pressure due to the declines in traditional mass retail channels. Our target is to neutralize these headwinds by improving our share performance in this region and most importantly by driving aggressive growth from new channels, new markets and, down the road, new businesses. Over the next few years, we believe rapidly expanding market in ALMEA, like China, Brazil, Middle East and Mexico as well as growing channels, like e-commerce and Younique, will provide increasing and disproportionate growth contributions.

Expanding on improving our share performance in North America and Western Europe, we will continue to build on the brand relaunches of COVERGIRL and Clairol. COVERGIRL accounts for low teens percentage of total Consumer Beauty sales and we have seen underlying improvement in the brand's net revenue and consumption trends. Our focus is on driving consumption productivity on shelves with our retailer partners. And we're making good progress on improving productivity through better innovation and optimized assortment. However, we see risk to our shelf space in fiscal '19 tied to both supply chain disruptions as well as our historical performance.

To offset these challenges, we are continuing to focus on 3 key areas: first, our innovation pipeline, which focuses on core franchises; second, our digital-first mindset, which has brought COVERGIRL into the top 10 color cosmetics brands in the U.S. in terms of earned media value; and third, introducing new ways for consumers to interact with the brand such as our planned Times Square flagship store.

Another key European and North American brand is Clairol. Although the relaunch of Nice'N'Easy helped to moderate the decline in consumer sell-out in the US, we have seen stronger improvement in the UK, and the recent increase in household penetration, for the first time in several years, gives us confidence that stronger innovation and execution will allow us to improve the trend.

)

In ALMEA, our focus is on accelerating growth through the brands that we know resonate extremely well with consumers, including Wella, Max Factor, and Bourjois.

Our Wella brand, which is the largest hair color brand in the Consumer Beauty division and has the majority of its revenues coming from ALMEA, gained share in several countries including Mexico and Turkey.

We believe that the potential of the overall retail hair color category in ALMEA is substantial, as consumers in many of these markets approach hair coloring as a social activity, and we see significant opportunities for growth of the Wella brand in fiscal '19 and beyond. The joyful, Parisian positioning of Bourjois resonates well in regions such as the Middle East, and we are in the very early days of introducing Bourjois in China, which allows to push further into the masstige price segment.

On e-commerce, while still a small proportion of our Consumer Beauty business, it has delivered very good growth on the back of partnership with major retailers such as Amazon, Tmall and JD.com.

While we still have a lot of work to do, we're actively adapting our product portfolio and processes to become a partner of choice in this rapidly growing channel.

Finally, Younique brings to Coty a differentiated and rapidly expanding business platform with a very attractive margin profile. In fiscal '18, the business showed strong growth on a full year basis. However, it's fair to say the Q4 '18 was a challenging one for Younique, as we lapped one of Younique's biggest ever active presenter quarters in Q4 '17. We're now implementing enhancements to the compensation program to further fuel presenter growth and loyalty as well as strengthening our innovation pipeline. This, coupled with new market expansion, should enable sustainable strong net revenue growth and profit contribution as this platform is very well positioned to capitalize on the trends of social selling with the purpose of empowering women as entrepreneurs.

Now let me turn back to the upcoming fiscal year. Given the supply chain constraints that I already mentioned, financial performance across quarters in fiscal '19 will not be linear, with the peak of the impact of the supply chain constraints to come in Q1 '19, and a smaller tail in Q2 '19. This will have a significant impact on both top and bottom line, and together with the impact of our brand rationalization program, is expected to drive a low teens decline in our Q1 adjusted operating income year-over-year. Our fiscal '19 target takes the supply chain disruption into consideration.

I will now turn it over to Patrice to speak about the fourth quarter and to elaborate on some of our key financial priorities.

Patrice de Talhouët - *Coty Inc. - CFO*

Thank you, Camillo, and good morning, everyone. I will start by providing a quick summary of our operating performance in Q4 '18 to round out the detail that Camillo has already provided for you. While we continue to strive for a better top line result, we were pleased to end fiscal '18 on a good note despite various internal and external headwinds. On a like-for-like basis, Q4 '18 revenues increased by 0.3%.

Camillo has already spoken about the supply chain disruption, but let me give a little more context to the scale of the supply chain changes we have implemented in the last 18 months.

With the goal of simplifying our footprint and processes and delivering our committed synergies, we have shut down 2 factories, restructured a third factory, consolidated several supply chain planning locations into 3 planning hubs, consolidated 6 distribution centers, and exited TSA agreements in our 30 countries.

We have accomplished this unprecedented level of transformation in record time and with virtually no disruption until the end of Q3 '18. Nevertheless, during Q4 '18, the ramp up of one of our new planning hubs in the U.K. and the consolidation of one of our distribution centers in the U.S. were disrupted, impacting mostly the Consumer Beauty division results in Q4 '18 but also the Professional Beauty results in North America. We do expect that these business integration related impacts will be largely over by the end of first half 2019 and our fiscal '19 targets take these disruption into consideration.

Let me mention that at the Coty Inc. level, the Q4 '18 gross margin declined by 20 basis points, which was primarily driven by higher freight cost and the supply chain disruptions. Without the supply chain issues, our gross margin would have slightly improved versus last year. Our A&CP investments remained in the mid-20s percentage in the quarter, which is fairly consistent with the year-to-date trend. The fourth quarter marked good progress in the reduction of our fixed cost base, although this is partially masked by FX translation impact. In total, our Q4 adjusted operating income more than doubled year-over-year with 600 basis points of margin expansion to a margin of 10%. In total, we reported adjusted EPS of $0.14, bringing the EPS for the year to $0.69.

Let me now shift to the status of the integration. Last quarter, we told you about a program that represent an important final step in the Coty integration journey, the 1 order, 1 shipment, 1 invoice program. This will make Coty a fully integrated company, able to sell, ship and invoice all of our brands in any integrated way for our customers. It will allow a significant simplification in our go-to-market execution, increase our scalability potential and with this final step, Coty will complete the most complex integration in the beauty industry.

In the context of our integration progress, we continue to expect cost savings of $750 million and have achieved the first half of the synergies by fiscal '18, including $225 million in fiscal '18 alone. We expect to achieve a realization of the balance by the end of fiscal '20. Additionally, we achieved $470 million of our $500 million working capital benefit target through the end of fiscal '18, largely driven by great progress with respect to payables.

We continue to expect to incur one-off costs of approximately $1.3 billion, of which approximately $1.2 billion are expected to be cash. As of fiscal '18, we have accrued the $1.15 billion, with $860 million having been paid in cash and the remaining $400 million still to come related to the P&G integration. One-time CapEx will remain in line with the original estimate of approximately $500 million. And as of fiscal '18, we have incurred approximately $370 million of these $500 million. I would now like to explain more about the new cost savings program that we are announcing today. This program, for which we will reserve a $250 million one-off charge over the next 3 years, is being run independently from our P&G integration cost program and is meant to drive simplicity and generate flexibility in our P&L to be able to fuel strategic investments such as those in the digital and e-commerce areas. We expect to deliver up to $150 million of gross savings over the next 3 years as a result of this program, with a significant portion reinvested in our digital transformation agenda.

As a result of these investments, we would expect incremental net savings to be approximately $60 million over the next 3 years. In Q4 '18, we had cash outflows of approximately $16 million in connection with this program and would expect the remaining costs to impact fiscal '19 and fiscal '20 cash flows.

Against this backdrop, let me provide some color on our cash flow. In fiscal '18, our operating cash flow totaled $414 million, down from $758 million in fiscal '17, which benefited from over $400 million related to the timing lag between one-time costs accruals and the associated cash outlay. While best-in-class working capital remains a key objective, we were disappointed to see working capital deterioration of approximately $100 million driven by receivables and inventory, even as we made strong progress on payables. Free cash flow ended the year at negative $33 million.

Now that the integration of the ex-P&G business is progressing towards its completion, we will be increasing our focus on cash generation and deleveraging. To that end, we have set a target of achieving a net debt adjusted EBITDA ratio of below 4x by the end of calendar year 2020. This target takes into account any minor M&A activity you might consider. Talking about M&A, let me take a moment to address our brand divestitures, as mentioned on the last earnings call.

Since announcing the P&G Beauty transaction, we have rationalized a total of 14 brands from the combined portfolio. This includes the sale of Playboy and Cerruti in recent months for total proceeds of $33 million. The sale of Cutex and JLo in the last 2 years for $40 million, and the termination or expiration of 10 other brands including CLC, Celine Dion, Chopard, Esprit, GUESS, Halle Berry, Lady Gaga, LOVE 2 LOVE, [Summer] and Tim McGraw.

As I have previous mentioned, these disposals allowed us to simplify the business, and we expect this portfolio rationalization to have a mid-single-digit annual impact on EPS, which is already reflected in our fiscal '19 EPS targets. On the other hand, at the start of Q1 '19, we took the opportunity for the Luxury division to purchase the license rights for our Escada fragrance brand for a total consideration of EUR 35 million. This was a good business opportunity that allows us to develop the Escada brand through unconstrained innovation, creative support and additional distribution.

Let me now walk you through the most important drivers of our deleveraging platform. In fiscal '19, deleveraging will principally occur through a combination of organic profit growth as well as an improvement of our net working capital. In 2020, we expect deleveraging to benefit from a significant decline in the cash impact from our one-off cost program. Our balance sheet remains strong, and we have approximately $3 billion of liquidity to cover all debt maturities in the short and medium term. I am pleased to report that in the beginning of August, we took advantage of good market conditions to further solidify our balance sheet by extending the maturity of our interest rate swap portfolio such that we maintain a comfortable 50-50 ratio of fixed to floating debt over the next 3 years. Looking forward, we would expect that ratio to improve as we reduce the notional value of our floating rate debt.

Finally, I would like to share some thoughts regarding this morning's announcement that I assume you all have seen.

After having been with Coty for 5 years, I feel incredibly proud of what has been achieved and the progress against our transformation agenda. My time here has been a very intense and fulfilling professional journey. My commitment has been such that I have neglected critical topics in my personal life. Therefore, knowing that we are getting close to the completion of fully integrating the ex-P&G business, I now feel comfortable making the decision to resign from Coty. I am and will remain a very strong advocate of the Coty story. I'm confident that the strategy and team in place will ultimately lead the company to fulfill its mission. As a consequence, I will hold onto my Coty shares, will remain CFO until mid-September and will assist Camillo with an orderly transition thereafter.

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

Thank you, Patrice. As you all know, Patrice has been a tremendous contributor to Coty for nearly 5 years, and a valuable partner to me for almost 2 years. He managed our finances during Coty's transformation from a newly public emerging contender in beauty to our current status as a nearly $10 billion global beauty powerhouse, including several complex M&A transactions. With integration of the P&G Beauty acquisition largely complete, we now have the foundation to allow us to focus on the next stage of our journey. I thank Patrice for his valued service and personal commitment. As group CFO, Patrice has been an important member of our leadership team and has been instrumental in helping Coty undertake the most ambitious integration in the beauty industry. I wish him well in his next chapter. With Patrice's announcement today, we now plan to begin a full search for our next CFO. We will look to appoint a successor as soon as reasonably possible and to ensure a smooth transition.

I'm pleased to announce that Ayesha Zafar, Coty's Senior Vice President, Group Controller, will serve as the Interim Chief Financial Officer effective September 15, 2018. Ayesha has been responsible for accounting operations and financial reporting, including as Coty's principal accounting officer for more than 2 years and she brings 30 years of finance experience across several multinational consumer goods and pharmaceutical companies, including the Hertz Corporation, Bristol-Myers Squibb, Campbell Soup Company, PepsiCo, Inc, and Colgate-Palmolive company. I thank Ayesha in advance for stepping into this role.

Now back to Candice for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Lauren Lieberman of Barclays.

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

I was hoping you could talk a little bit more about Brazil. Because the commentary around in-market performance is really interesting, and particularly contrasting the reported results. So could you talk a little bit about the outlook for '19? Are there inventory drawdowns that needed to take place? Is that done? Pricing in the right place and so on. Is '19 a year where we'll start to see what you're saying is very good in-market retail and market-share performance start to come through in the overall?

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

Thanks, Lauren. I'll be happy to expand on Brazil. So as I mentioned also in the last call, we clearly had a price increase, which led to the destocking and to clearly productive negotiation with our customers. I'm pleased to say that the negotiation with the customers are largely complete, so the price increase has been now accepted, and we continue to see share gains in the market on most of our brands -- actually all of our brands. If I look at our overall Coty performance in Brazil, we are growing more than double the market and among the multinationals, we are the fastest growing multinational company there in Brazil for the last couple of quarters for the second half of fiscal '18. So the strength of our brand in terms of the consumer pull and sell out is also resulting in some space gain, because clearly we're also talking to our customers about readjusting our shelf space. Now that we continue to see substantial gains in consumer sellout across the company.

Operator

And our next question comes from Robert Ottenstein of Evercore.

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

On July 3, there was an announcement of a fairly -- or what at least seemed to be a fairly significant reorganization of the Consumer Beauty group, including changes in the leadership, talking about more focus on the key brands. I'm wondering if you could go into that in a little bit more detail, kind of explain kind of the thought behind those changes. And then also address the what shelf space looks like going forward for consumer in the U.S. based on what you're seeing today.

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

Yes. Thank you for the question, Robert. So the -- we have announced a reorganization of the market structure within this Consumer Beauty division. So now we have 3 CMOs, which have come on board or have been with the company already for a while but have been brought up to report directly to Laurent, the President of Consumer Beauty. The intention is clearly to have much stronger agility, so faster decision-making and having the proximity of the 3 CMOs straight to the president. There is also higher consumer centricity because the CMOs have split the portfolio into 3 more or less equal areas, from color cosmetics to hair color and body care and so on. And then another change that we have made is that we have raised the position of the digital lead for the Consumer Beauty division, so that also this person will report directly to Laurent, given the importance of this rapidly growing channel and part of the business.

So all these changes have been done, clearly bringing onboard people with a great track record and with the objective of becoming more agile and continuing to really making progress in this division.

Your second question was about, I think, shelf space. I mentioned in my remarks that we do see some headwinds in the shelf space in North America. This is driven by the supply chain constraints that we are having in the last couple of months, because as you could imagine, this has made the conversation with the retailers a bit more complex. And also if you can imagine, it's all a matter of looking at the productivity of the shelves. Now what I said in my remarks, which is very positive, is the fact that we're seeing productivity improvement in COVERGIRL, and we'll continue, of course, our work on this key measure of productivity. And as a matter of fact, what we have done in the U.S. will also change the incentive system for the sales force by moving from gross sales, which means volume to net revenues, which is clearly a KPI that is much more focused on productivity and much more in line with the KPIs that our retailer partners have.

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

And just in terms of the shelf space, based on your conversations with the retailers, are -- is the issue purely one of supply or are there other concerns?

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

I think it's a mix. I think the supply has clearly brought on the table a different type of conversation in the last couple of months. But I also want to repeat what Patrice said, which is that we strongly believe that the supply issues will be over, the majority at the end of Q1 and definitely at the end of first half of 2019. So clearly that is a temporary issue, which unfortunately we have due to the consolidation of the planning centers that Patrice mentioned. The point that I made about productivity is more a productive point because really comes from many years, many years of the brand that indeed having the right level of investment. Now the situation is different. We are investing with the brand. We are having much stronger pipeline. We are seeing improvements in consumer sellout. Patrice mentioned that we have improvements on both brands in net revenues and the sellout. And we plan to continue to invest behind the brands to continue the trend towards the stabilization. Nevertheless, the decisions are made, and we continue to work with the retailers to offset this one. But we're very confident also about the innovation pipeline that we're bringing in 2019, in the second half of '19 on our brands. And this is one of our objectives to offset the headwinds.

Operator

And our next question comes from Faiza Alwy of Deutsche Bank.

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

So I wanted to pick up Camillo on the investment in brands. So it looks like the A&CP spending in the year and in the quarter was below last year and below what you talked about historically, sort of around the 25% to 26% of sales. So could you give us some color on the year-over-year decline in the quarter specifically? And also as we think about your outlook for next year, so what are you embedding for marketing spending for fiscal '19?

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

Thanks, Faiza. Look, in terms of the decline for '18, it's fair to say that some of the new businesses that have been now consolidated into -- for 2018, such as ghd, naturally have a lower level of A&CP spend, which clearly reduces the ratio on a year-to-year basis. We're also -- because we're doing other brand relaunches on COVERGIRL and Clairol, as you can imagine we have to allocate more resources into in-store investments. And of course, these type of investments don't flow into the A&CP line. And the third point, I think it's our continuous effort to invest more on digital media, which is typically more cost-effective than traditional media. We do have now over 30% of our media spending that is focused on digital and in some brands we're actually over 50%. So these 3 trends clearly, I think, explain fully the decline that you've seen in the ratio in 2018. Looking at the future, I think based on the strategic plans that we have across brands and division, we would expect A&CP to generally remain in the mid-20s percentage. But I would not get really too, let's say, obsessed about this percentage because there's always room for increases or decreases because we will continue to move money towards the digital media. And at the same time, we will consider higher investment to support. So this sort of dynamic is something that we will manage on a quarterly and annual basis as we see fit.

Operator

And our next question comes from Joe Lachky of Wells Fargo Securities.

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

I was hoping you could walk through the drivers of free cash flow in fiscal '18 and why it came in so far below your expectations? And I guess maybe there was an issue with receivables and inventory, I hoping you could expand on that? And then looking forward, on free cash flow, you specifically mentioned the timing of cash synergy cost, and so you're expecting ongoing pressure on free cash flow into fiscal '19, and what level of free cash do you expect in relation to your original guidance of roughly $900 million to $1 billion in fiscal '19?

Patrice de Talhouët - *Coty Inc. - CFO*

Okay. Thanks for the question. So on the free cash flow in fiscal '18, what you should really be reminded is that first we have made very good progress in terms of payables, because now we have achieved some synergies of $470 million versus the $500 million target. So on this one we have exceeded our expectation. It is true that we were disappointed by a couple of areas, mainly on inventories, it's related to our supply chain disruption. Now what also impacted quite a bit in fiscal '18 is the cash effect of the one-off costs that we have accrued last year, and there is a lag time between the accrual and the cash outlay that has impacted '18 and will also impact '19. And as a result of that, you should factor that into the equation into the free cash flow we will generate in '19 and '20. This being said, for the first time we have clearly laid out a target of what we would like to achieve in the leverage to be a ratio net debt to EBITDA to be below 4 by the end of the calendar 2020.

Operator

And our next question comes from Steph Wissink of Jefferies.

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

We have a question just on the competitive dynamics. I think you among your peers have talked about intensifying competition. Maybe that forces you to lean a little bit more aggressively into your brand investment. Could you just give us a scope of kind of worldwide, what you're seeing in terms of overall competition across channels and then across your different segments? And I'm wondering if you can just talk a little bit more about what you're seeing in market, across particularly your consumer and your Luxury segment with respect to the competitive dynamics?

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

Yes. So if I look -- if I start with Luxury, Steph, I think the competition that the competitive intensity has not changed massively as it's very intense without any doubt. But I'm very pleased to say that we've been growing share across most countries around the world. The performance in Luxury is absolutely excellent, and we are driving share not only with the new innovation, which I mentioned in my remarks, but also by growing share on our classics, on the classic pillars as we say in fragrances, and this is really pleasing. On top of it, we have very high strong growth in China, in Travel Retail, and clearly the rollout of philosophy in Asia and especially in China is also driving our performance.

When I look at Professional Beauty, of course the market remains clearly competitive and very intense. Here what I would say is that we have a couple of dynamics, which I believe are important for us. One is the untapped potential of OPI and ghd is a very complementary product to our go-to-market capabilities, which are very strong in the B2B in the service area. And I think when you look at e-commerce, what is important is that we are also building our own B2B platform with the mywella.com store, which would allow us really to take orders directly online from our very fragmented customer base. And we should not forget also the ghd we have, our own D2C platform on both ghd and OPI, and they are growing very, very fast.

Going on Consumer Beauty, which is also part of your question, this is where we have seen an increase in competitive activity, which is clearly something that we are working through. We have increased our investments, behind COVERGIRL and Clairol. This is something very different from the past, where these 2 brands didn't really receive enough attention. The innovation pipeline is also stronger, and we are confident because we do have a strong innovation pipeline coming in 2019. And we're also very much encouraged by the promising results that we see on digital, where COVERGIRL entered the top 10 in the color cosmetic brands for EMV and also we saw another reports from word of mouth, where COVERGIRL clearly is starting to get traction in the conversation with consumers and beauty experts. So overall, we see intense and competitive but we do have a lot of tools, and we should not forget that within Consumer Beauty, we also want to neutralize these headwinds by also making disproportionate growth and investments in ALMEA, e-commerce and Younique. These are 3 areas or 3 platforms where we have high level of confidence for the future for the reason that I explained before in my remarks.

Operator

And next question comes from Andrea Teixeira of JP Morgan.

Christina Marie Brathwaite - *JP Morgan Chase & Co, Research Division - Analyst*

It's Christina Brathwaite on for Andrea. I guess first circle back to the plan on shelf space. I just want to put a finer point on this question. Are you betting that shelf space continues to contract in the back half of the year in the flat to up like-for-like sales growth? And then second question, can you just talk about your commitment to dividend payment, just given kind of the contraction that you've seen in free cash flow and continuing to decline. Does it really make sense for this level of dividend going forward is even sustainable for your business?

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

I'll answer the first question Christina, and then Patrice will answer the one with dividends. Yes, the risk that we see on shelf space in U.S. is included in our targets for 2019. So that's a simple answer to that.

Patrice de Talhouët - *Coty Inc. - CFO*

Yes. And the second one will be as sweet and short. The dividends, we are going to maintain the dividends going forward. We don't have any plans to decrease it or increase it, but we will keep it flat probably in the foreseeable future.

Operator

And next question comes from Mark Astrachan of Stifel.

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

I wanted to follow-up first on the free cash flow question. So I guess, how should we think about free cash flow generation given, obviously, what happened in fiscal '18 and I think roughly $340 million delta between accrued and paid cost through year-end fiscal '18. So should we expect another year of free cash flow approaching 0 in fiscal '19? Should it improve even if not back to fiscal '17 levels. So any sort of commentary you can give there. And then just a broader question on EBIT margin targets, so you reiterated the high-teens expectation. I guess I don't get it. I mean, spend is going up for just about every one of your competitors out there. I think it's fair to say that certainly from a stock standpoint, most don't believe you can achieve it. So why stick with it at this point? What gives you confidence you can do that without harming the brands of the business, particularly on the consumer side that tend to be more actionable as it relates to the advertising marketing spend. So just sort of any commentary there would be helpful.

Patrice de Talhouët - *Coty Inc. - CFO*

Sure, Mark. So we start with the free cash flow. So on fiscal '19, what you should expect is that first we are going to work on the 2 levers of the working capital that we did not explore to the full extent so far, which are the receivables and inventory. Second, we're going to start to tighten the CapEx because for the time being we have spent quite a bit of amount of CapEx to integrate the 2 businesses together. So that should come back to a more normal level in '19 and even more so in 2020. And third, even more precisely on the one-off what you should estimate is that we expect to have roughly $400 million of cash outlay for our restructuring program that will still impact fiscal '19. And what you should see in 2020 is that as a result of that, you would have the full operating leverage with the working capital improvement, a significant impact to positively the free cash flow. So I would say, '20 will be back to normal, and '19 will still be negatively impacted by the $400 million cash outflow due to the restructuring program.

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

So the second part, Mark, of the question is clearly on the high-teens medium-term target over the next 5 years. So the focus is now clearly for us on enhancing the operating profit. So we will deliver the cost synergies and return the business to the low single digits like-for-like in the revenue growth. So if you take this top line -- this level of top line growth and you combine it with the synergies, the new cost-saving program and the ongoing focus on reducing cost, which will continue even after the synergies are delivered, this basically underpins our medium-term target of achieving the high teens adjusted margin. And when you look at the earnings model underneath, clearly the first thing that we will look at is to sustain an above market topline expansion on Luxury. We believe we can do that. We have a fantastic team with a great track record in the industry but also track record within Coty. If you think the sort of growth and in-market results that we have achieved in the Luxury division over the last 1.5 years, plus we do have a strong pipeline, still a lot of room in geographic expansion, and we have the Prestige skin color and the Prestige color cosmetics, that we still have to develop and we are only at the beginning. When I look at Luxury, clearly you can see has -- is a high level profitability, which will continue to really grow. Professional Beauty is also something that we aim to accelerate. I mentioned OPI and ghd clearly the strength on Wella color, but also there will be operating leverage because we will continue to invest more in digital educational tools and digital sales tools rather than on our current high fixed cost base. And looking at Consumer Beauty, this is what I said before. Our goal is, we recognize that Western Europe and North America will continue to be under pressure and we will work hard to neutralize these headwinds. And of course, trying to grow our share in these regions, but we're very confident in the future in the new markets in ALMEA, in e-commerce and Younique. And Younique has a much higher marginality or margin ratio versus everything else in Consumer Beauty. E-commerce is also proving to us to be a profitable channel and over time, once we build better supply capabilities for e-commerce, this will become even more profitable. And ALMEA, I think at the beginning of course, we are investing in capabilities. But over time, we believe that the margin will start going up, because we will cycle through our investment in capabilities and we will have operating leverage there as well. So I think by explaining to you a bit of the earnings model again, hopefully I've answered your question of why we believe that over the next 5 years, we can achieve the high teens operating margin.

Operator

And our next question comes from Jonathan Feeney of Consumer Edge Research.

Jonathan Patrick Feeney - *Consumer Edge Research, LLC - Senior Analyst of Food & HPC and Managing Partner*

I wanted to ask a bigger picture question, Camillo, and when we go about PG integration. I'm trying to understand what's -- how much of the what's been lost as far as this taking longer than we hoped is permanent versus just changes in the marketplace, a decline in the opportunity available to mass beauty companies, and how much of this is just deferred? And specifically, it seems like you've hit a lot of your integration targets but just been negatively surprised by the evolution of the business. So if you could just comment about when you think about the kind of targets you were thinking about 2 or 3 years ago, do we ever get to those at this point? And if so, when?

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

So I think the first thing that I need to say that a couple of quarters ago I already mentioned that the medium-term targets of higher teens operating margin and I did say that the original targets, which were discussed before the closing of the P&G transactions are not relevant anymore. They're not relevant anymore for a couple of reasons. One is because we have inherited a smaller business, and the second one is because we have faced headwinds and challenges. And the third one is because the organization was designed for a larger business and clearly, with a higher fixed cost base. Hence, the restructuring, the cost-saving program that I'm announcing today with the $250 million of one-off charges. So I think this answers a bit the question on what is our medium-term outlook versus the original numbers that were discussed before the transactions. In terms of your first question, which is are these headwinds permanent or have we lost the piece of business or we wanted to recover. And a lot of this, the business has contracted. First we inherited the small business because when we took it, it was smaller because it took so long that you might remember it was 16 months between the day of the announcement, July 2015, and the day we took over the business, October 2016. And so the business became smaller during that time. And then second, I think that the loss at the decline that we have in Consumer Beauty over the last 18 months, is something that we have to deal with because the market conditions have changed. This is an industry that has rapidly changing. So our focus is to be on the future, has to be on continuing to improve our share and productivity as I mentioned, launching better products to really delight our consumers and invest behind our brands. But at the same time, we've got to make smart choices, right. So ALMEA, Younique, e-commerce, these are the areas with high marginality that we need to invest because there is a lot of growth opportunities there.

Operator

And next question comes from Olivia Tong of Bank of America.

Olivia Tong - *BofA Merrill Lynch, Research Division - Director*

Just on COVERGIRL, a quick one. The supply chain disruptions you talked about. Is that on the new stuff or is it clearing out old inventory? And at this point are you done getting the old inventory out on COVERGIRL? And then my bigger question is just around your low single-digit like-for-like growth and better understanding your expectations and contribution by division. I'm assuming that you think that Luxury and professional continue to grow at a similar run rate in fiscal '18. But I also am kind of a little confused in terms of your view on Consumer Beauty. Is it -- is your expectation that it continues to decline, but decline at a lesser pace or that it actually stabilizes flat? Just given all the volatility and growth in the June quarter, it would be helpful to just understand your view on the growth potential by category.

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

Olivia, this is Camillo. Sorry again. I got all of your question. So the first one is on COVERGIRL inventory, so first of all let me clarify something. The supply chain disruptions happened because, as you know, as part of the transition we're consolidating the full -- we're optimizing the full supply and logistics footprint. And one of the things we're doing, we're consolidating planning centers. So one of the planning centers that mainly do color cosmetics in the U.K. they were disrupted, which means the capacity was affected and this is why we had this disruption, which as I said will continue with the heavier impact in Q1 2019. COVERGIRL was not impacted a lot by this, this was mostly on Rimmel and Max Factor and in other smaller brands. So I just want to reassure you that the supply and disruption doesn't relate to COVERGIRL. And to answer your second question, the inventory sell-through of the old stock, so the sell-through of the old stock of inventory of COVERGIRL is almost finished, it's going through towards the end because now all the new packaging I would say by December, end of calendar '18, we should have all the new packaging for all SKUs on shelf. Now your other question is how we have mentioned the target for 2019 of low single digits like-for-like in the revenue growth. So let me tell you how this is composed of it. So as you rightly so said, we expect strong growth from Luxury and Professional Beauty. I did mention before why we are confident about this division continuing to deliver above market performance and therefore gaining share. And regarding Consumer Beauty, our goal is to mark and have a progress towards stabilization. So yes, better performance than the minus 4% that we had in 2018 but not necessarily enough to stabilize the business already 2018. But the dynamic within this progress or this Consumer Beauty target is truly by also neutralizing the headwinds in North America and Europe by over-proportionally investing in ALMEA, Younique and e-commerce. The results that we saw in ALMEA, because if you exclude Brazil, ALMEA grew double-digit in Consumer Beauty, and the results that we have in Younique and clearly the results in e-commerce that I mentioned today really give us confidence that these earnings model can work and bring Consumer Beauty to make progress toward stabilization.

Operator

And the next question comes from Linda Bolton-Weiser with D.A. Davidson.

Linda Ann Bolton-Weiser - *D.A. Davidson & Co., Research Division - Senior Research Analyst*

So when you originally bought your Brazilian business, my understanding was that it would help you to penetrate into Brazil with some of your other mass market brands. Is that still the plan long term? And has any progress been made at all in trying to use that positioning in Brazil to expand some of your other brands into that market?

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

So thanks for the question, Linda. Absolutely, I think Brazil remains one of our powerhouse within Consumer Beauty. And I mentioned before to one of the earlier question from Lauren, about the continuing market success, which gives us confidence for 2019 and beyond about Coty, Brazil and the Consumer Beauty. Looking at our portfolio, I think it's important, 80% of our portfolio there is made by local brands. And these brands really -- brands, which are loved by consumers. And the good news is that they are always smart buys, because the acquisition is lower than the international brands. But they're also -- we're now also investing in innovation, packaging, in consumer connection by doing advertising. So we are actually treating and supporting our brands in a different way on how it was done before. Now our plan to increase price will also help us to improve profitability in Brazil, which will allow us to continue with our plans. Looking at the international brands, the 2 main brands really that we have there. One is Wella in hair retail, which clearly we acquired from P&G, it's the #2 brand there in hair color in retail. And the second one is adidas, and adidas is actually the brand that we have been developing for the last year, which was not recognized in Brazil before, clearly, the acquisition of the other markets company. And that is one of the answer to your question about how we're using some of our global brands in Brazil, using the footprint there. And of course, we will consider more in the future.

Operator

And that concludes our question-and-answer session for today. I'd like to turn the conference back over to Mr. Pane for any closing remarks.

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

So I would like to make a couple of closing remarks. So first, I would like to thank Patrice one more time and wish him well in this next chapter. Second, I would like to reemphasize the importance of the earnings model that I've gone through today, which will underpin our medium-term target. We look for Luxury to sustain its above market top line expansion, Professional Beauty to accelerate growth and maximize the untapped potential of OPI and ghd. And in Consumer Beauty, to stabilize their division top line and improve the bottom line. We recognize that Western Europe and North America will continue to be under pressure due to declines in traditional mass retail channels, but our target is to neutralize these headwinds by improving our share performance in these regions and most importantly by driving aggressive growth rapidly in expanding markets, as well as growing channels like e-commerce Younique. We are incredibly energized and excited about the year ahead, and I look forward to talking to you again in November. Thank you very much.

Operator

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

THOMSON REUTERS