

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

COTY - Q1 2018 Coty Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 09, 2017 / 1:00PM GMT



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

CORPORATE PARTICIPANTS

Camillo Pane *Coty Inc. - CEO & Director*

Kevin Monaco *Coty Inc. - SVP of IR and Treasurer*

Patrice de Talhouet *Coty Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

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

Christopher Michael Carey *BofA Merrill Lynch, Research Division - Research Analyst*

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

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

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

Jonathan Patrick Feeney *Consumer Edge Research, LLC - Senior Analyst*

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

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

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

Rosie Edwards *Berenberg, Research Division - Analyst*

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

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

PRESENTATION

Operator

Good morning. My name is Andrew, and I'll be your conference operator today. At this time, I would like to welcome everyone to Coty's quarterly earnings conference call. (Operator Instructions)

I will now turn the conference over to Mr. Monaco. Mr. Monaco, you may begin your conference.

Kevin Monaco - *Coty Inc. - SVP of IR and Treasurer*

Good morning, and thank you for joining us.

On today's call are Camillo Pane, Chief Executive Officer; and Patrice de Talhouet, Executive Vice President and Global Chief Financial Officer.

I would like to remind you that many of our comments may contain forward-looking statements. Please refer to our press release and our reports filed with the SEC, where we list factors that could cause actual results to differ materially from these forward-looking statements.

All commentary on organic net revenues reflect the comparison of Legacy-Coty and the P&G Beauty Business on a combined net revenue basis at constant currency in both the current and prior year periods, excluding the impact of acquisitions other than the acquisition of the P&G Beauty Business.



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

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

I will now turn the call over to Camillo.

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

Thank you, Kevin, and welcome, everyone, to our fiscal 2018 first quarter earnings call.

Q1 was a much better quarter. We saw strong growth in Luxury, continued positive momentum in Professional and a reduced net revenue decline in the Consumer Beauty division. We delivered significant improvement in profits, driven by better gross margin performance and strong financial discipline on the cost structure. We also continued making meaningful progress in our merger integration and I'm glad to announce that, as of September 1, we have exited our third and final TSA for the ALMEA region.

Starting with Luxury. This was the third consecutive quarter of positive top line growth. Luxury revenues increased 4% on an organic basis, driven by successful innovation pipeline, excellent performance from several brands and best-in-class in-store execution behind our launches leading to double-digit growth in several countries.

We also introduced 2 successful major new products this quarter: Gucci Bloom and Tiffany's debut fragrance. Gucci Bloom was the best fragrance launch ever in Macy's, the biggest Coty launch ever in Harrods and the top 2 new product launch in every retailer we launched globally. The Tiffany's launch was the biggest opening day and first week in 5 years at Bloomingdale's and has been a top seller at several other key retailers globally, including travel retail.

Our growth in Luxury is not limited to new launches. In fact, philosophy had a very strong quarter, growing net revenues double digits, driven by strong sell-through in the U.S., both in the retail channel and direct-to-consumer. Additionally, we also launched new campaigns for Hugo Boss and Marc Jacobs Daisy, which are driving very healthy growth in these pillars. These are clear results of what the new Coty is able to achieve.

In our Professional division, the first quarter marked the fourth consecutive quarter of positive growth with net revenues increasing 1% organically. Our hair business grew across all regions and we are seeing continued strong momentum on Wella Professionals, particularly in color. In addition, System Professional continues making good progress on its global rollout, growing double-digits in the quarter. Additionally, OPI has continued to grow in North America, with the international markets being our next area of focus.

Consumer Beauty net revenue declined 8% on an organic basis and this remains a key focus for us. The decline was driven by declines in some of our brands, particularly retail hair, combined with continued weakness in the global mass beauty market. Although I'm not happy with the Consumer Beauty division performance to-date, I'm starting to see signs of a stabilizing business. We're achieving this by actively engaging with retailer customers to amplify the in-store shopping experience to drive category growth, working on accelerating our time to market with on-trend collections and new products, accelerating our end-to-end digital transformation and driving our e-commerce efforts.

For instance, in line with our goal to be faster to market, we were able to bring Clairol's recent Color Crave, the hair and makeup innovation, to market in just 6 months. Where available, this exciting new product has outperformed its main competitor and, as such, we expect to see increased shelf space and location which, coupled with the game-changing innovation coming to Clairol in the second half, should further boost the brand.

While we continue to address challenges in North America and Europe, ALMEA continues to have several bright spots with highlights in Mexico, Australia and Brazil. Speaking of Brazil, this business continues to be a standout success story for Coty. Our year-to-date sellout is growing at double the rate of the underlying market. With a strong pipeline of innovations in our local and global brands, we remain confident in this story. And as an example, we just became the second-largest player by volume in the deodorant market, doubling our share in 18 months after increasing our focus on this segment 3 years ago. I'm extremely proud of what we've accomplished in Brazil and believe it's a clear example of what the company is capable of achieving via strategic M&A and focus on execution.



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

As you know, we are also preparing the relaunch of several brands and the recently announced COVERGIRL relaunch is another example of the strength of the new Coty. The brand's new statement of purpose, "I Am What I Make Up", is COVERGIRL's biggest reinvention in its 60-year history. Our powerful relaunch film featuring 6 boundary-breaking and cultural change agents COVERGIRLS result in outstanding 4.1 billion impressions and 11 million views in a matter of few days. I'm looking forward to sharing more good news in the second half of fiscal 2018 as the products and fixtures are rolled out in stores.

We expect the combination of these brand initiatives, improving the market execution and consumer-focused communication strategy to support the gradual improvement in Consumer Beauty revenue trends. As I said before, it will still take time for the full recovery of the Consumer Beauty division.

These positive results are directly linked to the growth strategy we've been articulating to you in the past several quarters focused on repositioning select brands in order to reconnect them with consumers, building on their already strong brand equity; making significant changes to our innovation and product development process in parts of the organization driven by faster and state-of-the-art execution; accelerating our end-to-end digital transformation, including e-commerce; collaborating even more closely with retailers to significantly ramp up our in-store execution.

I want to be clear that there is still much work to be done to achieve our goals. We have only just started this journey and fiscal 2018 will be the important milestone in this regards. After we put the foundation of the new Coty in place, we expect this year to be one of stabilization. And while results are likely to be uneven from quarter-to-quarter, the improvement in revenue trends give me confidence that the growth strategy outlined above is moving Coty gradually into the path of full recovery.

With regards to our cost control, following the disappointing fourth quarter, I told you that we would make the issue a top priority, and we have. This quarter, our management team put in place a number of initiatives to deliver meaningful sustainable expense and cost management results as part of our synergy program, which is expected to lead to healthy improvement in our adjusted operating income over time.

I want to also highlight the positive results we are seeing from our M&A strategy. I'm pleased to say that Hypermarchas is driving very positive results in Brazil, where we were previously lacking scale, and ghd is bringing complementary technology and products to our Professional division.

Yunique is another example of a great addition to the new Coty. From day one, Yunique has been a purpose-led business focused on empowering women. Moreover, Yunique's successful positioning at the intersection of social media and e-commerce is a best-in-class example of how brands can best connect with customers, a central objective for Coty as we work to reposition several of our key brands. The continued growth in Yunique Active Presenter base, which has increased nearly 20% since we began our partnership, coupled with the continued strong double-digit top line growth, is a testament to the ongoing success and viability of this business model.

These strategic and complementary additions to our business fit our M&A criteria. And overall, our acquisitions have performed very well. Further, the recent Burberry acquisition complements our expertise and leadership in luxury fragrances, accelerates our presence in the premium category and provides a strong platform to enter into the fast-growing prestige color cosmetic category.

All of these plans, launches and accomplishments would not be possible without the new culture and mindset that we worked so hard to nurture at Coty. Our new value of own it and drive it, which focuses on accountability and execution, will be one of the keys to delivering sustainable growth and industry-leading margins over time. We also have a great company purpose of celebrating and liberating the diversity of your beauty, which has been received extremely well by our employees and which distinguishes us in the industry. At Coty, we have decided to take a stand to fight prejudice with a specific focus on ethnicity, disability, sexual orientation and gender inequality. And I'm excited that we have partnered with Global Citizen to fight the prejudice and discrimination that creates barriers to self-expression, individuality and inclusion.

Looking ahead to the remainder of fiscal 2018, we expect to continue to deliver on our announced synergies, finalize the streamlining of our brand portfolio and relaunch several of our key brands. With this program, we aim to deliver improved net revenue growth trends for the remainder of the year with an organic second half decline roughly comparable to prior year as well as a healthy margin improvement over the balance of the year.



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

In closing, while there is much work to be done, I firmly believe our strategy is working and I'm confident that all our efforts will lead to Coty becoming a new global leader and challenger in beauty.

I will now turn the call over to Patrice.

Patrice de Talhouet - Coty Inc. - CFO

Thank you, Camillo, and good morning, everyone.

Q1 was a much better quarter with all key metrics, revenues, growth and operating margin and operating cash flow making progress.

Before further elaborating on our results, let us start with our integration plan. After an enormous amount of work by our very dedicated team, I am thrilled to announce the successful exit of the third and final stage of our Transition Service Agreement with P&G in the ALMEA regions following our exits from North America in May and Europe in July. This is an important moment for the new Coty as we now have control of our data, processes and systems. With TSA behind us, we will now work on the completion of the integration to fully leverage the simplified and optimized infrastructure, continue to stabilize the combined business and build on some of the momentum we are seeing across the portfolio.

As Camillo already mentioned, we significantly increased our efforts on the cost structure as part of our existing synergy program with many ongoing initiatives, from significantly strengthening cost control measures on expenses, consolidating commercial office facilities to gain scale and efficiency and deploying a number of global centers of excellence teams to help optimize our local operations, including the streamlining of our field sales force. Some of these initiatives, in addition to the continued execution of our growth strategies across our business lines, have already led to tangible signs of progress during the first quarter, when our overall profitability made good progress even though the bulk of our synergies from the P&G Beauty merger have yet to be achieved. Our focus now is on driving consistent profitable growth across our business while maintaining a very strong cost discipline in order to achieve our ambition of best-in-class operating margin. Indeed, it is fair to say reaching best-in-class operating margin is what is driving our business decisions.

Now, onto our results. First quarter net revenues were \$2.2 billion, a 107% increase versus last year, largely attributable to the acquisition of the P&G Beauty Business, while our organic net revenues declined 2%. Adjusted gross margin was 61.6%, representing a 280 basis point improvement year-over-year, the fourth consecutive quarter of increase, driven by supply chain and procurement synergies as well as our acquisition strategy.

A tight financial discipline allowed us to generate an adjusted operating income of \$195 million, well above Coty stand-alone, with a 17% growth resulting in a 9% adjusted operating margin. The increase is even more pronounced if we take into account that the inherited business from P&G was loss-making in Q1 prior year. This improved operating profit performance is good evidence that we are taking our operating margin ambition very seriously.

Interest expense of \$66 million reflects higher debt balance incurred as part of the financing of the P&G Beauty, ghd and Younique transactions. Our effective tax rate of 27%, in line with expectations, result in an adjusted net income for the quarter of \$76 million or an equivalent adjusted earnings per share of \$0.10, ahead of expectations.

We continue to achieve strong working capital improvement to free up cash to deleverage the business. Our averaging -- our average working capital was negative for Q1 and we believe there are still some more working capital improvement to come.

During the quarter, we also continued to return cash to shareholders, paying \$94 million in dividends.

I'd like to add a few additional details to our performance in our 3 divisions. First, in Luxury, our gross margin in the first quarter has improved thanks to accretive innovation and good productivity improvement in the supply chain. This, combined with a strong emphasis on our cost structure, delivered an adjusted operating income of \$90 million, roughly in line with the prior year, while absorbing the losses of the inherited P&G business. We are positive about the momentum as our investment behind innovation and new marketing campaigns began to bear fruit this year.



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

Our Professional division revenues grew moderately with the gross margin slightly improving and an adjusted operating income of \$17 million. The level of profitability has been impacted by the ghd seasonality, Q1 being the lowest quarter of the year from a revenue standpoint.

Despite the revenue challenges in Consumer Beauty, adjusted operating income increased 54% to \$88 million, resulting in a 9% adjusted operating income margin due to structural improvement in our gross margin as well as the continued success of Younique, which maintained double-digit top line growth while continuing to be accretive to overall margins.

Finally, as said before, we continue to focus on pursuing rationalization, whether via divestiture or discontinuation, of 6% to 8% of the combined portfolio, which we expect to announce by the close of fiscal 2018. This initiative should help to improve our revenue growth trajectory over time.

To conclude, this quarter has put an important milestone behind us with the successful TSA exit. We are now focusing on building our new foundation to match our ambition of being a serious challenger and delivering best-in-class operating margin. As Camillo said, we aim to deliver improved net revenue growth trends for the remainder of the year as well as a healthy operating margin improvement over the balance of the year with a more pronounced positive impact in Q4 thanks to synergies delivery and favorable base comparison.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Joe Lachky.

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

I'm with Wells Fargo Securities.

Could you talk about your long-term EPS target and whether you still expect to hit \$1.53 in EPS in fiscal 2020? I mean, obviously, you've seen some unexpected weakness in the business since you laid out those goals. I was wondering how much underlying improvement you'll need to hit the target. And I was also wondering how aggressive you plan to be with M&A in order to achieve your EPS goal and what other balance sheet activities you might consider using to get there.

Camillo Pane - Coty Inc. - CEO & Director

Thanks for the question, Joe. Let me start by reiterating what Patrice said, which is that our long-term focus is on achieving best-in-class sustainable operating margins. And this is in line with our investment thesis that we referred in our roadshow at the time of the merger. And this is how we are making business decisions.

Now, it's fair to say, as you know, that we have inherited a business which was smaller in revenues, but not in SG&A and, therefore, smaller in operating margin than our expectation at the time of the roadshow. And because of this, when you combine also with the business challenges that we have faced last year and our better visibility into the aspect of the business that we have now since we exit the TSA, we believe that it will take us longer to get to the \$1.53 even with our objectives of best-in-class operating margin of higher teens.

Patrice de Talhouet - Coty Inc. - CFO

Yes. And let me reinforce that reaching high teens as the best-in-class operating margin is our primary objective and our announced synergies are one of, if not the most important, milestone to get there.



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

Let me also add to what Camillo has just said and as we have said in the previous calls, that in order to achieve our EPS targets, we may also use different levers over time, including our balance sheet for strategic accretive M&A. And as you know, it's very difficult to put a precise timetable on an M&A agenda.

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

That's fair. And you touched on the progress you're making in addressing the high fixed cost issue that emerged last quarter, but I wonder if you still expect that to be a headwind going forward. And maybe if you could expand on some of the specific actions you've taken in Q1 or plan on taking in fiscal '18 outside of synergies in order to reduce fixed costs. And then, finally, along those lines, do you think you need top line growth or at least top line stabilization in order to fully rationalize your cost structure?

Patrice de Talhouet - Coty Inc. - CFO

Joe, so that's a lot of questions. So let me try to take one after the other. So first, on the cost structure, so we told you that we will make this issue a top priority, and we have. This quarter, the management team has put in place a number of initiatives to deliver meaningful sustainable expense and cost management result as part of our synergy program, which is expected to lead to a healthy improvement in our adjusted operating income over time.

So what we have done is to significantly strengthen our cost control measures on expenses. We have also taken some measures to consolidate some commercial office facilities to gain scale and efficiency, as I said in the script, and also deploying a number of global center of excellence teams to help optimize our local operations, including the streamlining of our sales force. So some of these initiatives have already led to tangible signs of progress in the first quarter and we are going to make some further progress in the year to come, and overall profitability will make good progress even though, as we said before, the bulk of our synergies from the P&G Beauty merger have yet to be achieved and are more second half of the year skewed.

It's also fair to say that I'm not sure that the Q4 was a good benchmark. Q4 results reflected certain nonrecurring costs that were not included as onetime. For example, there were a number of Coty employees who were not fully dedicated to the integration, but who worked somehow on the integration part time, and we did incur some costs related to supporting the TSA exit. So now, all of this is over because we have successfully exited all the TSA and now we can really focus on driving the business going forward.

Operator

And our next question comes from the line of Faiza Alwy.

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

Yes. It's Deutsche Bank.

So Camillo, I just wanted to talk to you a little bit more about your organic growth expectations for the back half and your level of confidence on that. So perhaps if you could talk a little bit more about COVERGIRL. How much of this is dependent on the COVERGIRL relaunch? What your expectations are for gaining shelf space versus is it just better velocity at existing retailers or are you expecting sort of increased shelf space or additional sort of distribution volumes? And then, how much of this is, perhaps, e-commerce-dependent?

Camillo Pane - Coty Inc. - CEO & Director

Okay. I'll answer all your question in more or less the order you asked me, okay? So, regarding the outlook, we expect to continue to deliver on the previously announced synergies. We're going to finalize on the streamlining of our brand portfolio and relaunch several of the key brands. And I'll



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

get to the relaunching in a second. Now, if we take all these programs together, we aim to deliver improved net revenue growth trends for the remainder of the year, as I said, with an organic second half top line roughly comparable to prior year, which means roughly flat.

And when I look at the different programs that we're doing, clearly we have an improvement in the revenue trends of Consumer Beauty. That is part of the objective that I just discussed. And within Consumer Beauty, we have a couple of relaunches which are quite important. The first one is the COVERGIRL, which we just announced in October. And I mentioned an early very positive sign of reaction from the market on COVERGIRL. But we also have the relaunch of Clairol. On Clairol, we just launched a product called Color Crave, which is a hair makeup product, which we launched off the classical shelf reset windows with the U.S. retailers. And clearly, we expect to gain some shelf space with this product once it's able to go in the normal shelf, plus we are going to also launch a second big innovation on Clairol in the second half of fiscal '18 and, therefore, we expect these 2 relaunches to help us improving the net revenue trends of Consumer Beauty.

Looking at the shelf space, I think it's important to remind that the shelf space decisions that impacted us were made prior to our acquisition of the P&G Beauty Business, and the impact of those decisions continue to impact our results today and will continue for a while because we need to annualize those decision the second half of 2018. And you know that not all the retailers redo their shelf at the same time. But based on encouraging conversations that we had with retailers regarding the restaging of the COVERGIRL and Clairol and other various brands, and also sharing our innovation pipeline, we believe that we should retain most of the space for our key brands.

And the last question, I think it was e-commerce. E-commerce is important for us. It's an area of focus for me and for the business. I already mentioned this in previous calls. And we don't disclose e-commerce sales, but I can confirm that we're growing at a healthy above-the-market rate in both our Consumer Beauty and Luxury division, although from a low base. I hope that I have answered all your questions.

Operator

And our next question comes from the line of Olivia Tong.

Christopher Michael Carey - BofA Merrill Lynch, Research Division - Research Analyst

It's Chris Carey on for Olivia with Bank of America Merrill Lynch.

So I just wanted to follow-up on that question around Consumer Beauty, specifically on the retailer hair color side. So like, what do you think is needed to get this business turned around? Obviously, you just mentioned some launches planned for the back half, but it seems like the category as a whole remains somewhat challenged. And connected to that, can you maybe frame the ability of Consumer Beauty to return to organic sales growth if you don't get the requisite lift from the retail color?

Camillo Pane - Coty Inc. - CEO & Director

Talking about retail color, I think there is a couple of things. One of the things that I did mention in the past is this category has been always treated very, very functionally by everybody and I think this needs to be treated more as a beauty category. Now, this transformation is not immediate. And regarding our brand, Clairol, this has been a brand that didn't receive a lot of investment attention for many years, and I did refer to this brand in the past as a neglected brand.

So from our point of view, we have a much stronger pipeline. I did mention one of the launches that happened in the last few months and I did kind of give you a preview that there's going to be a big launch coming in the second half of '18, but I believe that we have a very strong pipeline which covers both the functional and the beauty area, or the beauty part, of this brand and this category. And I think that our plans are strong and that's why we believe that, over time, we will be able to recover lost ground on this brand and really come back to much more positive performance. So I believe that the experience in the store and innovation are both part. And clearly, you have the communication, so the positioning. This brand also requires a bit of a different way of communicating to consumers, and we are working also on the relaunch from that point of view coming in the second half of '18.



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

Looking at Consumer Beauty, which is what you mentioned, as I said, because we're doing all this, we believe that we have a solid strategy in place and we are excited about the relaunches of several of our Consumer Beauty brands. And that's why we aim for the net revenue trends to improve over the year. But as I said, it will still take time for a full recovery of Consumer Beauty.

Christopher Michael Carey - *BofA Merrill Lynch, Research Division - Research Analyst*

Okay. Got it. And then, if I could, just one follow-up just in the context of your comments around the mass beauty market being sluggish. Can you talk about your ability in M&A to trade up the portfolio and maybe capitalize on growth opportunities in prestige?

Patrice de Talhouet - *Coty Inc. - CFO*

So on the M&A front, what I would say is that, for the time, clearly, there are some opportunities, but for the time being, our main objective is to make sure that the new Coty is delivering its ambition of best-in-class operating margin on an organic basis. And we are really focusing on deleveraging the business. So that's the current priority, that's what we're currently working on.

What you should also think about is that Younique, at one point in time, is going to come on the like-for-like basis. We are going to anniversarize the partnership with Younique and that is clearly a tangible sign that, first, we are shifting the portfolio, the growth profile of the portfolio. And this is clearly going to impact positively in the second half of the year.

Operator

And our next question comes from the line of Dara Mohsenian.

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

It's Morgan Stanley.

So in the release and here on the call, you mentioned the path to full recovery. Can you give us a bit more detail on what full recovery means exactly from a top line standpoint? Do you expect to maintain share in your product categories when you look out longer term? Do you expect to gain share? And also can you give us an update on what category growth is now on a weighted basis when you look across your geographies and product categories based on trends the last couple of quarters?

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

Look, full recovery, as I said, we are defining as 2018 as a year of stabilization and that's why we believe that our sales in the second half will be roughly comparable with previous year, roughly flat. And in terms of category growth, we believe that we are exposed more or less to around 2% of growth. So over time, we expect, of course, to generate a similar level to the category growth and then, over time, to grow share as well and become overperforming versus the market that we are exposed, but we're not going to put a time line behind this path. What is important is, for us, that 2018 is giving us signs, is making us confident about stabilizing the business so that we can, therefore, take it from there and go to the next step.

Patrice de Talhouet - *Coty Inc. - CFO*

Yes. And to complement on that, Dara, when we speak about full recovery, we are already seeing some pockets of growth and we have already 2 legs out of 3 that are growing. The Professional Beauty business is already growing since a couple of quarters. You have Luxury that is having a very good momentum and we have commented on that and we see this momentum is continuing. Now, as Camillo said, what we need is to focus



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

on Consumer Beauty and here also we see some good signs. So the full recovery means that the 3 divisions will be in a much better shape and able to fight back. So that's what we mean by full recovery.

Operator

And our next question comes from the line of Wendy Nicholson.

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

With Citigroup. I have, I think, 3 very simple and short questions. First, with the rollout of COVERGIRL, the new products coming, as we turn into 2018, do you expect inventory destocking to negatively impact the trends in that business? Or is it just going to be a "one in, one out" type of program, let's say, over the next couple of quarters? Second on Burberry. When should we start to include some sales from Burberry in our model? And how much inventory destocking do you think there might need to be of that from its prior distribution? And then just lastly, the M&A -- the 6% to 8% of your revenues that you expect to sort of announce plans to get rid of, is that going to also lead to a 6% to 8% reduction in your EPS? Or do those brands or businesses have lower margins than the rest?

Camillo Pane - Coty Inc. - CEO & Director

So taking your first question, Wendy, in terms of rollout of COVERGIRL. Yes, there will be some inventory destocking in the coming quarter, preparing for the arrival of all the new products, the new packaging, the new visuals on the shelf. And in terms of how we are implementing this launch, there will always be some part of the brand that will have the new innovation pipeline, which will be in and out, which means it's going to be a cut, right? And then the rest will probably be more of a phase-in. And you can understand why, depending on cost and inventory and on implementation as well. And in terms of your second question was about Burberry and regards to the inventory and when we expect some sales. As you can imagine, we only became the owner of Burberry, so we are in the process of understanding the level of stock that is in the market, so we're not able to make any comments about it. And so we expect to prepare our plans, which we're already preparing, which will be strong plans. And at some point, clearly, we will start recording sales. But I don't have a visibility to give you about the exact month when we will be able to do that because exactly of the questions you ask on the stock. Regarding the third question, Patrice, do you want to take the one about the 6% to 8%?

Patrice de Talhouet - Coty Inc. - CFO

Yes, so the 6% to 8%, as we said, we are going to finalize this by the end of this fiscal year, this fiscal year 2018. And so we did not comment about the profitability so far of these brands and the potential EPS impact. The only thing that we said so far is that we intend to target and to offset any earnings dilution from this portfolio rationalization with the acquisition that we have made, Younique, ghd, and the Burberry Beauty license. But we did not yet comment on any timing on that.

Operator

And our next question comes from the line of Jason Gere.

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

It's KeyBanc Capital Markets. Just 2 questions. One, if you can go back to Consumer Beauty. Just while you're going through the restage of COVERGIRL, some of your peers are doing restages as well. So I was just wondering if you could talk maybe about the merchandising dynamic, the promotional expense, the cost affiliated with that. While store traffic is a little bit softer, others are trying to do the same thing you're doing. What gives you the confidence that you will see that improvement that comes through while your peers are doing the same? And then secondly, just on the Professional business. I think that was -- I think you talked about e-commerce really kind of in Consumer Beauty and also in Luxury. But on the Professional side,



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

are you seeing anything that the trends may shift a little bit more away from specialty retail to online? Is that something that you're engaging in, in terms of driving some of the growth in the Professional side? I know there's a lot of new technology and apps where people can actually see what they look like with hair coloring, styles, et cetera, without actually having to go in into the store. So I was just wondering if that's something that you're seeing or something that you're actually contemplating.

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

Thanks, Jason, for the questions. So regarding the restage of COVERGIRL. As you can imagine, it's a complicated restage. We have over 60,000 doors in the U.S. -just in the U.S. -where COVERGIRL is distributed. So it's a complex one. But so far, everything that we are preparing is absolutely being prepared very well, and it's going in the right direction. And yes, we're going to have an inventory reduction, as I said before in my previous answer, because that's what we're going to do to ensure that the arrival of all the new products, the new packaging, will feed faster and will phase faster into the beauty bars, the walls. And what I can tell you why we're confident is, look, since we announced the restage with the new positioning the reaction has been truly, truly positive. I mean, we did something in terms of the positioning that is absolutely relevant. And when we talk about freedom of self-expression, when we talk about creating an evolution of you with makeup, but this is truly having the right reaction. But the one that makes me more confident is reaction of our retailers, the customers, our partners. They are also the ones that are telling us that the way we are preparing this is absolutely superior to anything that has been done before by Coty. And I guess also they have visibility over what they see in the market from other brands. And this reaction makes me confident, of course, that we're going to have an increased productivity once we're able to bring the new SKUs and the new visuals in the stores as well. Your second question, I think, was about e-commerce in Professional Beauty. And look, yes, I did mention healthy growth above-market rate in Consumer Beauty and Luxury, because that's really very good. In Professional Beauty, we also have a growing e-commerce business. It's smaller, because, as you can imagine, Professional Beauty is mostly focused on salon professionals -so hairdressers, manicurists and so on. But there has been some shift as well because some of the channels are blurring. So we're working actively in this area as well. And you mentioned an app to look at how you look and, therefore, being able to look at yourself, you choose the right shade and so on. We have something absolutely like that on our brand Clairol, which is going very well, because it's absolutely one of the new way that consumers are want to engage with brands, and we have absolutely some of this technology as well.

Operator

And our next question comes from the line of Lauren Lieberman.

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

It's Barclays. I was curious, the debt went up like over \$600 million sequentially, and so I just -- I'm not sure why. I'd love to get some color on that. I think Burberry is around \$200 million and would have happened in October. So curious about the debt level. And then just any other kind of general comment you can give us on being able to delever. Working capital's already negative, so -- which is super-impressive, but just not sure how much more that can be a source of delevering. So I'd love some color there.

Patrice de Talhouet - *Coty Inc. - CFO*

Yes, so actually to answer your first question. So that was really mainly related to the Burberry acquisition and to the related cost of this transaction. So that's really mainly Burberry related.

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

Yes, I think your second question, Lauren, was about the net working capital already negative, which is very good. This is a strong achievement, and we're very proud. And we're also confident that we have a bit more to go on net working capital, and we keep working on it. I think, as we said, we're still at the beginning of our journey. And we're putting in place a series of ideas and actions to improve this. So I think there is a bit more to come.



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

Patrice de Talhouet - *Coty Inc. - CFO*

Yes, and to give a little more color about that, Lauren. So, as you know, we have \$500 million synergies on the working capital. We have achieved roughly 1/3 of that so far, so it is still 2/3 to come. And this was mainly by using the levers of payables, which is on a more long-term basis. We also have to work on our inventory level. So I think it is fair to say that we still have some margin for improvement in working capital. And in Q1, what we achieved is, on average, a negative working capital, but we plan to continue on that topic. Clearly, there is still I'm quite positive about our cash flow generation.

Operator

And our next question comes from the line of Steph Wissink.

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

With Jefferies. It's a 2-part question. One is just clarification on the organic growth comments in the second half. I think, Patrice, you mentioned that Younique becomes organic in the beginning of February. Just give us some clarity on is that organic comment of stable including Younique? And then secondly, in the release, you mentioned just quarter-to-quarter variability in how the performance might play out this year. I'm wondering if you're willing to give us a bit more clarity on Q2, and then the comments that you made Q3, Q4 balance, sounds like a bit more Q4-focused. So maybe just some color on what you expect to see variability wise quarter-to-quarter.

Patrice de Talhouet - *Coty Inc. - CFO*

Yes, so I can -- so thanks for the questions, Steph. So I can start to answer the first one, and then I will leave Camillo for the second part of the question. So you are absolutely correct. So the like-for-like is going to include our M&A at one point in time, at the time of the anniversary. So for Younique, it's clearly going to impact Q3 going forward. So on this, that is absolutely correct. It's going to impact 2 months of Q3 and then the full Q4.

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

Yes, I think your second question regards -- it's more of a quarterly outlook, which we really don't do. What I can tell you is -- as we said, is -- we're going to -- we want to -- we aim to see an improved net revenue growth trends for the remainder of the year. And in the second half, our top line, we aim to be roughly flattish or comparable to the previous year. Now when you look at the healthy margin improvement which we aim to have over the balance of the year, this is where we aim. We expect to have a more pronounced impact in Q4 given the lower base of last year.

Patrice de Talhouet - *Coty Inc. - CFO*

And the impact of the synergy also in Q4. So that's the combination of the 2. That's the reason why we mentioned with a more pronounced impact in Q4.

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

On the margin, yes.



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

Operator

And our next question comes from the line of Andrea Teixeira.

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

It's JPMorgan. So just to circle back on your commentary I understand that you don't want to give us the cadence, but just like what you just mentioned to clarify on the destocking of COVERGIRL. So thinking about the second quarter, it seems like you're implying that it could be worse than the first quarter. Is that fair to say that it's -- part of it is this destocking, with the 60,000 doors being restaged? And if you can also comment on the general deceleration of the industry, especially specific to color cosmetics in -- and some of the -- some of your retailers trying to push more into private label. And then related to -- the related -- my related question would be the money behind brands and related to top line. So we saw this SG&A growth in the first quarter was even higher than the fourth. And -- can you talk a little bit about the drivers here? What this primarily related to the TSA? And how should we be thinking about SG&A going into the second quarter and third quarter, in particular? So I understand that you're lapping the initial integration of P&G, but there's still about 30 percentage points delta between the growth then and now, so we were just trying to kind of make the bridge there.

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

So Andrea, on your first question, which is the destocking in Q2. This -- sorry, this refers mostly to clearly some of the activities and the relaunches we're doing in the Consumer Beauty division. And it's true, we will have some destocking, but we still expect the net revenue trends of Consumer Beauty to improve as a trend over the year and in the next quarters, starting from Q2. Regarding your second question, which is more of a question about the U.S. mass channel, you mentioned color cosmetics. Mass channel is a really important channel for all the beauty players, and there has been some shift clearly in the way the consumers shop brands, e-commerce, specialty stores and so on. But there will always be a place for products with a strong value proposition, so for beauty brands with this characteristic. And so our focus is truly to build closer partnership with the retail customers and ensure that we create an amazing consumer experience in store and online. So this means right assortment, it means faster innovation, it means -- yes, yes, speed to market and so on. So that's where our focus is, and we're working with our retail partners to really bring back up the traffic in store through doing this. One of the things that we did recently is this new concept store in New York called the Story, which is sort of experiential playground, in which we test a lot of the digital innovation around color cosmetics in this experiential store. And what we're trying to do is to see if some of these ideas, because now we have the learnings of consumer interacting there, can go back to the classical standard retailing environment. So we are really working well to try to change this.

Patrice de Talhouet - *Coty Inc. - CFO*

And so on your last question. We usually don't give a split within SG&A between our fixed cost structure and our brand investment. And actually, we are seeing a decrease in Q1 fiscal '18 versus the level of Q4 fiscal '17, even if I don't think the last quarter was a good benchmark. What I can share with you is that what you should anticipate in Q2 is to have an increase in the overall level of SG&A. Not so much because of the cost structure, that should keep on declining, but much more behind the A&CP and the level of support because, of course, we're entering into a very heavy season. And it's very important that we fuel the top line momentum. So you should expect in the second quarter some increase in this overall line.

Operator

And our next question comes from the line of Mark Astrachan.

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

It's Stifel. Wanted to ask -- or maybe take a step back. So I guess, I'm surprised by the number of mentions regarding achieving best-in-class EBIT margin for the business, given the modest improvements so far from a revenue standpoint, just generally slower category growth globally, especially



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

in U.S. and maybe even in Europe directionally, if you exclude travel retail. And that your competitors also don't seem to be as focused on margin and in fact seem to be more willing to push the A&P spend than I think I've ever heard in the past. So, I guess, why is that still the right strategy here to focus so intently on EBIT margin when I think top line will ultimately be the driver of that business? Or maybe I'm missing something. You know your business better than I do. But I'm just sort of curious how that thinking has evolved over, call it, the last 12 months, since at least that roadshow.

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

Thanks Mark. So great question. So -- actually, it's a good opportunity for me to reiterate that our investment thesis is still very valid. So our investment thesis is that there is usually a direct relation between gross margin and EBIT across the FMCG industry, but in beauty industry, and what we want to demonstrate is that we should have -- we should be in a position to achieve best-in-class operating margin. Why? Because the level of investments that we currently have on our business is, according to us, roughly the right level of investment. There might be some difference between quarters here and there, between geographies, between segments. But overall, at Coty Inc. boundaries, the level of investment that we have is about to be the right one, which means that the overall level of synergies of \$750 million should fall bottom line. This represents roughly between 700 and 800 basis points of operating margin. That's where we see the best-in-class operating margin.

Patrice de Talhouet - *Coty Inc. - CFO*

Over time.

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

Over time.

Operator

And your next question comes from the line of Rosie Edwards.

Rosie Edwards - *Berenberg, Research Division - Analyst*

It's Berenberg. Just regarding -- just sort of, again, that's top line. It's noticeable that this quarter, you're talking much more optimistically about growth, certainly versus Q3 and Q4 of fiscal '17. But if we look at the group performance, the underlying declines are fairly similar in the sort of low single-digit range. So what data are you seeing that perhaps we're not that gives you the confidence to outline this recovery? Is it sort of future orders, sell-in, market share? I'm just trying to get an idea of the level of confidence there.

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

As I mentioned, Rosie, we have really 2 divisions, Luxury and Professional Beauty, that have been growing for quite a while. So the key focus area of attention is Consumer Beauty. The confidence in Luxury and in Professional Beauty comes from having seen the performance of our brands in the market. I mentioned in my script that the launch of Gucci Bloom and the launch of Tiffany had been successful so far. But it's not just these 2 new product launches, we're seeing market share growth in Hugo Boss and Marc Jacobs Daisy and several other brands. So overall, our portfolio, both in terms of the classic pillars in Luxury and also the innovation it brings to market, that includes philosophy, is performing quite well. And of course, that gives us confidence. When I look at Professional Beauty, the growth that we're having in hair, which is 1 of the 2 categories that we're working in Professional Beauty, is actually positive and has been positive now for several quarters. And this is the bulk of our business. This is where we believe we are growing market share, especially in color, which is the core part of Wella Professional. And we expect to have this positive momentum and performance to continue because of the strength of our brand, but also the strength of the capabilities that we have in the



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

Professional business, in the Professional service business. And regarding Consumer Beauty, it's really, first of all, there are some excellent results that we're seeing especially, in ALMEA, and so I mentioned Mexico, Australia, Brazil. But we also have some others -- Bourjois continues to grow market share, both in Europe but also in Russia, Middle East. We have Rimmel having market share growth in several countries. So there are several examples that clearly give us this confidence of improving trends. But as I said, Consumer Beauty will take time for a full recovery. This is clearly the largest division we have. We have faced some challenges. We continue to face some challenges, and that's why we're going to continue to implement all our actions to implement the recovery.

Rosie Edwards - *Berenberg, Research Division - Analyst*

Okay, and just one follow-up on just, again, the sort of improved Q1 performance. Clearly, a noticeable improvement on the profitability, and just following on from the SG&A question earlier. Because I think in Q4, certainly you talked about fixed cost headwinds of, I think, nearly \$700 million and also above-average marketing spend. It's around 27% of sales. Are you able to give us any idea of those 2 elements of certainly fixed cost headwinds and marketing spend in Q1 '18?

Patrice de Talhouet - *Coty Inc. - CFO*

No. So as we said, we don't give any split within the brand investment and the fixed cost structure. What I can tell you is that we made some significant progress on our cost structure, and I think the results are very telling about this. What is also true to say and what I've mentioned in one of the previous questions is that Q2, going forward, is usually a quarter where you put more money behind our brands in order to further fuel the top line, because it's clearly a quarter of a lot of activities and a very high season. But, clearly, when you compare Q4 and Q1, our overall SG&A has gone down very significantly on the back of cost structure decline and tight financial discipline. What is also fair to say is that some of the investments that we deliberately made in Q4 are yielding results. Some of them were in the Luxury division, and this has clearly paid off when I see the top line momentum that we start to see in Q1 and that's what we're targeting to see also in Q2.

Operator

And our next question comes from the line of Jonathan Feeney.

Jonathan Patrick Feeney - *Consumer Edge Research, LLC - Senior Analyst*

Consumer Edge Research. My question's on Younique. It was \$400 million, you said at the time of the partnership; growing, I think you said in the comments, strong double digits. Can you frame for us any better how much that's set to contribute in 2018 and maybe beyond that? Any detail within that around number of active presenters and any leading indicators? And sorry if I missed that anywhere. And does the success you're having here -- I know as a management team, you look closely at direct selling of all kinds, big and small, your competitors and other companies. Does the success here tell us anything about maybe a future for a greater role for direct selling within Coty in the future?

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

So Jonathan, Younique is clearly an acquisition, a very strategic acquisition that we are very pleased with. And it continues to grow double digits. So the performance that we mentioned at the time of the acquisition continues to be true. Now that is clearly under the partnership with us. In terms of additional KPIs that you asked, there is one that is very telling, which is the sign-ups or the basic recruitment of presenters. And right now, we are approaching 100,000 presenters totally, overall, with over 100,000 presenters that joined us in Q1 2018 alone. So, I guess, I think combining the net revenue double-digit growth and the growth of the presenters, that clearly makes us satisfied with the performance. In terms of the role that direct selling can play within Coty, I think that we have made, what I will call, a very strategic and successful acquisition with Younique. We are very satisfied with it. And I believe direct selling has clearly a role to play within Coty given the growing size of Younique. But the other reason why I believe that this is so relevant is because of the direct link between the presenters and the consumers. And this is very, very relevant in the current market where individualized and customized approach to consumers is a big trend. And having 100,000 presenters who are our brand



NOVEMBER 09, 2017 / 1:00PM, COTY - Q1 2018 Coty Inc Earnings Call

ambassadors, who talk to millions of consumers out there on a daily basis, almost on an individual basis, because sometimes they do parties with -- we throw parties with few people, but most of the time is individual basis, to me is also key to the performance that we are seeing in Younique.

Operator

This concludes today's conference call. You may now disconnect.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2017, Thomson Reuters. All Rights Reserved.

