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The Estée Lauder Companies, Inc. (EL)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone and welcome to the Estée Lauder Companies' Fiscal 2021 First Quarter Conference Call. Today's call is being recorded and webcast. For opening remarks and introductions, I would like to turn the call over to Senior Vice President of Investor Relations, Ms. Rainey Mancini.

Laraine A. Mancini

Senior Vice President-Investor Relations, The Estée Lauder Companies, Inc.

Hello. On today's call are Fabrizio Freda, President and Chief Executive Officer; and Tracey Travis, Executive Vice President and Chief Financial Officer. Since many of our remarks today contain forward-looking statements, let me refer you to our press release and our reports filed with the SEC, where you'll find factors that could cause actual results to differ materially from those forward-looking statements. To facilitate the discussion of our underlying business, the commentary on our financial results and expectations is, before restructuring and other charges disclosed in our press release. All net sales growth numbers are in constant currency.

You can find reconciliations between GAAP and non-GAAP measures in our press release and on the Investors section of our website. As a reminder references to online sales include sales we make directly to our consumers through our brand.com sites and through third-party platforms. It also includes estimated sales of our products through our retailers' websites.

During the Q&A session, we ask that you please limit yourself to one question so that we can respond to all of you within the time scheduled for this call.

And now, I'll turn the call over to Fabrizio.

Fabrizio Freda

President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

Thank you, Rainey, and hello, everyone. I hope that each of you are in good health as the world continues to confront COVID-19. Our hearts are with those impacted, and our focus remains first and foremost with the safety and wellbeing of our employees, their families and our consumers. I continue to be incredibly inspired by our employees enduring compassion, creativity and resiliency. You are making us a better company and I extend my deepest gratitude.

Our diversified prestige beauty portfolio of categories, channels, geographies, brands, consumer segments, and price points give us many levers to fuel the business, both in times of prosperity as well as during more challenging times. In this most difficult moment, our multiple engines of growth strategy is invaluable. For the first quarter of fiscal year 2021, sales declined only 9%; a significant sequential improvement driven by every category.

Fragrance and hair care in particular had striking progress. Our hero products and innovations strived and contributed meaningfully to sales. We successfully adjusted our cost structure to minimize the leveraging effects of lower sales, resulting in an operating margin of 20%, very close to the first quarter of last year when we had double-digit sales growth.

In different periods over the last decade we were driven by different engines, leading to prestige beauty share gains each year. And we expect this year to be no different. Since the pandemic began, we estimate that we have grown prestige beauty share globally.

On our last earnings calls, we explained that the growth engines at the moment are the skin care category, the online channel and the Asia-Pacific region. Each delivered terrific performance to begin our new fiscal year. The Estée Lauder brand performed exceptionally well, returning to growth in the quarter, powered by its hero franchises in skin care. It's Advanced Night Repair franchise delivered very strong double-digit sales growth.

Encouragingly, the brand's success in skin care was broad based as each of the Re-Nutriv, Revitalizing Supreme+, [ph] Perfectionist in Micro Essence, Nutritious (00:04:12) franchises also grew double digits. This is a remarkable achievement when compared to the brand's very strong skin care performance in the prior year. La Mer had a super quarter, with double digit sales growth globally driven by its continued outperformance of luxury skin care growth in mainland China. The August launch of its new The Concentrate delivered especially strong double-digit sales growth in Asia-Pacific, and consumer, so the soothing power of this barrier serum with its new protective antioxidant benefits. Even amid the pandemic, La Mer is welcoming many new consumers, further demonstrating the irresistible appeal of the brand's superior quality.

At our last Investor Day, we discussed growth strategies for each of our large, scaling and developing brands. And even in these challenging times, we are resolute in our focus on all three tiers. The Darphin brand is a beautiful example in the developing tier of a brand succeeding through these unparalleled times. Darphin contributed to the skin care category growth in the quarter, as the successful launch of Intral Rescue Super Concentrate serum amplified the strengths of the brand's hero products.

Our acquisition of Dr. Jart+ with its terrific entry prestige derma brand positioning and desirable hero products enhanced the organic sales growth of skin care. Momentum in the serum, watery lotion and eye care subcategories carried into the quarter, driving skin care growth. The August launch of Estée Lauder new Advanced Night Repair serum performed extraordinary across geographies and channel, aided by compelling activation and an over 40% surge in consumers' reviews since launch, when comparing to the entire life span of the previous version.

Impressively, Clinique Even Better Clinical Interrupter serum continues to perform strongly in its third quarter since launching. We delivered outstanding double-digit sales growth online, with skin care, makeup, fragrance and hair care, all prospering. Once again, each of our online channels contributed meaningfully. We continued to strategically invest in our brand sites globally, bringing our classic High-Touch services to consumers online.

The response has been phenomenal. We have seen tremendous growth in time spent on for chat, Virtual Try-On and shoppable live streams. Even with most retail doors reopened around the world, sales rose 60% organically on our brand sites. We now have Virtual Try-On across more brands and categories in more markets. In the first quarter alone, we hosted over 1 million Virtual Try-On sessions globally, with consumer spending more than 30 minutes on average in a session.

In North America, the Estée Lauder brand launched AI-driven product recommendation based on real-time consumers' behaviors and past preferences. These dynamic merchandising holds great promise across our brands and regions. Clinique global sales growth on brand.com in the quarter was exceptional. Among the strongest across the portfolio. Clinique's skin school on demand live streaming was a great success, leading to new daily programming that combines top consultants with influencers [ph] to fuse your holiday sets (00:08:31) in favorite Clinique products. Clinique is our first brand to launch new technology that pairs multiple hosts in one shoppable live stream.

Bobbi Brown continued to scale its Artistry Like Never Before program. Expanding virtual artistry to include live chat, pre booked video consultations, master classes and live streaming by rapidly converting some of its global makeup artists into a network of virtual sellers. Most of the brand's markets now offer these consultations on brand.com, on local social platform such as WhatsApp, WeChat and Instagram. These virtual services have a higher conversion rate up to 10 times the average, and a higher average order value.

With enticing innovation and engaging new services and tools, conversion grew strong double-digits across our brand sites. Most compelling is the significant conversion growth in markets that are under-penetrated online such as continental Europe. In the quarter, conversion there grew over 75%, while in Latin America, conversion growth far exceeded 100%. This positions us well for suitable profitable growth online.

We invested in online fulfillment during the quarter, strengthening our capacity globally and we are addressing seasonal fulfillment locations in our largest markets in anticipation of robust consumer demand for holiday.

Leveraging our investment in technology, we deployed more omni-channel capabilities in several markets. In the US, we have seen dramatic uptick in buy online, pickup in store for M·A·C. The brand also partnered with Postmates domestically to launch same-day delivery and opened a new experiential store in New York.

The store features extensive personalization options for consumers and interactive digital experiences. In these initiatives and more, we are meeting the desires of consumers who are craving convenience and choice, offering them new ways to shop in today's environment.

The third engines of growth, Asia-Pacific, also excelled. Several markets contributed to the region's high single-digit sales growth, which is most notable as some markets in the region dealt with new waves of COVID-19.

Mainland China, Korea and several smaller markets, grew organically. In mainland China, we continue to invest in the vibrant opportunity of our second home market. We expanded into more cities in the quarter, reaching over 130. We increased our advertising investment across social and digital platform, showcasing exciting innovation and building brand awareness as we reach new consumers. We continued expanding our talent in anticipation of our new state-of-art innovation center, which will open in Shanghai as we aim to best meet the needs of Chinese and Asian consumers with local relevancy and local trends through increased capabilities in product design, formulation, consumer insights and trend analytics.

In mainland China, the bricks-and-mortar channel returned to double-digit growth, such that both offline and online were powerful growth drivers. The travel retail channel further contributed driven by tremendous growth in Hainan, partly reflecting increased duty-free purchase limits, the opening of some travel corridors in Asia, and online pre-tail growth facilitating higher conversion.

[ph] Many find (00:12:53) Chinese consumer strengths. Indeed, demand from the Chinese consumers was very strong across these channels; most especially in skin care, and we estimate we grew our prestige beauty share.

The fragrance category sales growth accelerated in Asia-Pacific in the quarter. We introduced KILIAN PARIS and Frédéric Malle in mainland China in very select distribution in June. These unique luxurious brands are proving highly desirable, which, coupled with the ongoing strengths of Jo Malone London and Tom Ford, drove significant double-digit sales growth of fragrances.

In Korea, fragrances also soared. Le Labo new Citron 28 Seoul fragrance drove meaningful upside, demonstrating the strengths of our locally relevant innovation.

Around the world, we continue to closely monitor the evolution of consumer attitudes and purchase behavior related to COVID-19. We combine sophisticated social media listening capabilities with machine learning and proprietary consumer research techniques to develop insights and adapt our marketing and product offering with speed and agility to capture changing times.

Looking ahead, we are confident in the return of growth in the challenged makeup category as the recovery will unfold. In the meantime, we continue to focus on subcategories in makeup that are favorite in the era of masks for COVID-19. In fact, even in lip, which is overall pressured, the liquid lip subcategory is growing nicely, driven by M·A·C's launch of Powder Kiss Liquid Lip as consumer seek matte finish formulas that last. Our innovation represented over 30% of sales in the first quarter. We have an exciting pipeline of new product launches for the remainder of fiscal year 2021 for both engines of moment and what we expect to be engines of the future.

In October, Clinique launched Moisture Surge Intense Replenishing Hydrator, a new formula that hydrates skin for a full 72 hours in a cream gel formula that dries – for drier skin types. This month La Mer will introduce its new Genaissance de La Mer concentrated night balm, an ampoule-strength balm, slow crafted, with crystal miracle broth that promotes skin natural rebuilding of collagen to help transform the look of skin during sleep.

Continuing our progress on sustainability, Origins intend to be the first prestige beauty brand to bring an advanced recycle tube package to market with its Clear Improvement Active Charcoal Mask in 2021. This expands upon Clinique recent launch of All About Clean in packaging with most consumer recycled material and plant-derived plastic for its tube, and most consumer recycled material for its cap. For fiscal year 2021, we

continue to expect sequential improvement in sales growth each quarter and to build global share while prestige beauty progressively return to growth.

We are mindful of the ongoing impacts of COVID-19, most especially the very limited traffic in retail doors as store reopen, and the second waves occurring in certain markets. We are investing in several strategic priorities intended to drive our long-term sustainable growth [ph] that progressing (00:16:55) in the world of post-COVID business acceleration program. For the second quarter, we have magnificent plan for holiday and a 11/11 Global Shopping Festival.

Holiday merchandising began a few weeks ago and our brands created rich activations with engaging festive products. Estée Lauder and La Mer have kits that include best-selling hero products to drive recruitment. Origins is making holiday gifting easy, offering consumers the ability to text or email a gift, allowing the recipients to either accept or exchange their product before it is gift wrapped and sent to them. Bobbi Brown Holiday Wish List Deluxe Collection includes all the inspiration, goods and tools to create ultimate holiday looks. And M·A·C recently debuted its Frosted Firework Collection, partnering with a diverse range of beauty influencers who generated over 60 million media impression in the first 10 days after launching.

Today, we will release our fiscal 2020 Citizenship and Sustainability Report entitled Beauty Inspired, Values Driven. We are incredibly proud of the contribution of our employees around the world in accelerating our citizenship and sustainability efforts, and have featured their successes in this year's report. The report highlights the achievement of our 2020 ESG goals as well as meaningful progress toward our 2025 goals. These milestones were reached across citizenship and sustainability priority focus areas despite the challenges of the pandemic.

I'm pleased to announce the company has achieved net zero carbon emissions, a 100% renewable electricity globally for our own operations. Building upon this achievement, we also met our goal to set science-based emissions reduction targets addressing Scope 1 and 2 for our target operation and Scope 3 for our value chain.

Today announcement signals a new level of ambition and dedication to climate action for The Estée Lauder Companies, setting targets in line with the latest climate science in testament to our values and our commitment to managing our business for the long term.

We are also proud to have reached zero industrial waste to landfill for our manufacturing, distribution and innovation sites. And we are on track to provide access to training on basic sustainability and corporate social impact programs for our employees worldwide this month. In addition, over the past two years, our programs and grants focused on health, education and environment have positively impacted the lives of more than 20 million individuals worldwide.

Our collective vision is to be the most inclusive and diverse prestige beauty company in the world and to be the employer of choice for diverse talent as the brand of choice for diverse consumers. Our commitments to racial equality, especially our focus on driving racial equity across our business, is central to achieving our vision. In today's report, we'll be publicly disclosing enhanced employee diversity metrics and information on pay equity. We believe this transparency to all our stakeholders is important to holding ourself accountable to our vision while importantly setting the stage to share our progress.

In closing, there is no doubt that we are leading and working in a moment unlike any other. And yet we are confident, thanks to our passionate employees, cherished company values and proven strategy built on multiple engines of growth, we are well-equipped to face the challenges of today and even better positioned to embrace the opportunities of tomorrow and continue growing global prestige beauty share.

I will now turn the call over to Tracey.

Tracey Thomas Travis

Executive Vice President of Finance and Chief Financial Officer, The Estée Lauder Companies, Inc.

Thank you, Fabrizio, and hello, everyone. As a reminder, my commentary today is adjusted for the items that Rainey mentioned at the beginning of the call, and net sales growth numbers are in constant currency.

So starting with the first quarter results, net sales declined 9%, driven by the ongoing effects of the COVID-19 pandemic on our brick-and-mortar distribution throughout the world. We achieved strong growth in our global online channel, mainland China, and the skin care category, and delivered better than expected results in the travel retail channel and in North America. Other areas progressively improved compared to last quarter as retail doors reopened. The December 2019 acquisition of Dr. Jart+ contributed approximately three points of net sales growth.

From a geographic standpoint, our Asia-Pacific region rose 7%, driven primarily by strong double-digit growth in skin care and the addition of Dr. Jart+ [indiscernible] (00:22:34) sales in mainland China rose double digits as sales in brick-and-mortar retail continued to improve.

The pace of online sales growth in China was slower this quarter, following the highly successful 618 mid-year shopping festival programs last quarter. Most brands and channels rose double digits in China. Korea rose high single-digits, excluding Dr. Jart+, and several smaller markets returned to growth as well. Sales in Japan declined due to a tough comparison to the prior year in which sales grew nearly 20% as consumers bought ahead of an October 2019 vat increase. The market has also suffered from softer in store traffic due to a second wave of COVID-19. Sales in Hong Kong continued to be depressed as well due to the pandemic.

Net sales in our Europe, the Middle East and Africa region declined 9%, with virtually every market continuing to feel the effects of the pandemic. While online growth continued to be quite strong, brick-and-mortar traffic remained soft, heavily impacted by COVID-19, which also resulted in significantly lower tourism in key markets.

Skin care sales in the region grew double digits, driven by travel retail, but were more than offset by declines in makeup and fragrance. The major western markets of France, Spain and the UK contributed the most to the decline in sales, as did the Middle East.

Our global travel retail business was essentially flat as outstanding results in Greater China, particularly Hainan Island and Hong Kong, and sequential improvement in Korea offset the effects of the significant reduction in international travel. Additionally, the growth of pre-tail and the increase in duty free purchase limits in Hainan drove higher conversion rates.

Net sales in the Americas declined 24% as virtually all markets in the region continued to be impacted by COVID-19. Online sales growth continued to be a bright spot, rising over 40%. However, brick-and-mortar retail remained difficult especially in department stores and in free standing stores.

From a category standpoint, skin care was the most resilient. Net sales grew 10%, driven by continued strong performance from the Estee Lauder and La Mer brands in Asia, including travel retail, as well as incremental sales from the acquisition of Dr. Jart+. Net sales in makeup fell 32%, a significant sequential improvement from last quarter. Makeup has seen the biggest impact from COVID-19 as many consumers continue to partially or fully work from home and forego social gatherings. Fragrance net sales declined 13%, a substantial improvement from

last quarter. The category grew strongly in Asia, reflecting double-digit increases from both Tom Ford and Jo Malone London as well as the recent launches of KILIAN PARIS and Frédéric Malle in mainland China.

Bath, body and home fragrances continued to perform very well. Our hair care net sales were essentially flat declining only 1%. While stores and salons were not operating at full capacity during the quarter, the category benefited from exceptional innovation from Aveda including the recent launch of Botanical Repair as well as strong online sales.

Our gross margin increased 20 basis points compared to the first quarter last year. Favorable category mix and lower costs for in store testers were partially offset by negative currency impact. Operating expenses decreased 7%, and the deleveraging effect of the sales decline caused operating expenses as a percent of sales to increase 80 basis points. Agile cost management and lower selling costs resulting from both channel mix and the impact of the COVID-19 related temporary furloughs and salary reductions on employee costs resulted in a 20% operating margin which was just 60 basis points lower than the year-ago quarter, despite the lower sales. Diluted EPS of \$1.44 decreased 14%, compared to the prior year. EPS was higher than expected, due to both improved sales performance as well as more prudent cost management as doors reopened throughout the quarter.

During the quarter, we generated \$358 million in net cash flows from operating activities, which was above the prior year, due primarily to timing of working capital items. We invested \$116 million in capital expenditures, repaid the remaining \$750 million outstanding on our bank revolver and paid \$174 million in dividends. We also announced this morning a 10% increase in our quarterly dividend to \$0.53 per share. Our plans under the post-COVID business acceleration plan are on track with approvals expected to accelerate in the second quarter and benefits beginning to flow later in our fiscal year.

So now let's turn to our outlook. We are pleased with the sequential improvement we saw in nearly every market as the world continues to manage the effects of the pandemic. The path to recovery is not expected to be smooth as cases of COVID-19 have begun to surge again in many markets creating renewed restrictions on travel and social activities. We are mindful of the risk of a global recession or a slow economic recovery as government support measures in certain markets taper off. We also recognize macro risks such as ongoing trade tensions and political uncertainty. Nonetheless, prestige beauty remains a highly desirable product category as evidenced by the sequential improvement in sales trends we experienced this quarter. And we believe our multiple engines of growth strategy positions us well to return to strong global results when the impacts from the pandemic subside.

With only one quarter of the year completed, and the degree of uncertainty I just described, we are not providing explicit sales and EPS guidance for the full year. However, we will provide some underlying assumptions for the year.

We continue to expect sequential quarterly sales improvement as the global recovery unfolds, assuming no significant second wave resulting in broad scale retail door closures again or other major disruptive events. And we do expect to return to sales growth as of the end – as of the third quarter.

Comparisons to our record performance in the prior year first half will be difficult. Conversely, we expect sales and profit to grow significantly in the second half of the year against a period of considerable COVID-19 impacts, with particularly strong growth in the fourth quarter. The inclusion of six months of incremental sales from the acquisition of Dr. Jart+ should add about one to two percentage points to sales growth for the fiscal year but remains slightly dilutive to profit for the year. We expect to close a number of our less productive freestanding retail stores and exit certain wholesale doors, primarily in western markets, while several of our retail customers

are also reducing their store footprint. Many of the unproductive doors are expected to close later in the fiscal year.

Our gross margin has recovered from last quarter's inefficiencies related to the sudden COVID-19 impact. Additionally, we continue to invest in increased capacity to support our strong skin care growth. We will continue to leverage a portion of the savings generated from our cost programs to support advertising and expanding services and capabilities to enable strong growth in our online channels. As I mentioned before, we increased our quarterly dividend rate by 10% to \$0.53 per share. We also expect to reinstate share repurchases as we gain comfort that the recovery is more sustained.

So while the environment remains quite uncertain, we are providing guidance for the second quarter. For the quarter, we expect sales to decline between 4% and 6% in constant currency. As a reminder, we are comparing against a record prior-year quarter where we delivered 16% sales growth and 21% EPS growth last year. We have a robust lineup of holiday offerings at a variety of attractive price points that are carefully targeted to relevant consumer trends we are seeing during this pandemic. And we expect continued strong online sales at our retailers and on our own brand sites. The incremental sales from Dr. Jart+ are expected to add about two points to growth, and currency is expected to be accretive by approximately one point.

We expect second quarter EPS of \$1.45 to \$1.60, reflecting the sales outlook, continued cost containment measures and investment in key growth areas like online, innovation and China. Currency is expected to add \$0.02 to EPS, and Dr. Jart+ is forecasted to dilute EPS by \$0.03.

We will continue to leverage our multiple engines of growth to invest behind a strong recovery in the context of the macroenvironment. We are taking strategic actions to support long-term sustainable growth by investing appropriately for the long-term while supporting the recovery in the near term. With a more solid start to the fiscal year, and mindful of continued macro volatility over the next several months, we look forward to leveraging the tremendous strength of our brands and driving a strong recovery as the market accommodates.

And that concludes our prepared remarks. We'll be happy to take your questions now.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for questions. [Operator Instructions] And our first question is going to come from the line of Lauren Lieberman with Barclays Capital.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Great. Thank you. Good morning, everyone.

Fabrizio Freda

President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Good morning.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

My question was about channel mix shift, both longer term and in the quarter itself and for fiscal 2021. So first piece of it is just over the longer term with the things you've already talked about and the acceleration of e-commerce growth, curious if you think it's fair to say that half of your margin expansion over the next several years could come from that channel mix dynamic?

The second was that, as we look into fiscal 2021, how we should be thinking about the benefits of channel mix on one hand, but then the drags that you will experience as less productive doors get closed to the degree that there is stranded costs that come with that or what the impact of door closures, your own doors, and also wholesale doors, or customers choosing to close doors, what impact that has on the P&L in the short term. Thanks.

Fabrizio Freda

President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Yeah, I'll start, and then Tracey will join me in the answer. But basically, all our accelerating engine of growth by channel are more profitable. And that's the good news. On the other side, we have to deliver our brick-and-mortar productivity back to normal. And these, obviously, will be influenced by how fast COVID retire and how fast the consumer gets the confidence again to go in brick-and-mortar. And as you said, by managing some closures.

And then we need to turn the total company into growth. As Tracey said, we believe this will be possible as of quarter three. And so the combination of the improved accelerating engines of growth, which are more profitable, and the reestablishment [ph] of the routine (00:35:59) brick-and-mortar will determine when we can go back to our long-term algorithm of growing above half a margin point per year. Tracey?

Tracey Thomas Travis

Executive Vice President of Finance and Chief Financial Officer, The Estée Lauder Companies, Inc.

A

Yeah, and, Lauren, as you indicated, I mean timing will really impact that. So in terms of when we expect door closures to occur, we've already had a number of wholesale door closures and free-standing door closures over the last few years, when you think about the number of retailers that have gone out of business unfortunately in the last couple of years. And certain retailers have also indicated their intent to close doors over the next couple of quarters.

With our post-COVID acceleration program, we too will be closing doors over the next couple of quarters; more towards the end of the year as well as some free-standing stores. So there will be a timing issue where we do see pressure from underproductive brick-and-mortar doors while we see the uplift that Fabrizio spoke about from our online acceleration. And that's all embedded within the guidance that we've given certainly for the second quarter, and we'll see how the second half of the year plays out. But that's certainly a dynamic that we will be managing in fiscal 2021 as the door closures are staged throughout the balance of the year and into fiscal 2022.

Operator: Thank you. Our next question will come from the line of Dara Mohsenian, Morgan Stanley.

Dara W. Mohsenian

Analyst, Morgan Stanley & Co. LLC

Hey. Good morning, guys.

Q

Fabrizio Freda

President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

Good morning.

A

Dara W. Mohsenian

Analyst, Morgan Stanley & Co. LLC

So, Fabrizio, I was hoping maybe you could give us some perspective on how much of the increased e-commerce demand you've seen since the beginning of the pandemic is sustainable in your mind as you look out longer term. And perhaps within that, can you detail, with the e-commerce sales increase you've seen during the pandemic, how much of that you think is driven by new customers? What level of repeat rates you're seeing among those new customers? Thanks.

Q

Fabrizio Freda

President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

Yeah, so first of all, the increase of online [ph] as a store (00:38:21) during this quarter in total, we were growing about 40%. But our brand.com and other [ph] some retail.com (00:38:31) are growing much stronger. Our brand.com is 60%.

A

So the growth is consistent, and I believe, personally, it's here to stay. And the reason why it's here to stay because a lot of this growth is about the new consumers that we see online, and many of these new consumers are mature consumers. And before, online was mainly the destination of younger people, millennials, et cetera. Now it's for everyone. Everyone is online. And also, the people that before were not accustomed to go there are going there more often. So what we see is that people buy online. Maybe in the future, when the store will be open, we believe that omni-channel will be very strong. And so people will use both brick-and-mortar and online obviously.

But the amount of purchase online will stay higher, and particularly will stay higher, in our estimating, the mature group of consumers which are very important for us, very important for beauty. So this is a sustainable trend and it's a sustainable acceleration.

The second thing which is out there which is very important is historically, our High-Touch services of advice or the service of customization, or the service of trying the products, was exclusively done in stores. And then online, at the beginning, was mainly a convenience buying opportunity of what you already knew. Shopping was in brick-

and-mortar, buying was online. This has changed forever. Now there is shopping in brick-and-mortar and there is shopping online.

What I mean with that, is that the High-Touch services of customization of advice, of recommendation are now [ph] super present (00:40:19) online and the consumer really are catering to the service like never before. So we spoke in our prepared remarks about the availability of chats with consultants, the availability of Virtual Try-On, the availability of live streaming opportunities, all these is increasing. And the engagement of consumer online is increasing. We mentioned that we have 30 minutes presence in Virtual Try On versus only a few minutes in the past.

So the combination of new consumers, particularly more mature consumer, better services online [ph] which have (00:40:54) more time and more engagement and the development of these opportunities for everyone, I think, is going to be a sustainable and growing segment for many years to come. But obviously, we absolutely believe that omni-channel will be also important in the future and the brick-and-mortar will go back to the right level of productivity, to the right level of traffic, and it will be a combination of the two that will be an even better combination than in the past.

Operator: Thank you. Our next question will come from the line of Dana Telsey with Telsey Advisory Group.

Dana Lauren Telsey

Analyst, Telsey Advisory Group LLC

Q

Good morning, everyone, and nice to see the progress. As you think about the makeup category, how are you planning for innovation going forward? What does the timeline look like? And also, Fabrizio, when you talk about channels what are your thoughts on the specialty, multi-channels going forward? Thank you.

Tracey Thomas Travis

Executive Vice President of Finance and Chief Financial Officer, The Estée Lauder Companies, Inc.

A

So our point of view in makeup, will go back to the very attractive and very fast-growing category once COVID will retreat. And the makeup is very much linked to users occasions for makeup, and the users occasion for makeup include business obviously, meetings or going to the office, it includes social gathering of any kind and it includes also positive mood of recovery and the interest of expressing ourselves. And so all these will come back, it will come back strongly and makeup will come back with it. As we said in the prepared remarks, there are certain categories of makeup which is already coming back, already growing is visible that makeup is much stronger where COVID abate, like, in Asia.

So it's obviously going to come back and we will be ready for that. We are preparing, starting from the categories that in our opinion will come back first. And we are investing not only in ready to sustain the recovery but also investing in innovation in the category that will be the first one to come back. If you take today, [ph] the eye (00:43:09) for example, eye makeup is much stronger than other categories just because in a period of masking, eye makeup is more relevant than others, the lips for example. And so there is a very positive trend in our opinion. It's just a matter of time and the time will depend on the COVID.

In term of your second part of your question, specialty multi, around the world will remain a very strong channel. Very strong channel for us. A strong channel of growth, and in specialty multi, the strength in our opinion will also be the fact that retail.com of this channel should continue to increase [ph] it should be (00:43:46) very, very strong, is the specialty-multi key opportunity is to continue to be strong in store obviously but particularly to

become equally strong in the retail.com and to bring the services and the experiences that have been so strong in brick-and-mortar to the retail.com in the long term everywhere in world.

Dana Lauren Telsey*Analyst, Telsey Advisory Group LLC*

Thank you.

Operator: And our next question will come from the line of Steve Powers with Deutsche Bank.

Stephen Powers*Analyst, Deutsche Bank Securities, Inc.*

Yes. Hey. Good morning. Thanks. Can we just talk a little bit more about the exit rates in consumption coming out of the first quarter? And what you're seeing in terms of momentum? A little bit more granularity whether by geography, or category, or channel, however you think is most instructive. And if you're able to share a little bit of data around October results that would be great because we clearly saw volatility in shipments, shipment timing over the course of the September quarter. So I'm just curious as to how you're thinking about that month-to-month lumpiness as we look through and out toward the end of the calendar year as well? Thank you.

Fabrizio Freda*President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.*

Yeah, I'll start and please, Tracey, add any perspective. If I understand correctly your question, so the strength by category is in consumption, is clearly in skin care, and this remains very strong and in certain regions further accelerating. And within skin care there are certain sub-categories like moisturizers, serum, masks, which are really flying. Or eye products. So products for the contour of the eye, et cetera. So there are skin care and certain skin care category is clearly the fastest growing consumption. Makeup, I just answered one question. Makeup's depended by category. Eye makeup has strong consumption, for example lip makeup is under pressure in this moment. But even with this, [ph] within covered (00:45:44) it allow us to focus more on the growth consumption in these categories.

Fragrances are surprisingly back faster than what we originally thought. And this is great news for the holidays. In fact, we are ready to try to push fragrances really in the best possible way during the holidays that we believe is a big opportunity, particularly our high-end fragrances and our artisanal fragrances like Jo Malone, Tom Ford, Frédéric Malle, KILIAN and Le Labo. And Le Labo is doing extraordinarily well everywhere in the world.

And so then Hair Care, as I think Tracey explained in her prepared remarks, that Aveda is doing exceptionally well. For us, Aveda is having great innovation, a great program, great work online in support of also the salons [ph] the world (00:46:38) with Aveda. And this brand is also hitting all the areas because is obviously, is about natural, is about taking care of the [ph] world. (00:46:45) And so is also very much into the consumer space of sustainability. And this is started paying big dividends. So hair care also is strong in consumption. And so net by category is skin care is strong, hair care is strong, fragrance recovering and makeup is the more gradual recovery that we assume for the long term.

In term of the dynamic of the regions, obviously you have a consumption recovery in Asia which is much faster than anyone else. And on the contrary, in the US and in Europe, the impact of COVID on recovery has been much bigger. But we see progress everywhere. That's the important thing. The important thing is that the level of progress is recovery is consistent every part of the world despite Asia is ahead in the trend of recovery.

And then in terms of consumer groups, consumption, I found particularly interesting that the consumption has been extraordinary in a more mature consumers. And that's what we see that is a long-term benefit. I mean, the younger consumer's been the driver of many categories, particularly makeup. And in this moment, that's less the case. But the mature consumer has been a bit more following the young consumer in the last probably five years. I think this is changing. And the mature consumers are getting much more active, even in experimenting and trying new innovation. And again, this is, for us, is a very positive sign for the long term. So consumption overall is gradually recovering. And it's gradual recovery across every segment but with very different rhythm and speed by segment.

Tracey Thomas Travis

Executive Vice President of Finance and Chief Financial Officer, The Estée Lauder Companies, Inc.

A

And then in terms of the month for the second quarter, October came in – is coming in as we expected. So – and it is reflected in our guidance. So I know we had starting in July a little bit of a shipment to restart the business given the fact that some of our inventory levels were low, particularly in North America. We don't see anything like that in the second quarter. And as you probably know, Steve, October is the smaller of the three months in the second quarter. Obviously, November and December with, for us, both Singles Day in China and in Asia as well as holiday, November and December are by far the two bigger months.

Stephen Powers

Analyst, Deutsche Bank Securities, Inc.

Q

Yes. Thanks so much.

Operator: And our next question will come from the line of Erinn Murphy, Piper Sandler.

Erinn E. Murphy

Analyst, Piper Sandler Companies

Q

My question is around travel retail. It improved very nicely in the quarter. Can you just share a little bit about how much was driven from the higher duty-free allowances in Hainan Island? And then how are you thinking about travel retail for the balance of the year? Thank you.

Fabrizio Freda

President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Travel retail had an exceptional performance. And clearly the west, meaning Europe and the Americas are very, very basically closed or very, very small in the retail travel. So the first thing is the recovery has been driven by Asia and within Asia, there are three elements which are driving this recovery. The first as we discussed is the acceleration of domestic travel within China with Hainan at the center of that. And Hainan has seen both an increase of traffic, meaning domestic tourism that came back at a very high percent. I think the number published, they're already about 80% of what they historically were in terms of domestic travel and, in terms of traffic. And then the increase of possibility of buying per consumer that together generated the very big growth that we have seen and we believe this is so sustainable.

Then there is the opening of certain corridor in Asia which has started, particular Hong Kong, Macau and we see in Korea is also started being more solid. And then is the pre-tail, meaning the online, the ability to reserve online the product, which is accelerating dramatically obviously in a moment whether the consumers are still concerned to go in stores with a lot of people, the ability to do pre-tail is serving their purpose and make them feeling safer and protected. So the combination of those three things is [ph] of ever (00:51:33) important result which is

increasing conversion. As I said several times in travel retail, the results are driven by traffic and conversion. And in this moment even in presence of lower traffic we are seeing a dramatic increase in conversion.

And what we see for the long-term and the long term will be dependent obviously how traffic will be restated. The domestic travel in China is new elements. And obviously, we believe will remain an opportunity for the long term. When international traffic will be reestablished will depend on COVID obviously and we will monitor closely and serve this purpose. But the increase of pre-tail as a percentage, particularly in Asia, will remain a very positive element for the long-term because we'll have an extraordinary positive impact, sorry, on conversion even when international traffic will restart. That because of this is the combination of what's happened during COVID and the opportunity of traffic recovery in the long term will make this channel in our opinion, will remain one of the most interesting channels for the long term.

Operator: Thank you. Our next question will come from Jason English, Goldman Sachs.

Jason English

Analyst, Goldman Sachs & Co. LLC

Hey, good morning, folks.

Q

Fabrizio Freda

President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

Good morning.

A

Jason English

Analyst, Goldman Sachs & Co. LLC

Congratulations on – thank you. Congratulations on sequential improvement, especially in travel retail. It's quite impressive. I wanted to come back to some of the questions on margins. As we were closing fiscal 2019, I think you finished with 17.5% EBIT margin. Your 50-bps algorithm would have landed us to around a 19.5% by fiscal 2023. I reference fiscal 2023 because it may be like the first year where we're back to sort of normal because we're going to have a lot of turbulence obviously through the remainder of this year, and then residual spill over just on door closures, et cetera, in 2022.

But if we were tracking towards the 19.5% in 2023 before, is there any reason that we can't get to it, if not actually exceed it? Right. You're pulling a lot of cost out of the P&L right now, I imagine that you'll discover that not all of that need to go back. And you've got this pretty compelling, from a margin mix perspective, tailwind. Why – are there any offsets that will prevent you from getting to that 19.5%, if not actually exceeding it assuming 2023 is indeed normalized?

Q

Tracey Thomas Travis

Executive Vice President of Finance and Chief Financial Officer, The Estée Lauder Companies, Inc.

Yeah, I mean, I think on the last call, Jason, we indicated that we expected to get potentially to our fiscal 2019 margins by fiscal 2022. Now, part of the post-COVID acceleration program certainly is helping to accelerate the achievement of that. But I think that math is a little aggressive right now for fiscal 2023 as we think about the recovery of the business. And obviously, it all depends on how quickly we get back to your point, normal as it relates to normal consumption from a brick-and-mortar standpoint and where the balance of the channel mix plays out. So that's a little bit aggressive.

A

But recognize that certainly, given the cost actions we take as it relates to post-COVID acceleration to accelerate our brick-and-mortar productivity and, therefore, help our margin and some of the favorable mix items that Lauren indicated earlier from the growth of online as well as when travel retail resumes, which is another factor for us. We had good travel retail performance this quarter. Travel retail is another accretive channel for us in international travel, whenever that resumes and what that looks like, will also be a factor.

So we're very comfortable that we will have margin progression. And we will get to the 19.5% that you were referencing. It's just a matter of timing.

Operator: Thank you. Our next question will come from the line of Rob Ottenstein, Evercore.

Robert Ottenstein

Analyst, Evercore ISI

Q

Great. Thank you very much. I'd love to circle back to mainland China. And perhaps can you tell us a little bit about the overall sales growth online and offline, kind of what sort of impact travel retail had on the business. And given your comments about increases in domestic travel retail in China and Hainan should we kind of think that for mainland China, ex travel retail, may not see the kind of growth that it's had before? And then finally, related to China, any kind of impact for timing on 11/11? Did that have any impact? Thank you.

Fabrizio Freda

President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

So no. I think we look at the Chinese consumers in total. And this was another extraordinary quarter for China's consumer consumption. We estimated the total Chinese consumer consumption was about plus 20%. And we were plus 28%, plus 30% range. So when you look at the total, so extraordinary. Actually, I think we have developed the strengths that, when the Chinese consumers are shopping mainly online, we are online, and there are high traffic moment where this up. And when they come back to the store, we are there in brick-and-mortar and this was, again, a double-digit growth in brick-and-mortar for the first time after COVID. When they go domestically travel, they go to Hainan we are among the first being there being ready for that.

So look at us as being dynamically following the Chinese consumer wherever they choose to shop and wherever the traffic is high by quarter, and see that flexibility as a strength rather than having every single channel having to perform in the same way every quarter. This is not going to happen. China is a very dynamic market.

And, in fact, the online, the 11/11 and then the 18/6, meaning the June events, which are two huge peak, do create the fact that in July, August, online is less strong. But then domestic travel was much stronger. And the real strength is to be able to be there at the right moment in everyone of these channels.

So Chinese consumer is strong. Our growth in China is strong. We are a local organization in China, really focused on the long term with enormously built-in flexibility and collaboration between different groups.

This quarter was particularly interesting because we have the most cities as explained. Brick-and-mortar went back to double-digit growth. Domestic travel went to about 80% of traffic. New consumers were coming in our brands, particularly from lower-tiered cities via online and via the travel, and we launched two new brands as you heard on fragrances.

On top of that, we are expanding our scientific presence and investing in a new research center, an R&D center in Shanghai, that will give us new capabilities to even more locally relevant.

So it is a very strong momentum for China. And I personally believe that the consumption of the Chinese consumer will be growing strongly for the long term.

Operator: Thank you. And our next question will come from the line of Fulvio Cazzol with Berenberg.

Fulvio Cazzol

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)

Q

Yes. Good morning. And thank you for taking my question. I was wanting to ask about the innovation pipeline. There was some mentions made in the prepared remarks and I remember in previous quarters you highlighted that you were being opportunistic in terms of product launches, trying to time them when they could be the most effective. So I was just wondering if you could give us a bit of color on how your first quarter played out? Did that benefit from some of the shifts of innovations from previous quarter? Or was it fairly normalized? And then following up on that, how should we think about Q2 and maybe even 2021? Is there a lot of pent up let's say innovations to come out and help your growth along please? Thank you.

Fabrizio Freda

President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Yeah, no. First of all, our innovation has been very strong at 30% of sales, in the previous quarters being 20%, 25%. So frankly we don't aim to a specific percentage of innovation is very strong. And we have a great pipeline. So your question is how do we decide how to focus on which innovation. This obviously was the moment where skin care was the most demanded from consumers. And we tend to focus our innovation where there is the strongest trend and the stronger consumer demand. And so that's why skin care was a big focus.

Now obviously on skin care, you cannot plan innovation in a few months. It's a very important investment for the long term. So we had this extraordinary innovation, the Advanced Night Repair and The Concentrate, La Mer that were planned for the period. It just that we went even deeper, even stronger because we saw the opportunity. So the innovation timing is set that we have flexibility obviously to move them when needed. But the most important thing, which is flexible, is the amount of investment, the amount of focus that we can have on different innovation depending on the consumer demand in that specific moment and in every different location.

So our agility is about retailer innovation locally. And so the local teams have the opportunity to launch it lite, launch it big, go deeper, [ph] postpone the demand anticipate the demand, (01:02:03) there is a lot of flexibility to tailor the innovation to the local consumers. But the fundamental innovation is done with a very accurate pipeline for the long term. And that's why we're saying that our pipeline has never been stronger, frankly. And this was already in place before COVID.

Tracey Thomas Travis

Executive Vice President of Finance and Chief Financial Officer, The Estée Lauder Companies, Inc.

A

And the only thing I would add to that, we had also very strong innovation. We spoke about the fact that the fragrance category has been a nice surprise for us. And that has been driven by innovation across the board with our fragrance brands. And then obviously hair care with Aveda. Aveda has had a couple of very strong innovation launches this year that really has driven a lot of momentum for us in hair care, and certainly helped from a recovery standpoint. Where we did see some shifts in innovation and from a timing standpoint is in the makeup category. Understandably so. So we do have strong programs lined up for the second half of the year in addition to skin care and fragrance and hair care also for our makeup category. Hopefully as people start to gradually wear

more makeup and perhaps become more socially active that that innovation will actually pan out to help to continue to grow the makeup category.

Fulvio Cazzol

Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)



Fantastic. Thank you.

Operator: Thank you. That concludes the question-and-answer portion of today's call. If you were unable to join for the entire call, a playback will be available at 1:00 PM Eastern Time today through November 16. To hear a recording of the call, please dial 855-859-2056. Pass code 1797894. Again, 855-859-2056 and then enter pass code 1797894. That concludes today's Estée Lauder Conference Call. I would like to thank you all for your participation, and wish you all a good day.

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