

03-May-2021

The Estée Lauder Companies, Inc. (EL)

Q3 2021 Earnings Call

CORPORATE PARTICIPANTS

Laraine A. Mancini

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

Fabrizio Freda

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

Tracey Thomas Travis

Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.

OTHER PARTICIPANTS

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Nik Modi

Analyst, RBC Capital Markets LLC

Dara W. Mohsenian

Analyst, Morgan Stanley & Co. LLC

Jason English

Analyst, Goldman Sachs & Co. LLC

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Christopher M. Carey

Analyst, Wells Fargo Securities

MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to The Estée Lauder Companies Fiscal 2021 Third 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. Please go ahead.

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 on the SEC where you will find factors that could cause actual results to differ materially from these 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 and adjustments disclosed in our press release. Unless otherwise stated, all net sales growth numbers are in constant currency and all organic results exclude the impact of

acquisitions. 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 dot-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 we can respond to all of you in 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. It's a pleasure to speak with you today and I hope that you and your families are in good health. Our hearts are with those impacted by COVID-19 particularly in places like India and Brazil that are experiencing severe resurgences. We remain committed to doing what we can to support our employees and these communities.

Our third quarter of the fiscal year 2021 marks the continuation of strong sequential sales growth improvements despite the ongoing challenges from the pandemic. We exceeded our sales and earning growth expectation even as several markets experienced increasing COVID-19 pressure throughout the quarter. Our multiple engines of growth strategy drove our success, empowered by the exceptional creativity and passion of our employees.

We achieved these outstanding results while acting on our values. First and foremost, we continued to invest in employees and consumer safety and well-being during the health crisis. We expanded our work for the environment from setting innovative new sustainability goals in Travel Retail to seeing a wind farm in Oklahoma become fully operational, which is our largest renewable energy contract to-date and a project we were proud to support.

We made progress on our racial equity commitments and also outlined a new set of commitments for women advanced and gender equality, inclusive of achieving gender equity and globally increase representation of women from underrepresented groups.

In March, we launched our new Equity and Engagement Center of Excellence to drive greater equity representation within our business and across the value chain. We also launched a partnership with Howard University to support the success of its alumni through our experiential learning, career coaching, professional training, and mentorship opportunities.

While there was joy in this progress, there was also sorrow. We stood with our employees, consumers, and partners in denouncing the rise in act of violence, hate, and discrimination against the Asia and Pacific Islander community and committed to donate to organization that support justice and equal treatment from Asian community in the United States. We keep our employees and communities top of mind through these challenging times.

With that, as our guiding principle, let me turn back to financial results. Constant currency sales rose 13%, representing a sequential acceleration of organic sale growth improvement. We delivered this strong performance

despite increases in COVID-19 hardship in Western Europe, Latin America, and parts of North America during the quarter.

Estée Lauder, La Mer, Jo Malone London, Clinique, and Tom Ford Beauty led the impressive performance of many brands. Skin Care and Fragrance once again delivered superior sales growth, although they had the toughest comparison to the year-ago period. In fact, our Skin Care category was nearly 30% larger on a reported basis this quarter than it was two years ago, owing to innovation in our powerful hero franchises, strength across multiple subcategories, and the addition of Dr. Jart+ but before the future inclusion of DECIEM.

And our Fragrance category was 16% bigger than it was in fiscal year 2019 on a reported basis, driven by our strategic focus on the luxury and artisanal segments. Both of these categories now have even greater scale to capture prestige beauty share as the recovery unfolds.

In the third quarter of fiscal year 2021, we focused our investment decisions on engines of growth and employed cost discipline in other areas, resulting in a near doubling of adjusted diluted earnings per share versus the prior-year period.

While the complexities of the pandemic are ever-present, adjusted operating margin nonetheless exceeded that of the third quarter of fiscal year 2019, and adjusted diluted earning per share was 5% higher.

Throughout the pandemic, we have been steadfast in our commitment to the long-term as we successfully navigate the short-term. We continue to strategically invest to drive sustainable growth including building an end-to-end innovation center in Shanghai and state-of-the art manufacturing facility near Tokyo. These are expected to open in calendar year 2022.

More recently, several of our brands decided to participate in the new partnership of Sephora with Kohl's and Ulta Beauty with Target, beginning in the second half of this calendar year. This new consumer coverage represents the promising evolution of the retail land-scape both in-store and online in the United States for prestige beauty.

We also agreed to increase our ownership in DECIEM, becoming majority investors with a path to full ownership in three years. DECIEM, with its fast-growing brand, The Ordinary, and new brand incubation capability aligns well with our multiple engines of growth strategy. The Ordinary further diversifies our Skin Care growth engine by consumer segment, price point, and geography with a superior online business. The brand has redefined entry prestige with an increased ingredient focus [indiscernible] (00:07:58) product portfolio that drives basket size. The Ordinary has quickly established itself as the top five skincare brands in the US prestige beauty, having improved its rank significantly over the last year.

Sustainability is integral to DECIEM equity, products, and retail practices, which will enhance our sustainability brand portfolio and fuel the achievement of our ESG strategy and goals. We look forward to continue the exciting journey with Nicola Kilner and her incredibly talented team to realize DECIEM global opportunities.

In the third quarter, the Estée Lauder brand delivered stellar results led by strong double-digit growth in Skin Care, sequentially improving trends in Makeup, and a return to growth in Fragrance. The brand is driving a renewal in the signification of makeup trend with a significant growth of its Futurist franchise and its new Beautiful Magnolia Fragrance is off to a very promising start.

The Estée Lauder Skin Care franchises performed exceptionally well, led by Advanced Night Repair and its recently reformulated namesake serum. Revitalizing Supreme+ also was a standout as the launch of Supreme+

Bright proved highly sought. Supreme+ Bright is an amazing story of East to West success with the product born in the brightening trend in Asia and realizing global appeals for its uneven skin tone benefits.

Re-Nutriv new eye serum surged and created a halo effect for the franchise face and eye creams. La Mer performance was once again outstanding. The brand's worldwide success is multifaceted from both loyal and new consumers and with increasing demand from men who now represent more than 15% of sales in Mainland China.

La Mer's iconic product, rich storytelling, and ideal merchandising aligned to deliver the successful journey to renewal campaign for Chinese New Year. As well, the brand executed a superb global campaign focused on moisturizers. The new Genaissance de la Mer, the concentrated night balm, continued to spark consumer desires, innovating the brand ultra-luxury franchise.

Clinique sales growth accelerated sequentially and rose in every region, driven by its Skin Care portfolio. From consumers excellent response to the new Moisture Surge 100-Hour in the United States to Even Better Clinical Interrupter fueling substantial growth in Mainland China to in-demand hero franchises like Dramatically Different moisturizing, Clinique prospered.

Our luxury and artisanal fragrances realized significant growth in the Americas and Asia-Pacific. Like Skin Care, Fragrance offers a means to express self-care, and that's so through the emotional comfort of scent. We have seen strong repeat from the emerging category in Asia-Pacific while we continue to welcome new consumers in the region.

This strength in Fragrances, driven by our strategic shift to the higher end, is favorable to margin enhancement in the category. Jo Malone London, Tom Ford Beauty, Kilian Paris, Le Labo, and Frederic Malle each grew double digits. Innovation in hero products work in harmony to fulfill consumer desires, with newness from Jo Malone London and Tom Ford Beauty incredibly well received.

Kilian Paris virtual selling which engaged founder, Kilian Hennessy, influencers and education ambassadors through live chat and shoppable live streams contributed to superb online growth.

Each region grew this quarter, led by Asia-Pacific which saw sales rise in every category and many countries contributed. Mainland China was exceptional, delivering sequentially accelerating double-digit sales growth, with Skin Care and Fragrance performing ahead of the prior quarter; and Makeup returning to growth, up double-digits. Both brick-and-mortar and online thrived, driven by the strong equity of our brands, desirable innovation, high quality products leading to repeat purchase, competitive investment in advertising, and investment in local talent and capabilities.

For the Chinese New Year, we met the consumer where she or he chose to shop, serving the local consumer as well the traveling consumer in Hainan both in-store and pretail to tremendous success. Online continued to be a powerful growth engine as global sales increased strong double digits in every region. Sales of brand dot-com, third-party platforms, and retail dot-com rose strong double-digits, while sales of pure play grew triple-digit as we are building our consumer coverage with select pure play retailers.

Our online channel is now nearly double the size it was two years ago. Importantly, the media value of brand dot-com continued to rise as live chat, digital try-on, and live streaming led to increased traffic and time spent on our sites.

EMEA online sales increased near triple-digits, while Latin America's growth was also very high. We have actually met consumer demand in these regions which were more pressured than others from temporary brick-and-mortar closures.

In Asia-Pacific and North America where in-store traffic is gradually improving in comparisons to the prior year are increasingly more difficult, online sales still grew double digits. We are innovating in the high-touch online consumer experience and harnessing our data to increase engagement and drive sales.

Let me share two examples from [indiscernible] (00:15:02). In the United Kingdom, Clinique launched an integrated platform to deliver seamless end-to-end high-touch virtual experiences with a personalized data-led version of its Skin School on Demand. Clinique is providing consultants with data to unlock more sophisticated recommendation with a multitude of tools to ensure the consumer experience is customized based on preferences. Consultants can now enable co-browsing and the adding of friends to services. This new platform, while still in its early days, is delivering above-average conversion rates.

La Mer enhanced its virtual experiences with more expert classes and one-to-one consultations tailored to local consumers. The brand expanded live chat to every market in the region with a standard hours and additional days leading to incredible growth in conversion. All told, La Mer saw its regional online mix of business surge.

Our brands are investing for growth with social media platform. Too Faced introduced a new Virtual Try-On lens on Snapchat to add to its growing portfolio of virtual try-on experiences.

On TikTok, it launched a mini movie showcasing the transformative experience of Better Than Sex Mascara via its first world premiere on the platform. Dr. Jart+ Cicapair color-correcting treatment started strong online sales in the United States for the brand, amplified by social selling, TikTok and influencer support.

Looking ahead, we are preparing a renaissance in Makeup, and we anticipate that momentum will gradually build around the world, driven by local reopening and social and professional occasions. Our data and insights are driving new creativity to inspire consumer as they increase their occasion-based makeup. We are strategically well-positioned to grow our sales and capture prestige beauty share makeup recovery with our hero products, robust innovation pipeline, analytics engine, driving aspirational intelligence, and enticing in-store and online activation centered on the omni-channel consumer.

Already in the third quarter, newness from Clinique Even Better franchise in Foundation and Concealer was highly sought as we saw consumers restocking their core makeup products. Too Faced new Lip Plumper was a major hit. Hero products like Tom Ford Beauty eye shadows and mascara from Too Faced and Bobbi Brown also performed very well. MAC is launching a new mascara, and there is exciting innovation from many brands to come.

In closing, we delivered outstanding performance despite the resurging impact of the pandemic in many countries. We led with our values as we continued to prioritize the safety and well-being of our employees and consumers. We made progress on our environmental goals, and acted on our social commitment. We invested in accelerating drivers for sustainable growth including innovation in China, manufacturing in Asia-Pacific, global online, and consumer analytics.

For the long-term, we are confident that our multiple engines of growth strategy will continue to create value for our stockholders.

I want to say thank you to our employees who are integral to our success and are making us a better company through this difficult moment. We are beautifully positioned in prestige beauty to continue driving recovery with the house of the most dedicated and talented employees.

I will now turn the call over to Tracey.

Tracey Thomas Travis

Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.

Thank you, Fabrizio. I certainly echo that statement and look forward to the continued progression of our recovery.

For our fiscal third quarter, net sales rose 13% as we lapped the onset of the COVID pandemic and delivered exceptional growth in the Asia-Pacific region and in the Skin Care and Fragrance categories. While our brick-and-mortar distribution continued to experience soft foot traffic, our online channel delivered strong growth across all formats and all regions. Conversely, the environments in Western Europe, Latin America, and parts of North America were challenged throughout the quarter.

Our gross margin increased 90 basis points compared to the prior-year quarter. Favorability in category and channel mix driven by Skin Care and Online growth, as well as lower tester costs, were partially offset by obsolescence, negative currency, and COVID-related under-recovery of fixed cost primarily in our facilities that manufacture makeup products.

Operating expenses improved by 530 basis points compared to the prior-year quarter, largely reflecting the improved sales leverage this year. You will recall that when the pandemic struck in the prior-year quarter, the sudden and dramatic drop in sales created expense deleverage that was difficult to fully offset despite the cost actions we took at that time. This quarter, we benefited from both temporary and longer-term cost savings which is reflected in the substantially lower selling and store operating cost as a percent of sales continued to shift from brick-and-mortar to online as sales continued to shift from brick-and-mortar to online.

This was due in part to temporary store closures in response to a resurgence of the virus in certain EMEA and Latin America markets. We realized some subsidies and the extension of furlough benefits in some of the affected markets. We've also prudently managed staffing levels in our stores and new hires on our management teams until we see the recovery gaining more consistent momentum.

Advertising spending grew double digits and was predominantly focused on digital spending. We invested to support our online acceleration as well as our new product launches, a strong recovery in certain markets, and key shopping moments such as Lunar New Year, Women's Day, and Valentine's Day. As a result, our operating margin rose 620 basis points to 20.5% which was 40 basis points above fiscal 2019 levels.

Our effective tax rate for the quarter came in at 20.7%. The lower tax rate for the quarter was primarily due to a lower rate on the company's foreign operations.

Diluted EPS of \$1.62 increased 92% compared to the prior year. EPS exceeded our expectations primarily due to the higher sales, continued cost management, and a lower effective tax rate.

Our plans under the Post-COVID Business Acceleration Program are progressing. Year-to-date, we have taken actions in three main areas to adjust our distribution footprint in Latin America and EMEA, including Travel Retail; to exit global distribution of BECCA products; and to realign resources and capabilities including employee-related

costs between our brick-and-mortar and online channels. We are already beginning to realize some modest benefits from these actions. As the program continues, we expect to further rationalize our brick-and-mortar retail footprint primarily in western markets.

For the nine months, we generated \$2.78 billion in net cash flows from operating activities which was substantially above the prior year, primarily due to higher net earnings as well as working capital improvements.

We invested \$386 million in capital expenditures to support key investment areas like production and distribution capacity, and technology including our online business. Conversely, we spent far less on counters and stores.

We ended the period with approximately \$6.4 billion in cash and cash equivalents, including cash from \$600 million in senior notes issued in March to support the increased equity investment in DECIEM once the deal is finalized.

We also reinstated our share buyback program in March and utilized \$316 million of cash to repurchase our stock. And we paid \$561 million in dividends. After the end of the quarter, we used \$450 million in cash to pay down debt maturing in the fourth quarter.

Given our strong cash generation this year, we still remain in a very strong position to pursue further growth opportunities after these actions.

So now, let's turn to our outlook. We continue to be encouraged by the sequential improvement we have seen in our business throughout the fiscal year and we are optimistic that restrictions and hesitancy on travel and social activities will begin to ease in certain markets as vaccine coverage steadily increases.

In China, Australia, and Israel, which are at the leading edge of recovery, we are seeing higher makeup sales with usage occasions increasing as social and professional engagements gradually normalize. For example, sales in our free-standing stores in Israel have returned to pre-pandemic levels, and even lipstick sales are almost back to normal. The upcoming addition of the DECIEM brands to our portfolio and the expansion of our business with Sephora and Ulta Beauty in the US represent additional growth drivers for us as we progress in recovery from the pandemic shock giving us further cause for optimism.

We have led with our strengths, our values, and our amazing team and have proactively addressed areas which we could control while at the same time ensuring we are protecting our strategic growth areas. As a result, in the context of a very challenging environment in fiscal 2021, we expect to end the year with sales growth of between 9% and 10% in constant currency. Currency translation is expected to add approximately 2 percentage points to reported growth, reflecting rates of 1.18 for the euro, 1.33 for the pound, and 6.64 for the yuan.

Six months of incremental sales from the December 2019 acquisition of Dr. Jart+ and approximately one month expected from DECIEM are contributing approximately 2 percentage points to our expectations of growth for the year.

Mindful of the more gradual resumption of traffic to our brick-and-mortar distribution, we kept tight control over costs this year to protect investments needed for long-term growth. Some of the costs we cut temporarily will gradually return as more doors open. Subsidies will correspondingly diminish, and we plan to meaningfully ramp-up advertising spending in our fourth quarter as consumers return to social and professional engagements.

That said, we expect to end this fiscal year with an operating margin of approximately 18.5%, an improvement of roughly 100 basis points above fiscal 2019.

Full-year EPS is expected to be between \$6.05 and \$6.15 before restructuring and other charges. This reflects approximately \$0.10 accretion from currency translation and \$0.04 dilution from acquisitions.

Our fourth quarter sales are expected to rise between 44% and 50% in constant currency. This reflects both the recovery in many parts of the world as well as an easier comparison against the prior-year period most impacted by the pandemic.

Currency is expected to be accretive by approximately 4 percentage points and the addition of approximately 1 month of sales from DECIEM would contribute less than 2 percentage points to sales growth.

Fourth quarter EPS is expected to be between \$0.38 and \$0.48, reflecting the sales outlook and increased investments to support the ramp-up of our innovation and manufacturing capabilities in Asia, continued investment to drive our online business and the advertising and promotion to support recovery, with the resulting operating margin more typical of our pre-pandemic levels of mid- to high-single-digit in the quarter.

Currency is expected to add \$0.02 to EPS and the addition of DECIEM is immaterial for the quarter given the short timeframe and purchase accounting.

In closing, we are pleased with our performance in the third quarter in the context of a challenging macro backdrop. Our Skin Care and Fragrance brands have proven to be resilient during this time as consumers shifted online and we enhanced the digital experience with increased services on our sites.

As we navigate through the final months of our fiscal year, we are investing in both the near-term recovery and the drivers of long-term sustainable growth that create value for our multiple stakeholders. While it is difficult to predict the growth of global prestige beauty in the near-term, we are confident as we have demonstrated that we can nimbly allocate resources to continue to operate with agility and gain share as the recovery gives way to the new normal.

That concludes our prepared remarks, and we'll be happy to take your questions at this time.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for questions. [Operator Instructions] Our first question comes from the line of Laura Lieberman with Barclays.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Great. Thanks. Good morning.

Q

Fabrizio Freda

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

Good morning.

A

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Good morning. I was hoping you could talk a little bit about Asia-Pacific, because as strong as trends are, on a two-year basis things were a little bit slower this quarter, and I know in the fiscal second quarter you have 11/11, that's probably a much bigger shopping holiday than Chinese New Year. But from the aggregate level that we see in Asia, things were probably a little bit slower than people expected.

Q

So could you just give us a little bit more color there describing maybe trends in China – Mainland China I should say, versus whether it was Hong Kong, Japan, other areas where things might have slowed down?

And also, any other thoughts on Hainan and the degree to which shopping there may be overlapping with things that – purchases that used to happen in other Asian markets as Chinese were traveling more overseas, they're now maybe repatriating those purchases to Hainan. Thanks.

Fabrizio Freda

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

Yeah, no, sure. Let me start, and then Tracey will add some perspective. The – first of all, no, we believe China is super strong. I mean, we have accelerated the size, our reported number is 63% growth, which is almost double last quarter. So China Mainland is very, very strong. Now, this number include Dr. Jart+, which is also a strong growing brand in Asia and now is now part of our portfolio. So all good.

A

Now, your question on Hainan, Hainan was also strong and continues to grow. And as we said, we really look and manage the Chinese consumers. So we sell to the Chinese consumers where they are. When they travel to Hainan, we sell to them in their travel; and when they are in their cities, we sell to them in their cities. The opportunity of continue serving the growing middle-class and the multiple smaller cities which are becoming very important for consumption from which the demand is growing continues.

And we are serving these multiple growth, meaning also there's more cities, the Tier 3, Tier 4, and the different consumer groups. We are serving these both in Mainland and in Hainan when they travel in a very positive way. So China is very strong. And in our opinion, will continue very strong trend.

The other thing that we've seen which is important to us in China is the recovery of makeup, because China is ahead of other regions in the control of COVID, and so in people going back with more confidence to shopping also in brick-and-mortar. And we see the positive impact on that on Makeup which I said in my prepared remarks grew double digit. And it obviously is encouraging for what the recovery will represent also in the West as the brick-and-mortar sales go back into the new normal.

The other part of your question was about Asia in total. And, yes, Hong Kong is obviously smaller than what it used to be, and the recovery is lower. And so, Hong Kong is getting better, but it had been resized at least for the time being to what it used to be, so still is a drag versus the historical levels.

And Japan was definitely hit by a new wave and there was new closures and a lot of government activity to limit shopping in brick-and-mortar anyway to limit the social life activity which means again a very big impact on Makeup.

And so, Korea, on the contrary, started recovery, had a better quarter; and Australia had definitely a better quarter. By the way, Australia is another place where it's visible the recovery on makeup, because of the re-opening of the brick-and-mortar and more social life.

So Asia was a very mixed bag. In summary, a very strong China, very strong Hainan, a better Korea, a better Australia-New Zealand, and still very hard-hit some of the emerging markets, Japan and Hong Kong.

Tracey Thomas Travis

Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

And you covered it, Fabrizio.

Fabrizio Freda

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

A

Okay.

Operator: Your next question is from Erinn Murphy with Piper Sandler.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Q

Great. Thanks. Good morning. Fabrizio, I was hoping you could share a little bit more about the renaissance of Makeup you spoke to in China in particular. How is the consumer interacting with the category there? Are there new trends that they're starting to embrace? And then are they sticking with Virtual Try-On in some of the new ways of shopping like social selling or live streaming? And/or do you anticipate testers or samples coming back? Just curious on some of the behavior behind that category there.

Fabrizio Freda

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

A

And so, well, first of all, what we see is that the recovery on Makeup is particularly – benefits particularly of the recovery of brick-and-mortar and omni-channel shopping because people does like to interact with the products and likes the experience of shopping together. And so, this is really one driver. And so, in China, we see these getting stronger and as the recovery unleash.

What we see in term of product that people – and again, I'm speaking about China, where it is up, but also Australia and Israel is another place where we see signs of what happens during the recovery. And the signs are consistent, by the way.

And, first of all, people go back to their core makeup, also because they have not used it for some time, it may not be fresh anymore in some cases, so there is a lot of back to foundation, to lipstick, to mascaras that needs to be purchased back. And now, depending which region of the world, there are different proportion of the subcategories, as you know. But this is back to core.

But there is also a huge interest in newness. It's obviously, from an emotional standpoint, people don't want to go back to the past. They want a new normal. They want to forget actually this very difficult year when they are in a recovery mood and go back to a new future. So they look for newness, for novelty, and that's why in our renaissance plan we are both planning in every region of the world where, when this recovery will happen. We are ready to bring back our core and allow the consumer to reload what is their core habits, their core products, and at the same time an outstanding mix of new product, innovation, [indiscernible] (00:38:00) fresh way to use makeup, new looks, and most importantly, looks which are consistent with the renaissance of the usage occasions.

Because to be clear, makeup is not only about shopping, emotional shopping; it's about having the occasions in your social life, your professional life, to use makeup. And so, we are studying how those occasions come back and which kind of makeup core and newness is of interest for each occasions. And the occasions are different by region. And so, with this level of analytics, we are preparing what we call the renaissance which is a comeback that is very specific and our ability today to manage this with precisions and avoid excessive push or avoiding wrong subcategories focus. In other words, ensuring a good return of our investments during the recovery.

Our ability to do that has dramatically increased, thanks to analytics which are not only giving us more data to understand what's happening, but is giving us more data to anticipate what is going to happen. And that's what we are working on.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Q

Great. Thank you.

Operator: Your next question is from Nik Modi with RBC Capital Markets.

Nik Modi

Analyst, RBC Capital Markets LLC

Q

Hi. Good morning, everyone.

Fabrizio Freda

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

A

Good morning.

Nik Modi

Analyst, RBC Capital Markets LLC

Q

Good morning. I wanted to ask about the recent new hire for the Online President that you brought in from the outside. I mean, obviously, the Online business for you has done incredibly well over the last 10-plus years. And

so, just wanted to get your thoughts on kind of what the priorities will be for new leadership, especially given that they do have outside perspective of both CPG and retail. Thanks.

Fabrizio Freda

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

A

Yeah, sure. First of all, Gibu is now in [indiscernible] (00:40:01) and is an exceptional new hire and a leader well integrated by now in our organization. He will bring our Online business to next level. As you said, we have done well for many years, but he's here to bring it to a completely new level.

And so, the priority is first of all to continue our growth and leverage this huge acceleration in every single channel, in brand dot-com, in third parties, in pure plays, in retail dot-com, and in making sure that we have the circulation of the best practices around the world that we learn from what's happening in every angle of the world both in our business and in what competition of retailers are doing and third-party are doing.

But I would say the center of all this is to add more technology in order to make the consumer experience in each one of these touch points really, really high quality, even more competitive. So the focus is on taking the consumer experience to the next level. You heard me speaking in the past about charts, digital try-on, live streaming, and many other experiences that are possible but need to become better and better over time, and surprise the consumer for positive. And if we do that correctly, we will continue to drive traffic to our online because we'll attract traffic not only because of our great brands, of our great innovation but also because of our outstanding services online and because of the experience online that will be frictionless.

And also we will need to make sure that this happens in a very efficient way and in a way which is driven by technology and become consistent across the world so that we can scale it very fast every single time this is going to be needed.

And finally, we – also one of the priorities is to make digital advertising and particularly all the advertising linked to e-commerce more efficient and more effective. And with this, to continue to push conversion that will be one of the key challenges and the key opportunities of the next years in the world of online.

Operator: Your next question is from Dara Mohsenian with Morgan Stanley.

Dara W. Mohsenian

Analyst, Morgan Stanley & Co. LLC

Q

Hey, guys.

Fabrizio Freda

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

A

Hello.

Dara W. Mohsenian

Analyst, Morgan Stanley & Co. LLC

Q

Just given the unique nature of the COVID crisis, can you just give us a bit of an update on your expectations for the Travel Retail category going forward? How quickly do you think demand comes back? How do you manage the business for the pace of recovery but also potential volatility? I'd just love a bit of an update there. Thanks.

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

A

Yeah. Again, Tracey, I'll let you add any perspective. But our Travel Retail business is up, and so is, I would say, the recovery will be a net extra versus what has already growth. So what's happened in this period, as you well know, is that the domestic travel in general and particularly within China has been more than offsetting the lack of international travel all over the world and particularly in the West. And so, in this moment, we expect the strength that today in Travel Retail in domestic travel in China with Hainan and with new centers like Shenzhen, the Greater Bay, and other opportunities which are emerging over time, we expect this to continue and to remain very, very solid.

But then at a certain moment when international travel will be restated, then we expect international travel to bring net extra opportunities, particularly in the West where there will be obviously many more populations going back to travel. And when this will happen, we envision Travel Retail to be even stronger than what used to be historically and definitely stronger than today, which is mainly driven by only the domestic travel part. So a strong reality today, a strong future for Travel Retail.

Now, Travel Retail is about traffic, which is what I was commenting on now, speaking about the future recovery in international travel. But it's also about conversion which is the percentage of travelers that buy something. So we have seen recently the conversion going up driven by pretail, so the ability to buy online when you travel. Now, pretail is accelerating in Asia. It's a very – it's already about one-third of the business in many part of Asia and is not yet very present or very significant in the West.

So we see in the future pretail to continue to grow and to be a significant part on Travel Retail, and with the growth of pretail, we see the opportunity of increased growth or conversion. And in that sense, the traffic coming back plus conversion of travelers into buyers continue to progress. Those two KPIs will represent a very solid future for Travel Retail.

Tracey Thomas Travis*Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.*

A

And the only thing I would add, Dara, to what Fabrizio said, we are obviously watching traffic patterns and travel patterns pretty closely, our Travel Retail team is. So international travel is really projected at this point in time not to recover until perhaps even the second half of fiscal – our fiscal 2022.

So, again, we're watching it closely. Obviously, I mean, if it recovers sooner, the Travel Retail business internationally in terms of consumption would pick up correspondingly. But in the meantime, the Travel Retail team has done a fantastic job of making sure that we are managing the Western Travel Retail markets prudently in terms of investments until we see the recovery of traffic and consumption in the Western markets.

And the only thing I – the other thing I would say is that Travel Retail and Online combined now are a little more than half of our total business. And so, when you think about our growth momentum going forward and the recovery, the strength that we see in Online and the recovery of Travel Retail, it bodes very well for our future growth.

Dara W. Mohsenian*Analyst, Morgan Stanley & Co. LLC*

Q

Great. Thanks.

Operator: Your next question is from Jason English with Goldman Sachs.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good morning, folks. Thank you for slotting me in.

Fabrizio Freda

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

A

Good morning.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

I guess, I want to...

Tracey Thomas Travis

Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

Good morning, Jason.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

Good morning. I wanted to come back to, I guess, the first question where growth was a bit slower than many of us expected, and one thing that surprised me was just the sequential drop. I know that 2Q is always bigger than 3Q, but the dropdown from 3Q to 2Q in terms of revenue was larger than is typical pretty much across every region, but especially Asia-Pacific.

So it begs one or two questions. One, was last quarter maybe a bit inflated with some retailers once again kind of stepping back in the market reloading inventory, or is – are we seeing more of a setback? I mean, I know you talked about some markets tightening down, but generally from where we sit and look globally, it looks like the world is slowly re-opening, obviously not all consistently. So, help me contextualize or wrap my head around why we would see the sequential dip.

Tracey Thomas Travis

Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

Yeah, I mean, I'll start, Jason. I think that what we're seeing more and more in the business particularly in Asia-Pacific is more seasonality of the business. So Q2, as you indicate, has become a very large quarter for us. It always was a large quarter with holiday. But with the addition of 11/11 and tremendous growth of that holiday year-over-year, we're seeing a very large sales number in our second quarter.

In the third quarter, as Fabrizio mentioned, China had a very strong third quarter. We did have some large markets in Asia that were a bit softer, Japan. And I think through this pandemic, we're going to see ups and downs until things really more sustainably get back to normal, when vaccine rates obviously accelerate a bit. So, I would not read anything long-term into it other than this is still part of the pandemic in terms of seeing up and down performance in various markets.

Similarly in terms of EMEA as well. Obviously outside of Travel Retail, but the Western markets in EMEA were also quite challenged in the quarter as well. So, that we expect to see until again we see more stabilization and normalization from the pandemic.

Fabrizio Freda

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

A

Yeah. And so, frankly, I just want to underline what Tracey said. I would read in this more of a strong quarter two, particularly driven by an extraordinary 11/11 where some of our brands were topped in the 11/11 project. And by the fact that holidays were a moment also in the West, they were pretty positive. People, where possible, were allowed went back to shopping. Some brick-and-mortar were open. And then, maybe because these holidays were in some places were open too early, then there was a lot of closures immediately after. And so, Japan, UK, Italy, part of North America, Canada. So we got an enormous amount of closures in the January-March period and – in the West particularly, and Japan obviously.

And so that's the combination. The combination is the pandemic impact on brick-and-mortar. Now, keep in mind that as you have seen in the results, we have an extraordinary Skin Care and Fragrance and also our Aveda brand is doing really strong. The question is the Makeup recovery. And the Makeup is very linked to the comeback of the brick-and-mortar experience. So, all the closures that happened actually after the holidays in many Western markets and in Japan did have an impact on makeup, and we have seen that.

So, I will not say there is any long-term sign in this quarter three. Actually is an extraordinarily strong quarter 3. By the way, it was ahead of our guidance because we had seen that in our guidance. We had seen these kinds of things that would have happened because of the closures. And so, it was a very strong quarter. And quarter two was just an extraordinary quarter. But as Tracey said, quarter two will be pretty strong because in the future there will be always a combination of holidays and strong peak of commercial activities like in 11/11 and more that will create a high in term of absolute level of sales.

Tracey Thomas Travis

Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

Operator, next question?

Operator: Your next question is from Rupesh Parikh with Oppenheimer.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Q

Good morning. Thanks for taking my question. So, Fabrizio, just getting – going back to your comments, so Skin Care and Fragrance have now exceeded FY 2019 levels. So I was just curious if you look at makeup going forward, do you see any structural impediments in your business to get back to where Makeup was pre-pandemic from a sales perspective?

Fabrizio Freda

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

A

No. No. Definitely not. We are counting on it. Again, as COVID abates and the opening – as I said before, I want to repeat that – makeup is about usage occasions. So – and the usage occasion on makeup are exactly the social and professional occasions that when there are closures and when the pandemic is very active are not there. And so consumption goes down. So, we are really – we don't see any reason why we will not go back to first

stabilization and then growth in makeup when these social occasions come back and these professional occasions come back.

Just want to take an opportunity to the pictures. Today, we have our current drivers which are the Chinese consumer, the global online, and the Skin Care category and now the high-end Fragrance category that will continue to drive. There is no discussion. These areas have been accelerated by COVID, but in reality, their trends were strong already before. So COVID has accelerated. We are really ready, and as you see, we are having great success on these drivers even in the middle of COVID.

Now, there are new drivers that should be added to these drivers as COVID will abate. Makeup usage, as I said, brick-and-mortar productivity in most markets, certain markets in consumer growth like US, UK, Japan, Continental Europe, emerging markets that today are unfortunately really badly hit by COVID, will come back and will gradually come back as the COVID improves. Younger consumer consumption, which is especially linked to makeup, will come back. And TR outside of Hainan as we said before and the pretail acceleration will come back.

So there are all these new drivers that we need to accelerate in the next 18 months assuming that will be the pace of return from COVID gradually.

Then, there are new strengths that we have built during COVID and we have invested them. There is better innovation in Asia with a center in Shanghai and the quality of our innovation that is creating higher repeat process rate. There is more Skin Care and more Makeup skinification, and we have more production capacity of high quality production capacity in our upcoming factory in Tokyo; better consumer understanding, and better ability to anticipate trend driven by our investment in analytics; more resources for advertising, especially the digital advertising which is increasing; better high-touch service online, as I explained before when there was the question on online; a brand portfolio which is becoming stronger and stronger with the acquisition of DECIEM and Dr. Jart+, a huge investment and acceleration in every ESG activity during COVID.

And all of these combined is what I call the new strengths that we are bringing to the party. So the way we see it is that the current drivers will drive, the new drivers including makeup will come back, and the new strengths that we have built in Estée Lauder Companies during this year will hit. And that's why we really believe that this quarter is just the confirmation that we are creating a very solid long-term sustainable growth pattern for the company.

Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.

Okay, great. Thank you.



Tracey Thomas Travis

Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.

And the only thing I would add to that is just to underscore some of the investment in technology we've made for virtual try-on. So when you think about those social and professional occasions coming back, whether someone wants to come in the store and try makeup or if they want to try it online, the engagement that we see online from some of the capabilities and features that we've added to online certainly bodes very well for when those occasions come back and the makeup category acceleration.



Rupesh Parikh

Analyst, Oppenheimer & Co., Inc.



Okay, great. Thank you.

Operator: We have time for one more question. Your final question will come from Chris Carey with Wells Fargo.

Christopher M. Carey

Analyst, Wells Fargo Securities

Q

Hi. Good morning, everyone. So, I wonder if you can just provide some comments on how you're thinking about that operating margin for fiscal 2021, which I think you said was 18.4%, but correct me if I got that wrong. And you noted this quarter that there are temporary but also longer-term cost savings, substantial operating costs in store with the shift to online, some subsidies in play.

But you're also reallocating costs for the longer term for brick-and-mortar to online. Channel mix is obviously going to be a dynamic going forward. And, I guess, underlying the question is that margins continue to come through at a much higher level, channel mix is clearly an element, but there are some costs that have come out permanently but also costs that are going to be coming back into the base.

And so, I guess, getting back to it, I wonder how you view this fiscal 2021 target. Do you think that you can move up from there with all the initiatives that you have noted, or would you expect some service step back as you weather some of these costs coming back in the base and channel mix evolving over the next year? Thanks so much.

Tracey Thomas Travis

Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

Yeah. So, Chris, as you know, we typically give forward guidance for the upcoming fiscal year in August, which we will certainly do. I mean, this has been an unusual year because of all of the things that you mentioned. We had part of the year where we had temporary salary reductions, we've had furloughs, and we've also done a fantastic job – our teams have – in terms of managing costs.

Some of those costs will come back next year, and some of them won't. Some of the door closures that we've permanently done, those costs and the remaining fleet of doors should be more productive as traffic continues to accelerate to brick-and-mortar which is where we see the bulk of the recovery.

So, given the cost actions that we've taken, given where we expect growth to come from next year disproportionately, we would expect continued margin progression, but we'll be able to say more specifically what that will be in the August timeframe.

But as we've said for many years, our growth areas are all margin accretive when you think about Travel Retail, when you think about online, when you think about the strength that we've had over multiple years in terms of Skin Care. And as Fabrizio said, we expect Skin Care and Fragrance to continue to grow and Makeup will also grow more strongly certainly next year as those occasions come back.

So, we've got multiple engines, multiple ways to progress margin even as investments do come back for brick-and-mortar and in other areas. We will in the fourth quarter, as you indicate, and I said in my prepared remarks, so, strongly invest as we normally do for the start of a strong fiscal year, and we will invest more in advertising to support what we believe will be an acceleration. It's selectively in the markets that we think that it will happen in.

Christopher M. Carey
Analyst, Wells Fargo Securities



Thanks so much for the perspective.

Operator: That concludes today's question-and-answer session. I would like to turn it back over to management for closing remarks.

Tracey Thomas Travis

Executive Vice President-Finance & Chief Financial Officer, The Estée Lauder Companies, Inc.

No. I'll just thank everybody for obviously their interest in the company, and again, I think we want to thank all of our teams for the fantastic performance navigating through what has been a difficult year. But we are incredibly proud, as I mentioned and Fabrizio mentioned, of our results and certainly look forward to closing the year strong with the guidance that we provided. So thank you, everyone.

Operator: Thank you. If you were unable to join the entire call, a playback will be available at 1:00 PM Eastern Time today through May 17. To hear a recording of this call, please dial 1-855-859-2056. Pass code number 5569398. That concludes today's Estée Lauder conference call. I would like to thank you all for your participation, and wish you a good day.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2021 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.