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The Estée Lauder Companies, Inc. (EL)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to The Estée Lauder Companies Fiscal 2021 Fourth Quarter and Full-Year 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 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, divestitures, brand closures and the impact of currency translation. 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 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 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 you and your families are in good health, and our hearts continue to be with those impacted by COVID-19. We delivered outstanding performance amid the pandemic in fiscal year 2021, capped with an exceptional fourth quarter and powered by our dynamic multiple engines of growth strategy, as well as the timeless desirability of prestige beauty.

In a year of pain and sorrow, our employees cared for each other, their families and our company with compassion, creativity and resolve. While the challenges of COVID-19 persist, we confidently begin fiscal year 2022 as a stronger company full of aspiration for the opportunities of tomorrow. For fiscal year 2021, sales rose 11%, as we pivoted our energy resources to the growth engines of skin care, fragrance, Asia/Pacific, travel retail in Asia/Pacific global online. Impressively, eight brands grew double-digits, led by Estée Lauder, La Mer and Jo Malone London.

Multiple waves and variants of COVID-19 [indiscernible] (00:02:58) a year ago drove volatility and variability throughout the year. We saw reopenings revert to closings and reopenings in one market met with renewed lockdowns in other markets. Despite this, we delivered on the goal we set last August for sales growth to improve sequentially each quarter. Our sales exceeded \$16 billion for the first time ever, up 9% from fiscal year 2019 on a reported basis, fueled by skin care and fragrance.

Adjusted operating margin expanded to 18.9%, which is 140 basis points above fiscal year 2019, as we invested in today's strongest growth engines, managed cost with discipline and funded long-term growth opportunities. Adjusted diluted earnings per share rose 21% relative to two years ago. We delivered these excellent results while pushing our social impact and sustainability goals and commitment.

First and foremost, we remain focused on employee and consumer safety and wellbeing. We achieved important milestones for our 2025 sustainability goals; expanded our inclusion, diversity and equity programs; defined a strategy for women's advancement and gender equality; and advanced work toward our racial equity commitments. Here are a few among the many areas of our progress. We achieved net zero carbon emissions and 100% renewable electricity globally for our own operations.

We also set science-based emissions reduction targets addressing Scope 1 and 2 for our direct operation and certain elements of Scope 3 for our value chain, signaling our new level of ambition for climate actions. We launched ingredient glossaries for seven additional brands, such that 11 brands now offer this insightful content. We transformed our traditional Inclusion, Diversity and Equity Week into a blockbuster virtual experience with 35 events involving thousands of participants from 25 countries. We also introduced new educational offerings, including for anti-racism and inclusive leadership.

We expanded our grassroots-led employee resource groups, which served as a source of support and comfort throughout the tumult of last year. The Women's Leadership Network is our largest group and is now global with its expansion into Latin America and Asia/Pacific. We created two new leadership programs for women and Black employees. The Open Doors Women's Leadership Program is a unique intensive course to develop our next

generation of women leaders. Building on its success, we designed the Open Doors [ph] Collection (00:06:30), a self-guided program to bring these leadership skills to all our employees around the world.

The From Every Chair, Leadership & Development Program has successfully helped to ensure that Black employees have equitable access to leadership trainings, mentorships, career development and advancement opportunity, as well as to build a stronger, more inclusive network of talent across the organization by promoting visibility and facilitating leadership connections points with participants. Our new partnership with Howard University focused on its alumni-hosted 12 engaging events and launched an accelerator program to help increase the pipeline for Black talent with career coaching, professional training and self-empowering networking.

Let me now turn to product innovation, which served as an impactful catalyst for growth in fiscal year 2021. Innovation represented over 30% of sales, exceeding our expectations. We combined data analytics with our creative talent and R&D to successfully anticipate, scale and set trends across categories. The Estée Lauder brand achieved its fourth consecutive year of double-digit sales growth in fiscal year 2021, fueled by strength across its many hero franchises in skin care. Trusted products along with innovation were highly sought from Shanghai to New York, Paris and now São Paulo, given the brand's well-received launched in Brazil.

Advanced Night Repair newly reformulated serum sparked excellent sales growth. Revitalizing Supreme+'s new Supreme+ Bright Moisturizer further bolstered the accelerating franchise, while Re-Nutriv new eye serum surged and created a halo effect on demand. In makeup, the brands Double Wear, Futurist and Pure Color franchises produced significant double-digit sales growth in the fourth quarter, an exciting early sign of makeup renaissance.

La Mer delivered outstanding double-digit sales growth in the fiscal year, as innovation soared and engaging campaigns with iconic ingredient-based narratives drove demand for its hero products. The new Genaissance de la Mer Concentrated Night Balm proved highly sought after and expanded the brand's ultra-luxury franchise, as it both welcomed new consumers and captivated loyal consumers globally.

Clinique skin care excelled in fiscal year 2021. Sales rose double-digits and powered the brand to high single-digit sales growth. The brand successfully met consumer needs through the launch of Moisture Surge 100H with its unique hydration benefits and target solution for hard-to-solve skin care problems like Even Better Clinical Interrupter. Clinique showcased its promise for makeup renaissance with stellar double-digit category growth in the fourth quarter, with the new Even Better Clinical Serum Foundation and Even Better Concealer capitalizing on its skin care authority.

All told, our robust skin care portfolio from entry prestige to luxury and across subcategories [ph] is fulfilling these journey needs (00:10:28) around the world. Dr. Jart+ with its artful derma brand positioning and hero products delivered strong double-digit organic sales growth in the second half of fiscal year 2021. In May, we amplified the strength of our skin care portfolio as we became majority owner of DECIEM with its coveted ingredient-based brand, The Ordinary, and emerging science-driven NIOD brand as part of its portfolio.

Complementing skin care strengths, fragrance delivered striking sequential sales growth acceleration throughout the year. Each of our luxury and artisanal fragrance brands contributed meaningfully from Jo Malone London to Tom Ford Beauty, Le Labo, KILIAN PARIS and Frédéric Malle in both established fragrance markets of the West and emerging fragrance market of the East. Tom Ford Beauty's Private Blend franchise is both recruiting new consumers and driving strong repeat in markets newly embracing the category, with the brand's fragrance sales more than doubling in Mainland China during the year.

The Asia/Pacific region was another dynamic growth engine in fiscal year 2021, as annual sales growth accelerated from 18% to 22%, led by Mainland China where sales rose strong double-digits. Korea grew organically. Several smaller markets also contributed to Asia/Pacific's strength. The region, however, experienced increasing pressure from the pandemic as the year evolved, with Japan and many markets in Southeast Asia particularly impacted from renewed lockdowns in the second half.

Mainland China prospered as we invested in its vibrancy of today and opportunity of tomorrow. We entered more cities reaching 145, expanded our presence in specialty multi, opened freestanding doors and increased our advertising spending. Skin care and fragrance sales grew strong double-digit for the fiscal year. We are encouraged that the makeup accelerated to double-digit sales growth in the second half. Our brands delivered excellent results for the key events of Tmall's 11.11 Global Shopping Festival and 6.18 Mid-Year Shopping Festival, as engaging live streaming generated further discovery for many new consumers.

For the recent 6.18, among Tmall beauty flagship stores, the Estée Lauder brand ranked number one in total beauty, while La Mer ranked first in luxury beauty and Jo Malone London led the fragrance category. To further capture [indiscernible] (00:13:31) online growth opportunity, we have continued to invest in Tmall and brand dot-com to expand our capabilities. Most recently, some brands increased coverage of a different demographic by launching on JD in July.

With international travel largely curtailed, we expanded our investment in the dynamic travel retail development of Hainan Island to serve the Chinese consumers in the best possible way, given the island's tremendous traffic growth and higher duty-free purchase limits. Our brands further elevated the in-store and prepaid shopping experiences, delivered ideal merchandising and leveraged live streaming to drive strong sales growth.

Looking at channels, online thrived globally in fiscal year 2021, characterized by strong double-digit sales gain and step change in its power as a growth engine. We accelerated our consumer-facing digital infrastructure and fulfillment investments. The channel is now more than twice as big as it was two years ago and greatly benefits from its diversification as each of brand dot-com, third-party platforms, retail dot-com and pure-play retailers delivered outstanding performance.

During the year, brand dot-com came to epitomize the allure of a luxury flagship store for each brands, localized by market and reimagined with our classic high-touch services. We expanded virtual try-on, live streaming, omni-channel capabilities and consultations with our expert beauty advisors. Consumers of all ages explored, replenished and engaged in an immersive environment of entertainment and community. Our brands increasingly leveraged exciting trends in social commerce by integrating with Instagram, WeChat, Snapchat and others.

Estée Lauder launched on TikTok with the #NightDoneRight hashtag, driving nearly 12 billion views and the creation of almost 2 million videos. [ph] It challenged US (00:16:01) diverse creators to educate a younger audience on how important it is to take care of your skin at night, showcasing Advanced Night Repair. Clinique #ZitHappens campaigns on TikTok became a viral sensation, highlighting the brand's acne solution [ph] and exposing (00:16:23) the creation of nearly 700,000 videos on the app. Together, these and other strategic actions delivered exceptional results for brand do-com, as new consumers, conversion, basket size, repeat and loyalty members grew considerably.

Beyond the favorable growth rates, the direct relationship we fostered with consumers enabled us to better optimize engagement in-store and online, offering exciting future growth opportunities. We are investing across all channels of online, collaborating with traditional and pure-play retailers on initiatives to actualize prestige beauty online potential. We spoke on the last call about having expanded our presence with pure-play retailers, which

continued into the fourth quarter, most especially in EMEA. And as I discussed few minutes ago, we are expanding our consumer coverage in Mainland China.

For fiscal year 2022, we expect these growth engines of skin care, fragrance, Asia/Pacific, travel retail Asia/Pacific and global online to continue to thrive, owing to our strong repeat purchase rates, sophisticated data analytics to drive consumer acquisitions and retention, high-touch online services, and robust innovation pipeline.

Three compelling skin care innovations recently launched. Estée Lauder new Advanced Night Repair Eye Matrix is focused on lines in every eye zone, while La Mer The Hydrating Infused Emulsion is designed to replenish, strengthen and stabilize skin with healing moisture and has already proven to attract new consumers. Clinique Smart Clinical Repair Wrinkle Correcting Serum is designed to visibly reduce stubborn lines.

Our Shanghai innovation center is expected to open in the second half of this fiscal year, enriching our capability in product design, formulation, consumer insight, and trend analytics for Chinese and Asian consumers. Also, with the new center, our East to West innovation will benefit, enabling us to create more successes like Estée Lauder Futurist Hydra or Supreme+ Bright and La Mer The Treatment Lotion.

As the world emerges from the pandemic, we will be the best diversified pure-play in prestige beauty, as more engines of growth contribute across categories, geographies and channels. Makeup and hair care are poised to gradually reignite as growth engines, as are developed markets in the West and brick-and-mortar retail. Growth in emerging markets is expected to resume over time as vaccination rates increase. We anticipate the momentum in makeup will build around the world, driven by local reopening and increasing social and professional use education, just as we saw in the fourth quarter.

Indeed, makeup started to improve to the end of fiscal year 2021, driven by our hero subcategories of foundation and mascara. Newness in the category was highly sought, as evidenced by the success of M·A·C's Magic Extension Mascara, Too Faced Lip Plumper, Smashbox Halo Tinted Moisturizer and Bobbi Brown Sheer Pressed Powder. Contributing to makeup's emerging renaissance, M·A·C launched M·A·C THE MOMENT, a campaign linking its makeup products and artistry-inspired trends to key experiences such as date night, parties, weddings and back-to-school shopping. Too Faced expanded into brows in July with a collection that includes an innovative brow gel that adds color and texture.

Similar to makeup, hair care is set to benefit from the rise of social and professional use education, as well as salon reopenings. Aveda, which is now 100% vegan, and Bumble and bumble entered fiscal year 2022 with momentum, owing to desirable innovation and rich consumer engagements from strong online performance globally over the past year. As makeup and hair care reignite, we expect our engines of growth will gradually diversify by geography and channel, initially driven by developed markets in the West and over time by emerging markets.

In the United States, in the fourth quarter, we aligned innovation, advertising spending and in-store activations as consumers returned to stores eager to explore beauty and experience high-touch services. Across brick-and-mortar, from regional and national department stores to specialty multi and freestanding stores, our business in the United States prospered, most especially in makeup and fragrance, and exceeded our expectations.

As we start our new fiscal year, Bobbi Brown recently debuted in Ulta Beauty. Several of our brands launched online and in-store with Sephora at Kohl's and Ulta Beauty at Target. In closing, we leveraged the power of our multiple engines of growth strategy to elevate the company to new heights in fiscal year 2021. We did this while

living our values, with the health and wellbeing of our employees as primary focus and making important progress on our social impact commitments and sustainability goals.

Our success and agility in operating amid the challenges of the past year give us confidence for fiscal year 2022, as we expect volatility and variability from the pandemic to persist for some time to come. This year, we are celebrating our 75th anniversary as a company and beginning our next 75 years incredibly inspired by the opportunities of tomorrow as the leading global house of prestige beauty with the most talented employees, to whom I extend my deepest gratitude.

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, and hello everyone. I concur with Fabrizio in thanking our incredible team, who have demonstrated great resilience during the pandemic. Navigating through the highly uneven recovery this past year has certainly required greater agility and flexibility, and our teams across the globe rose to the occasion, delivering superb results for the fiscal year, while also establishing a stronger foundation for future growth and profitability.

We delivered exceptional net sales growth of 56% in our fourth quarter, as we anniversaried pandemic-related store closures in the prior year period. The inclusion of six weeks of sales from DECIEM added approximately 3 points to growth in the quarter. Our performance also exceeded the pre-pandemic levels of the fiscal 2019 fourth quarter by 9%, driven by significant sales increases in Mainland China, the skin care and fragrance categories, global online and travel retail in Asia.

All three regions grew and all product categories within each region grew during the quarter. Net sales in the Americas region rose 86% against the prior year period with almost no brick-and-mortar retail open. Throughout the quarter, consumer confidence in the US grew, as COVID restrictions abated and people resumed shopping in stores again. Our brands responded with strong programs supporting recovery, new product launches and animating key brand shopping events like Mother's Day.

Sales in the region remained below fiscal 2019 levels for the quarter, reflecting in part the loss of over 900 retail locations that represented nearly \$170 million in annual sales. Additionally, makeup has historically been the largest category in the region and the category has yet to fully recoup sales lost during the pandemic. Nevertheless, we are encouraged by the sequential acceleration in North American sales, which has been better than we expected.

Net sales in our Europe, the Middle East and Africa region increased 65%, with all markets contributing to growth as COVID restrictions eased throughout the quarter. Global travel retail, which is primarily reported in this region, continued to suffer from a significant drop in international passenger traffic, but grew strong double-digits in the quarter as comparisons eased and local tourism in China, especially to Hainan, remained robust.

Across developed markets in the region, store traffic has begun to pick up and retailers have become more comfortable with restocking. Emerging markets in the region saw strong retail in the quarter, driven by locally relevant holiday activations, retailer events and online performance. Sales in the region were slightly above fiscal 2019 levels for the quarter, primarily due to the resilience of travel retail.

Net sales in the Asia/Pacific region rose 30%. Virtually, every country contributed to growth, although the pace of improvement varied widely among the markets and a resurgence of COVID has slowed a full recovery. Sales of our products online continued to rise strong double-digits in the region, driven by the successful 6.18 Shopping Festival campaign in China and including the continued strength of social e-commerce.

Mainland China continued to experience robust double-digit growth with broad-based improvement across product categories, brands and channels. Other markets in the region including Korea, Hong Kong and Japan grew exceptionally against prior year brick-and-mortar lockdowns. Sales in the region were 50% above 2019 levels, largely reflecting China's rapid emergence from the pandemic last year.

Net sales in all product categories grew sharply this quarter, and skin care, fragrance and hair care drove higher sales than fiscal 2019. Fragrance led growth with net sales rising 150% versus prior year. Luxury fragrances resonated with consumers looking for self-care and indulgence and among Chinese consumers increasingly attracted to the category. Home, bath and body products have also gained traction during the pandemic and helped to attract new consumers.

Jo Malone London saw a recovery to pre-pandemic levels in brick-and-mortar and the brand's Blossom and Brit collections were popular in Asia. Standouts from Tom Ford Beauty include the recent launch of Tubereuse Nue and the continued strength of Bitter Peach and Rose Prick. Net sales in makeup jumped 70% against a prior year that reflected the greatest beauty category impact of COVID-19, particularly in Western markets, where makeup is the largest category.

The makeup category in prestige beauty has proven to be especially sensitive to brick-and-mortar recovery due to the use of testers and in-store services by consumers. Estée Lauder saw strong growth of Futurist and Double Wear foundations in Asia, and M-A-C liquid lip color and eye products, especially mascara, outperformed. Hair care net sales grew 52% as salons and stores reopened. The launch of Aveda's blonde revival shampoo and conditioner also contributed to category growth, adding to other strong innovation programs over the past several months from Aveda.

Net sales in skin care continued to thrive. They rose 42% in the quarter, driven by strong increases from the La Mer, Estée Lauder, Clinique and Dr. Jart+ brands, particularly in Asia. Skin care sales growth also benefited from the addition of DECIEM in the quarter by approximately 4 percentage points. Our gross margin improved 650 basis points compared to the fourth quarter last year. This favorability reflected significant improvements in obsolescence and manufacturing efficiencies compared to the prior year impact of COVID-19 on our sales and on our manufacturing locations.

Operating expenses rose 36%, driven by the planned increase in advertising and selling costs to support the reopening of retail and the recovery. Additionally, we sharply curtailed spending last year in response to the onset of the pandemic and some of these costs were reinstated, primarily compensation. We delivered operating income of \$385 million for the quarter compared to a \$228 million operating loss in the prior year quarter. Diluted earnings per share of \$0.78 included \$0.02 of favorable currency translation and \$0.02 dilution from the acquisition of DECIEM.

Our full-year results reflect the benefits of our strategic focus, as we leaned into current growth drivers and invested behind future areas of growth, while effectively managing both costs and cash. The sequential acceleration of our business throughout the year culminated in net sales growth of 11%. The strength of Chinese consumer demand both at home and in travel retail, the resilience of the skin care and fragrance categories, and the momentum we drove in our online channels all supported our growth.

Our distribution mix continued to evolve even as brick-and-mortar reopened. Sales of our products through all online channels continued to thrive as they rose 34% for the year and represented 28% of sales. Despite the continued curtailment of international travel, our business in the travel retail channel grew, ending fiscal 2021 at 29% of sales. Among brick-and-mortar retail, specialty multi and perfumeries grew, while department stores and freestanding stores experienced the greatest impact from the ongoing pandemic and declined for the year.

Our gross margin rose 120 basis points to 76.4%, driven by favorable pricing, lower obsolescence, increased manufacturing efficiencies and lower cost for testers in stores, and partially offset by currency due to the weakening of the US dollar. Operating expenses declined 300 basis points to 57.5% of sales. Selling and store operating costs decreased as high service doors were either closed for part of the year or they reopened with reduced traffic and staffing levels.

Additionally, in-store merchandising costs decreased while advertising investments, primarily digital media, rose faster than sales to support our brands and the recovery. We achieved significant savings from our cost initiatives, including Leading Beauty Forward and the preliminary benefits from the Post-COVID Business Acceleration Program, and this gave us the flexibility to reinvest in necessary capabilities, absorb some of the inflation and media and logistics costs, as well as support the reinstatement of certain compensation elements that were reduced or frozen due to the onset of the pandemic.

Our full-year operating margin was 18.9%, representing a 420 basis point improvement over last year and 140 basis points above fiscal 2019. This year also includes 50 basis points of dilution from the inclusion of Dr. Jart+ and DECIEM. Our effective tax rate for the year was 18.7%, a decrease of 450 basis points over the prior year, primarily driven by the geographic mix of earnings, which included a favorable one-time adjustment for fiscal years 2019 and 2020 related to recently issued GILTI tax regulations.

Net earnings rose 57% to \$2.4 billion and diluted EPS increased 57% to \$6.45. Earnings per share includes \$0.11 accretion from currency translation and \$0.08 dilution from the acquisitions of Dr. Jart+ and DECIEM. In fiscal 2021, we recorded \$148 million after-tax or \$0.40 per share of impairment charges related to our Smashbox and GLAMGLOW brands, as well as certain freestanding retail stores. Restructuring and other charges related primarily to the Post-COVID Business Acceleration Program were \$176 million after-tax or \$0.48 per share. These charges were more than offset by the one-time gain on our minority interest in DECIEM of \$847 million after-tax or \$2.30 per share.

The Post-COVID Business Acceleration Program is progressing quickly, with projects underway across all regions. We have closed nearly 500 doors or counters, including about 50 freestanding stores under the program in fiscal 2021. We also closed approximately 100 additional freestanding stores outside of the program and upon lease expiration primarily in North America and in Europe. We realigned our go-to-market organizations to better reflect our evolving channel mix.

We are also winding down certain brands such as BECCA and RODIN. These actions are expected to continue into fiscal 2022. For the total program, we continue to expect to take charges of between \$400 million and \$500 million through fiscal 2022 and generate savings of \$300 million to \$400 million before tax by fiscal 2023, a portion of which will be reinvested.

We continued to focus on maintaining strong liquidity, while also investing for future growth during the year. Cash generated from operations rose 59% to \$3.6 billion, primarily reflecting the higher net earnings. We utilized \$637

million for capital improvements, supporting increased capacity and other supply chain improvements, further e-commerce development and information technology.

We repaid \$750 million of debt outstanding from our revolving credit facility, issued \$600 million of new long-term debt and retired \$450 million of debt. We used \$1.1 billion, net of cash acquired, to increase our ownership interest in DECIEM, and we returned \$1.5 billion in cash to stockholders during the year via increased dividends and the reinstatement of share repurchase activities in the second half of the fiscal year.

So, looking ahead to fiscal 2022, we are encouraged by the increasing vaccination rates and reopening of markets around the world. We look forward to the resumption of international travel, increasing foot traffic in brick-and-mortar retail and the development of our recent acquisitions. We are still mindful, however, that the recovery has evolved unevenly and some markets are seeing their third or fourth waves of COVID, including increasing effects of new, more contagious strains of the virus hindering a return to normal life. This has been particularly evident in the US over the past several weeks.

Additionally, increasing climate and geopolitical events make it difficult to predict the corresponding impact on our business. Nevertheless, given the strength of our programs, we are cautiously optimistic, and therefore, providing a range of sales and EPS expectations for the fiscal year caveated with the following underlying assumptions: progressive recovery in the makeup category as full vaccination rates increase and mask wearing abates in Western markets during the first half of the fiscal year; beginning of the resumption of international travel in the second half of the fiscal year.

The addition of new retail accounts for some of our brands should provide broader access to new consumers, notably through Sephora at Kohl's and Ulta at Target in North America, and the addition of JD.com in China online. The inclusion of incremental sales from DECIEM benefiting sales growth for the fiscal year, primarily in the Americas and EMEA regions and in the skin care category. Pricing is expected to add approximately 3 points of growth, helping to offset inflation risk in freight, media, labor and commodities.

Increased advertising support as markets reopen and further investment behind select capabilities, including data analytics, innovation, technology and sustainability initiatives, while maintaining good cost discipline elsewhere. We forecast increasing benefits from our Post-COVID Business Acceleration Program as it ramps up this year. Approximately \$200 million of the costs we cut during the pandemic are expected to be reinstated. These primarily include hiring, travel and meeting expenses, furloughs and other leaves of absence, and compensation.

In addition to these assumptions, there are a few non-operating items you should be aware of as you adjust your models. Our full-year effective tax rate is expected to return to a more normalized level of approximately 23% from 18.7% in fiscal 2021. Net interest and investment expense is expected to be around \$150 million. The increase is primarily due to the comparison to last year when we recorded the benefit of our minority interest in DECIEM through May 18, 2021. At that time, we acquired a majority ownership in DECIEM and we began to fully consolidate the entire business and deduct the portion of the income we don't own as a charge to net earnings attributable to non-controlling interest. This charge is expected to be less than \$5 million in fiscal 2022.

Net cash flows from operating activities are forecast between \$3.2 billion and \$3.4 billion. Capital expenditures are planned at approximately 5% of projected sales, as we develop additional manufacturing and distribution capacity, notably for the building of our new facility in Japan. We also expect to fund more robust research and development capabilities in China and North America, increase investment in technology, and support new distribution and e-commerce for our brands. Our CapEx plan for the year also includes some spending deferred from last year.

Also, beginning in fiscal 2022, we plan to introduce the concept of organic sales growth in our earnings materials and investor presentations. Organic growth adjusts reported sales growth for both currency and changes in structure such as acquisitions, divestitures and brand closures. This should help provide a more meaningful understanding of the performance of our comparable business.

Additionally, reflecting the level of volatility still in the environment, we are at this point widening our guidance ranges for the year. For the full fiscal year, organic net sales are forecasted to grow 9% to 12%. Based on August 13 spot rates of \$1.17 for the euro, \$1.381 for the pound, [ph] 1,164 for the Korean won and 6.479 for the Chinese yuan (00:42:22), we expect currency translation to add 1 point to reported sales growth for the full fiscal year.

As I mentioned earlier, this range excludes approximately 3 points from acquisitions, divestitures and brand closures, primarily the inclusion of DECIEM. Diluted EPS is expected to range between \$7.23 and \$7.38 before restructuring and other charges. This includes approximately \$0.19 of accretion from currency translation. In constant currency, we expect EPS to rise by 9% to 12%. This also includes approximately \$0.03 accretion from DECIEM.

At this time, we expect organic sales for our first quarter to rise 11% to 13%. The incremental sales from acquisitions, divestitures and brand closures are expected to add about 3 points to reported growth and currency is expected to be accretive by approximately 3 points. Operating expenses are expected to rise in the first quarter, as we invest in the reopening and recovery of brick-and-mortar retail around the world and some of the temporary cost measures start to ease. We expect first quarter EPS of \$1.55 to \$1.65. Currency is expected to be accretive to EPS by \$0.05 and DECIEM is forecast to have no impact.

In closing, while we are cautious about the uneven recovery to-date, we remain confident about the strategic actions we continue to take to support sustainable profitable growth post-pandemic and the agility we have demonstrated this past year. On behalf of the entire Estée Lauder Companies leadership team, we give thanks to our incredible teams around the world for their extraordinary efforts to manage during this unprecedented period.

And that concludes our prepared remarks. 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] And our first question today will come from the line of Dara Mohsenian with Morgan Stanley.

Dara Mohsenian

Analyst, Morgan Stanley & Co. LLC

Hey. Good morning, guys.

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Tracey Thomas Travis

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

Hey, Dara.

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Fabrizio Freda

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

Good morning.

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Dara Mohsenian

Analyst, Morgan Stanley & Co. LLC

Can you give us an update on how much of the incremental e-commerce business and new customers you obtained during COVID are proving sticky, now that we've fully cycled COVID? And perhaps also just give us a sense for expectations for e-commerce sales growth in fiscal 2022 and how you sort of think about that versus a COVID boost. And then longer-term, can you also spend some time just discussing how you're better using or upgrading technology to drive e-commerce sales longer term? Thanks.

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Fabrizio Freda

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

So, let me start. First of all, I would say the large majority of our online progress during COVID is very sticky. And keep in mind that we attracted also many new consumers. The new consumers were also among the older consumers and they really liked it. And so, we see they're coming back and they're staying even when store reopens, obviously, with a different balance, but it is definitely happening. But then in total, our online is continuing to grow, and we expect this to continue to grow for many years to come and the trend will not stop after COVID.

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Also, our online mix, which is 3PP in China, for example which, as you heard from the prepared remarks, [ph] flying our last 18.6 (00:46:33) event was really strong. And then, retail dot-com that for many retailers around the world is booming. Pure-play which is very much growing and then brand dot-com. And obviously, brand dot-com in the moment – the part of brand dot-com in the moment, there is the big reopening and people go back to store, will temporarily stabilize or largely decrease, but then will start growing again. That's our expectation. So, overall, all-in-all our online business will continue to progress as a percentage of total business over the next years.

Tracey Thomas Travis

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

And keep in mind, Dara, we also explained in our prepared remarks that we do have some new customers. So, retailer dot-com should pick up as well with the US expansion of Ulta into Target and Sephora into Kohl's. And the

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same with JD in China. So, again, we got, as Fabrizio said, very strong plans for online again this year and expect that it will again increase as a percent of our penetration of sales.

As it relates to technology, we are investing quite a bit in our e-commerce platform to enable capabilities, many of which we have spoken about, whether it's virtual try-on, our data analytics that certainly support our being able to more personalize experiences for consumers and many other capabilities. And beyond online, we continue to invest in the consumer experience in our stores and in other areas as well. So, we do have a robust technology investment plan that I would expect to continue over the next couple of years. We're also investing in new technology in our new facility and that is opening in a couple of years in Japan and it will be a state-of-the-art manufacturing facility. So, it will leverage quite a bit of technology also.

Dara Mohsenian

Analyst, Morgan Stanley & Co. LLC

Great. Thanks.



Operator: Our next question will come from the line of Olivia Tong with Raymond James.

Olivia Tong

Analyst, Raymond James Financial, Inc.

Great. Thank you. Good morning. I was wondering if you could talk a little bit more about Asia/Pacific and the improvement there and if you could talk about the drivers there. You mentioned the strength of 6.18. So, should we expect more quarterly variability in Asia, whether it's because of 6.18 or 11.11 and how that could influence how the year develops? And then, if you could just talk a little bit about the current trends given another uptick in volatility associated with the pandemic. Thank you.



Fabrizio Freda

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

No. There is very – very big strengths in Asia/Pacific that will continue in the long-term. Obviously, as we said in the prepared remarks, there's been some pandemic issues and lockdowns in places like Japan and some parts of Southeast Asia, which become an obstacle to this, so a temporary obstacle to this growth in these specific markets. But overall, Asia/Pacific will continue to be very strong and will be led by China, whose progress will continue to develop in our opinion and also that's what's happening so far.



Now, the – what you call variability of sales, meaning up and down, so sales in Asia/Pacific, particularly in China, frankly is more about seasonality. There is a clear seasonality like there is in the US, like there is in Europe. And there are holiday moments, Chinese New Year moments, moments where the Chinese population travel, moments in which they are more at home, moments where there are festivities, and there are moments of the year where certain products particularly in skin care is more used than others. Obviously, there is important elements of seasonality.

Now, the good news, we are completely on top of those and we manage seasonality with anticipation. And that's why our quarter-by-quarter year programs pretty well articulate and recognize consumer seasonality and trade [ph] promotionality (00:50:52) period in a very accurate way at this point in time. So, this is a leverage point rather than an issue. That's why I will not call it variability, but rather seasonality.

Operator: Thank you. Our next question will come from the line of Lauren Lieberman with Barclays.

Lauren R. Lieberman*Analyst, Barclays Capital, Inc.*

Q

Great. Thanks. Good morning. I will start with the discussion of 3% contribution from pricing in 2022. I know there's always some pricing in the business and it's somewhat subtle at least from a consumer standpoint. But 3% just sounded higher than usual to me. So, I was curious if it's more centered in categories, in brands, are there areas where you're just like the momentum is so strong that it's an untapped opportunity or is this more in response to the broadly inflationary environment?

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

A

Well, as you mentioned, Lauren, we take pricing every year usually in the 2% to 2.5% range. We are taking approximately 3% of pricing this year. And yes, it is certainly considering the inflationary environment that we're operating in. We do take differential pricing, so that is in average across all of our markets, all of our brands. So, there's no specific category that we're taking any more pricing in than others, but it is tiered certainly by the tiering of our brand portfolio.

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

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And I just want to add, we do have the ability to price where there is the opportunity and – because of our loyalty, repeat levels, et cetera, obviously in certain markets [ph] we have spaces (00:52:37). And so, we are planning because of the current inflationary environment, as you said, to take about 0.5 points more prices than in the previous years, and this is completely justified. And this, combined with our cost saving programs, should allow us to manage the inflation without any negative impact, neither on our advertising, nor on our profitability, and that's our plan.

The other thing I want to say about our flexibility on pricing is that with the kind of success we are having of innovation and the kind of very attractiveness of our innovation, that can command luxury pricing very easily because of the great – great quality that we are deploying to the consumers. And the moment you have between 20% and 30% every year of this coming from innovation, you can imagine that we can decide the pricing of 20% to 30% every year based also on our intent and the power of our innovation. So, this is an extra flexibility that we have in terms of managing pricings over the years.

Operator: And our next question is going to come from the line of Rob Ottenstein with Evercore.

Robert Ottenstein*Analyst, Evercore ISI*

Q

Great. Thank you very much. Just two questions, if I can, just a quick follow-up on the China. We are reading a little bit about government actions in terms of cracking down on wealth-flaunting luxury particularly in social media. And so, I just wanted to be – make sure that that's not something that you see affecting your business. And then, my deeper question is, is if you could give us an update on the e-commerce in the US as a percent of sales and how that breaks out between your direct brand dot-com business and the retail dot-com business and any changes in trends there that you see? Thank you.

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

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Sorry. Could you repeat the one on the US?

Tracey Thomas Travis

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

The dot-com business split.

A

Robert Ottenstein

Analyst, Evercore ISI

Just – yeah, just an update on the dot-com business in the US, the percent of sales. I think it was running 40%, and then how that's breaking out between the direct business and the retail dot-com.

Q

Fabrizio Freda

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

Yeah. Okay. Starting with China, no, we don't see any issue on China potential in our industry on luxury, what you're saying. Actually, we see a lot of support to the trend and a lot of interest in our products as the middle-class evolves. And we see also given for example all the government actions that have been taken to support the development of Hainan and the duty-free in Hainan, there is obviously an interest in supporting internal consumption. And somehow our industry is benefiting from the interest in being a creation of internal consumption and also bringing the consumption that in the past was outside more internally. So, it's all on a positive trend.

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The other thing – when you speak about luxury, I just want to say we are really affordable luxury, in the sense that our products are luxury within the beauty category, but they are very affordable purchases in the context of total luxury. So, we don't see any negative at this point in time on this front. On the contrary, very strong support for the long-term. Going to the internal online development in the US, I'll turn this to Tracey for your specific question on the percentages.

Tracey Thomas Travis

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

Yeah. In terms of the online percentage, we ended last year a little over 40% online. Again, as you know, we started the year with some of our brick-and-mortar doors actually closed, so very, very strong online penetration. And as brick-and-mortar reopened, the online penetration lessened a bit, but we did end the year at about 40%. In terms of the retailer dot-com versus brand dot-com, we are seeing – and it varies. So, we saw quite a bit of strength in retailer dot-com towards the second half the year and strength in brand dot-com earlier in the year. And this year, obviously, we have some very strong plans for both brand dot-com and retailer dot-com in the US to continue to grow.

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Robert Ottenstein

Analyst, Evercore ISI

Thank you.

Q

Operator: Our next question will come from the line of Steve Powers, Deutsche Bank.

Stephen Powers

Analyst, Deutsche Bank Securities, Inc.

Yes. Thanks and good morning. I was hoping you could just elaborate a bit further on what you're doing to best position your portfolio to take advantage of the anticipated recovery in makeup and to what degree you see your business as likely to accrue net share gains alongside that recovery. Thank you.

Q

Fabrizio Freda

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

A

So, we are preparing for the makeup renaissance, and we are working on all our makeup brands and in all our regions to leverage this as usage occasions comes back. [indiscernible] (00:58:11) in the US in this last quarter is very encouraging. In this last quarter, our makeup was extraordinarily strong, for example, in countries where there was a recovery, a reopening like the US. And we saw great results on M·A·C, on Too Faced, on many other brands. And we saw particularly the recovery start from foundation and lipsticks, which is a very good news, a very good sign.

So, what we are doing is, first of all, we are preparing programs, marketing programs and innovation programs, and new launches for every market, making sure that we time those to the expected recovery trend. That will be gradual, but we will be – as you know, will be dependent on vaccination levels and on the ability to control the COVID spikes where this happens. And so, we have all analytics that tell us when this timing could be in different parts of the world, and we time our marketing action, our advertising re-launch actions, our innovation actions to the different expected recovery moments. So, it's a pretty complex elaboration, a plan that is very effective and so far has given us the kind of results we wanted, but most importantly the kind of return on the investment that we wanted when you time it correctly.

The second thing that we are doing, obviously, is making sure that we use data analytics and we use the understanding of the consumers to really tailor it to where the trend will start. And as I said, by makeup subcategories, there are very different – very different priorities that a consumer choose in coming back to the makeup when the user education get restated. And so, we have some outstanding new capability in analytics that drive us also in maximal effectiveness in these areas. So, all-in-all, we are very, very encouraged by the early recovery in the countries where this happened, which are mainly US, China, and we are well-organized to follow up on the recovery and gradually in the course of 2022.

Operator: And our next question will come from the line of Stephanie Wissink with Jefferies.

Q

Hey. Good morning. This is [ph] Grace (01:00:43) on for Steph. I wanted to dig in a little on the travel retail recovery that you're expecting and how you think about the growth in market locations like Hainan. Would you expect that Hainan continues to grow as international travel resumes or is there a rebalancing where the demand is realized? Thank you.

Fabrizio Freda

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

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Yeah. First of all, we expect Hainan to continue to grow in the future, and we expect Hainan success to be relatively independent from the come back to international travel. Let me explain that. If you put in the number of Chinese consumers that have a passport, which is about 10%, evolving toward the 15% from the informations which are available, and you assume that only a percentage of those consumers with a passport travel internationally in a given year, you immediately see that the international travel is going to create consumption that is a certain percentage of the Chinese population. Hainan is domestic travel. So, it's open to 100% of the Chinese middle-class that wants to travel and is traveling as we speak. So, the Hainan phenomenon basically goes well beyond international travel, because it's domestic travel and appeals 100% to the population.

That's why we believe that Hainan is here to stay and is a great opportunity for the long-term that will continue to grow even when international travel will restart. As far as the international travel question, we are assuming that some international travel will gradually restart in the second semester of our fiscal year 2022 fiscal year. And obviously, this is an assumption, nobody knows, and will depend not only from the pandemic development, will depend also from the government decisions on how to manage the various rules around the management of the pandemic. So, we can only go with estimates. But that's what we are currently estimating. And we have seen already some – for example, in summer in Europe, we have seen some new travels or new movements and some increase, but obviously relatively still very much below what was before COVID. And then, in fiscal year 2023, we assume there will be a more robust international travel acceleration.

Operator: And our next question is going to come from the line of Mark Astrachan with Stifel.

Mark Astrachan

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks and morning, everyone. I wanted to ask a bit of a follow-up on China and just maybe talk a bit about what's embedded in your expectations just overall for the business for that country for fiscal 2022. And maybe in the context of things that we've seen around slowing sales on Tmall and discuss the commentary about expanding on JD and just how does that fit in. And you talked about different demographics. So, if you could elaborate a bit on what you're hoping to accomplish there, that'd be helpful. Thank you.

Fabrizio Freda

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

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So, we expect the market in China to continue to grow double-digit, and we are very, very optimistic on the strength of this market, as well as on our position with the consumers in this market. We expect to see a continuous acceleration of online, which is already 50% of Mainland China business today and further growing. We see the possibility of continued growth in the existing platforms like Tmall, which is for us, for beauty, for our brands, very successful and a great partner that we will continue to develop and manage with also specific products, specific brands, specific new brands in the future.

And then, we see an acceleration of brand dot-com and in the marketing models around the brand dot-com in which we are investing and also improving our technologies to keep it aligned with the extraordinary development of technology in China and the ability to make this technology very appealing to the consumers. And so, we keep learning and keep evolving in this area. And then, there are certain brands that are appealing to certain demographics that also decided to expand in JD and just now in July. And so, we are very optimistic with also the results on this increased coverage of consumers that we are getting. And there will be more opportunity in the future.

It's a very, very dynamic market and competitive market which keeps evolving. And our principle is always to stay ahead of the evolution, which admittedly is not easy in such a dynamic market. But we are trying to stay always ahead of the evolution and anticipate change. And we get helped in this by our extraordinary Chinese leadership team that keep us abreast around what's happening and help us anticipating all the trends. And we get help by our [ph] compass that we discussed another time (01:06:10), which give us a good point of view on what will be the evolution in the consumer preferences in every market, but particularly in China.

Operator: And our next question is going to come from the line of Erinn Murphy with Piper Sandler.

Erinn E. Murphy*Analyst, Piper Sandler & Co.*

Great. Thanks. Good morning. My question is for Tracey. If you could talk a little bit more about what you expect for the sales and the profitability of rebound in the North American segment in fiscal 2022, particularly when you're kind of layering on some of the new distribution partnership, both Kohl's and Sephora, and Ulta at Target? And then, I do have a follow-up for Fabrizio. On DECIEM, I know The Ordinary has been driving the large success to-date, but they do have a number of other brands in their portfolio. So, curious on your plans to scale some of them. Thank you.

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

Okay. Let me start with North America. We're very optimistic, given the trends that we saw in the fourth quarter and that are continuing into the first quarter as it relates to North America. So, people are coming back to stores. People are still shopping online. And certainly, the new retail partnerships of our retail partners, we are expecting will also contribute to growth this year. But across the board, the team has really been working on terrific innovation. We're increasing advertising in North America in fiscal 2022. So, we expect both top line growth and margin expansion in North America related to our strategies in 2022.

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

And on DECIEM, you're absolutely right. DECIEM is a company with an extraordinary portfolio of brands. The Ordinary is today the biggest and is continuing to be very successful and growing. It's an extraordinary brand. But there are other brands like NIOD, which is more science-based that we intend with the DECIEM team to continue to develop. And also DECIEM is adding to Estée Lauder Companies the capability of an extraordinary incubation model and ability. So, we definitely intend to continue incubating new brands, develop new ideas and continue with the DECIEM philosophy of challenge the status quo and seeing new different point of views to be offered to the consumers and develop extraordinary new brands in the long-term. But in this moment, the opportunity for The Ordinary to continue to grow, to continue to expand is frankly amazing and is obviously the priority we are focusing on in fiscal year 2022.

Erinn E. Murphy*Analyst, Piper Sandler & Co.*

Thank you so much.

Operator: And our next question is going to be from the line of Chris Carey with Wells Fargo.

Chris Carey*Analyst, Wells Fargo Securities LLC*

Hi. Thank you very much. I just wanted to follow up on the disclosure around travel retail being 29% of fiscal 2021 sales. Can you just confirm that? And then, that would imply that you had a pretty big acceleration in Q4 in the travel retail business. And then, does that mean that the Continental Europe business declined in the quarter? So, any – just any clarification just around that. And then, just longer term, this decision to partner with Ulta at Target, Sephora at Kohl's, this is really an expansion of distribution perhaps into some channels where you've been less comfortable going in the past. But there's just more of a – these brands are being curated in a different setting. What are your thoughts on that and other channels, say, Amazon or other online forums over time? So, thanks so much for those.

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

A

Yeah. So, I can confirm travel retail in terms of the percent of mix at 29%. We did have strong growth in travel retail in the fourth quarter. And in terms of the EMEA region, we did see growth as well in the EMEA region excluding travel retail. The UK was a little challenged. But as we mentioned in the prepared remarks, all regions grew in the fourth quarter.

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

A

Yeah. And the other thing I want to say on travel retail on the long-term, as I said, is the travel retail has this addition of the domestic travel in China, which is a very important addition. And so, the development of the business with the Chinese consumers is extraordinary. And then, the Chinese consumer, depending on the period of the year or their choices, some of them will travel, travel to Hainan, buy there, others will buy in the cities. And so, you will see this expanding growth of the Chinese consumers in the China region or in the travel retail Hainan depending on what the Chinese consumers decide to do.

Our strategy is very simple. We are going to serve the growing demand of Chinese consumers wherever they choose to shop. And so, we are online, we are in the outstanding quality department stores in China, we are in Hainan, and in all these areas where they shop, we tend to be present with outstanding execution, great luxury quality of services, and to really give justice to our elevated luxury positioning in these positions. And that's the strategy to cover the Chinese consumer shopping. And as far as when the international traveling will restart, we'll obviously also cover the international travels in the best possible way.

In terms of your second part of the question, I would like to clarify one thing. I think fiscal year 2021 was an extraordinary year to build our luxury position and to elevate our consumer expression in a very luxury way. If you think that the core investment that we have done has been in elevating the brand-building, the luxury experience online, and we have been able to bring online a lot of the luxury experiences and services than in the past were only in the best department stores or in the best brick-and-mortar locations. So, this now means that we have elevated to the best possible experience about 30% of our business.

Then, as I explained, our best expression of luxury is frankly in TR, has been for us since a long time particularly in the best airports of the world, but now is in Hainan where there is the best expression of the brands in the world. And as you said, it's another 29%. So, we have elevated our luxury expression in more than 60% of our business around the world, and that's the key areas where we invest in. We have also taken the opportunity where there is the opportunity to [ph] source from us and to (01:13:36) continue growing the prestige segment to bring some of our brands that have the power of [ph] sourcing from us (01:13:44) closer to where the mass consumers are choosing to shop and wants to have the opportunity to upgrade to different quality. And that's where some opportunities like the Ulta-Target and Sephora-Kohl's offer us the opportunity to further [ph] source from us (01:14:04) and further serve more consumers and consumers that we didn't access before with our best experience and best quality products.

Operator: Thank you. And that's all the time we have for questions and answers. With that, I would like to conclude the Q&A 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 September 2. To hear a recording of the call, please dial 855-859-2056. Passcode is 6687487. Again, dial 855-859-2056 and passcode is 6687487. That concludes The Estée Lauder conference call. I would like to thank everyone for their participation and I wish you all a good day.

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