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The Estée Lauder Companies, Inc. (EL)

Q1 2022 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

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Nik Modi

Analyst, RBC Capital Markets LLC

Dara Mohsenian

Analyst, Morgan Stanley & Co. LLC

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

Grace Menk

Analyst, Jefferies LLC

Andrea Teixeira

Analyst, JPMorgan Securities LLC

Olivia Tong

Analyst, Raymond James Financial, Inc.

Mark Astrachan

Analyst, Stifel, Nicolaus & Co., Inc.

Wendy C. Nicholson

Analyst, Citigroup Global Markets, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to The Estée Lauder Companies' Fiscal 2022 First Quarter Conference Call. Today's call is being recorded and webcast.

For opening remarks and introductions, I would like to turn the call over to Senior Vice President of Investor Relations, Ms. Rainey Mancini.

Laraine A. Mancini

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

Hello. On today's call are Fabrizio Freda, President and Chief Executive Officer; and Tracey Travis, Executive Vice President and Chief Financial Officer. Since many of our remarks today contain forward-looking statements, let me refer you to our press release and our reports filed with the SEC, where you'll find factors that could cause actual results to differ materially from 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 non-comparable impacts 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 our retailers' websites. During the Q&A session, we ask that you please limit yourself to one question, so that we can respond to all of you within the time scheduled for this call.

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

Fabrizio Freda

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

Thank you, Rainey. And hello, everyone. We are grateful you have joined us today. We delivered excellent performance to begin fiscal year 2022, reinforcing our optimism in the opportunities of tomorrow as we discussed with you in August. Our multiple engines of growth strategy enabled us to excel amid continued volatility and variability from the pandemic.

Organic sales rose 18% and adjusted diluted earnings per share grew an even stronger 31%. Encouragingly, relatively to the pre-pandemic first quarter of fiscal year 2020, our business is 13% larger on a reported basis and more profitable.

We achieved these outstanding results with increasingly diverse growth engines as we expected. By virtue of our dynamic strategy, we could act locally amid the complexity of the pandemic to both create and capture demand. The growth engines of Makeup, developed markets in the West and brick-and-mortar reignited and complemented momentum in Skin Care, Fragrance, mainland China, Travel Retail in Asia Pacific, and global online.

13 brands contributed double-digit organic sales growth, demonstrating the breadth of strength across our portfolio. Estée Lauder and M·A·C drove Makeup emerging renaissance, while La Mer and Clinique delivered stand-out results in Skin Care. Impressively, Skin Care solidly outpaced its prior-year organic sales growth performance despite having the far toughest comparison among the categories. Fragrance soared double digits, driven by Tom Ford Beauty and Jo Malone London.

Let me share a few highlights by brand. Estée Lauder advanced planning for the Makeup renaissance delivered significant sales growth. As social and professional usage occasions resumed in certain markets, the brand was well positioned with compelling innovation, superb merchandizing, and on-point communication. It's Double Wear and Futurist foundation franchises rose strong double digits, while it's new Pure Color Whipped Matte lipstick was a hit.

M·A·C strategically engaged consumers to drive performance in Makeup. In the Americas and EMEA, excellent results from in-store activations and regional M·A·C the Moment campaigns combined with desirable innovation like Lustreglass Sheer-Shine Lipstick and Magic Extension Mascara. The brand's new omni-channel capabilities, which leverage its freestanding stores, also contributed to the strength and demonstrate a new capability for M·A·C to benefit from going forward.

La Mer performed magnificent and led the company, with sales rising strong double digits. Its new The Hydrating Infused Emulsion expanded our portfolio of east to west innovation, captivating consumers in every region.

The product successes are many as it welcome new and younger consumers, as well as men, into the brand and created a powerful halo benefit for La Mer Skin Care portfolio. It is a striking example of the innovation gains we can achieve when the power of our data analytics combines with our creative talent and R&D. La Mer's iconic Crème de La Mer prospered as a new global campaign focused on its moisturizing benefit realized terrific initial results.

Clinique thrived in Skin Care from the strength of its heroes. Moreover, it's new Smart Clinical Repair Wrinkle Correcting Serum with powerful clinically-led claims and compelling before and after visualizations extended Clinique winning streak with innovation and further demonstrated the brand's ability to be highly relevant for consumers of all ages.

In Makeup, Clinique Skin Care authority drove growth in complexion-led subcategories, while in lip the brand Brilliant leveraged Black Honey viral sensation on TikTok to expand its consumer base, especially among Gen Z. DECIEM complemented our organic sales growth in Skin Care, with its coveted vegan brand The Ordinary. DECIEM is known for its transparency, which has enamored it with consumers. And in the first quarter, it launched the insightful Everything is Chemicals campaign and the new Regimen Builder by The Ordinary on brand dot-com realized spectacular adoption, further enhancing the brand powerful online ecosystem.

Fragrance momentum continued with stellar double-digit performance in every region, powered by hero product and innovation from Tom Ford Beauty, Jo Malone London, and our artisanal offerings. We are excited for the Estée Lauder brand launch of its luxury collection in the second quarter as it expands our portfolio in the high-growth segment of Fragrances.

Our Fragrance category benefits from diversification amongst our categories as well as regions, with outstanding performance from both historically strong markets for Fragrance and emerging Fragrance opportunities. The self-

care rituals related to scent, which were embraced during the pandemic, continue even as social and professional use education resume.

Of note, Tom Ford Beauty performed strongly in both Fragrance and Makeup, such that the brand was among our top performers in the quarter. Its new Ombre Leather Parfum and heroes Oud Wood and Lost Cherry fueled the brand's success.

Our growth engines also diversified geographically led by developed markets in the West. Our business in North America executed with excellence to deliver strong double-digit organic sales growth, powered by readiness for Makeup's emerging renaissance, ongoing strength in Skin Care, Fragrance, and recovery in Hair Care.

Strategic go-to-market initiatives supported by on-trend innovation, increased advertising spending, and expert in-store additional services delighted consumers. Our expanded consumer reach enhanced these initiatives as Bobbi Brown launch in Ulta Beauty exceeded expectation. And we are encouraged by the early results of the new Ulta Beauty at Target and Sephora at Kohl's relationships.

In Asia Pacific, many markets faced COVID-induced lockdowns and temporary store closures, which pressured performance. Despite this, the region still grew 10% organically, driven by strength in Greater China and Korea. Mainland China achieved double-digit organic sales growth owing to Skin Care and Fragrance, with online and brick-and-mortar both higher. We launched locally-relevant innovation, which proved highly desirable, while we also increased advertising spending, strategically expanded our consumer reach to match success on JD and designed successful activation for Chinese Valentine's Day.

We continue to invest in the vibrant and compelling long-term growth opportunity of Mainland China, led by our talented local team. We are enthusiastic for our new innovation center in Shanghai to open in the second half of this fiscal year. This new world-class innovation center will be the first of its kind for our company. With it, we will have a unique ability to grow and build on our market and consumer insights to develop exceptional products to meet and surpass the needs and desires of Chinese consumers.

What is more, we are seeing the benefits of recent investment in online fulfillment, which have led to higher service levels and better inventory management, while setting the stage for expanded omni-channel capabilities in the market.

From a channel perspective globally, brick-and-mortar grew strongly in markets, which are gradually emerging from the latest wave of COVID-19. We realized excellent results across the board in brick-and-mortar, most especially in the Americas and EMEA. Our brands created excitement in store with enticing High-Touch services and unique activations. We are encouraged by improving trends in the productivity of brick-and-mortar owing to both increased traffic and our strategic actions, including those under the Post-COVID Business Acceleration Program.

As brick-and-mortar reignites, our global online business continued to showcase its tremendous promise, with impressive organic results, despite significant organic sales growth in the year-ago period. Online grew to be nearly double the size on a reported basis of the pre-pandemic first quarter of fiscal year 2020. Many markets capitalized on the remarkable new consumer acquisition trend of the pandemic to deliver sustained gain in repeat purchases.

As we seek to engage with consumers in innovative ways, we advanced our work with Instagram, Snapchat, TikTok, WeChat and others, to capitalize on exciting trends in social commerce. We also deployed a technology

solution, which enables brands to better customize consumer outreach by leveraging data to merchandize and personalize communication. This is leading to higher conversion rates for new consumers and a deeper level of relationship building after the initial purchase to foster retention. Initiatives such as these position us well to realize even greater success with trial and repeat.

We continue to invest in online to strategically extend our consumer reach and realize promising results. For example, in the first quarter, La Mer launched on Lazada in Southeast Asia to tremendous success, with differentiated merchandising, unique services and prestige packaging, making it one of the platform's biggest brand launches ever. Our relationship with Lazada expanded in the current quarter with Jo Malone London debut.

Before I close, I wanted to share that today we will release our Fiscal Year 2021 Social Impact and Sustainability Report. We are incredibly inspired by the achievements of our employees globally. The report highlights initiative across key areas, including inclusion, diversity and equity, climate, packaging, social investments, responsible sources, and green chemistry. I'm particularly proud of our support to employees globally, who face financial hardships due to COVID-19. The ELC Cares Employee Relief Fund awarded nearly 14,000 grants and distributed nearly \$8 million through June 30, 2021.

Here are few among the many other highlights of the report. We are continuing to contribute to a low carbon future. For the second year in a row, we sourced 100% renewable electricity globally for our direct operations and achieved Net Zero Scope 1 and Scope 2 emissions. The company also made strong progress in its science-based targets for Scope 1 and 2, and made efforts toward meeting its Scope 3 science-based targets.

We achieved our existing post-consumer recycled content goal ahead of schedule and announced a more ambitious goal to increase the amount of such material in our packaging to 25% or more by the end of calendar year 2025. We also committed to reduce the amount of virgin petroleum plastic in our packaging to 50% or less by the end of calendar year 2030.

On the last few earnings calls, I discussed actions we are taking to make more progress in our commitments for racial equity as well as women advancement and gender equality, which are reflected in the report. We also deepened our work by further aligning the strategy of The Estée Lauder Companies Charitable Foundation to identify and support programs at the intersection of climate, justice, human rights and wellbeing, with a focus on equity, building upon our legacy of founding girls' education and leadership programs.

In the beginning of fiscal year 2022 and aligned with our social impact commitments, we were pleased to announce a three-year partnership with Amanda Gorman, activist, award-winning writer, and the youngest inaugural poet in US history. The Estée Lauder Companies will contribute \$3 million over three years to support WRITING CHANGE, a special initiative to advance literacy as a pathway to equality, access and social change. In addition, Mrs. Gorman will bring her voice of change to the Estée Lauder brand, debuting her first campaign in the second half of this fiscal year.

In closing, we delivered outstanding performance to begin the new fiscal year amid the volatility and variability of the pandemic, while continuing to invest in sustainable long-term growth drivers. We are focusing on fundamental capabilities for product quality and the consumer-centric elements of acquisition, engagement, and High-Touch experiences and services. We are doing this while improving our cost structure, diversifying our portfolio, and its distribution, investing behind the best growth opportunities and living our values. Our confidence in the long-term growth opportunities for global prestige beauty and our company is reflected in the announcement today to raise the quarterly dividend. I'm forever grateful to the grace, wisdom, and ingenuity of our employees globally who are making us a stronger company each and every day.

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. We are off to an outstanding start, with first quarter net sales growing 18% organically, driven by the nascent recovery in the Americas and EMEA during the quarter compared to a more difficult environment in the prior year.

Global logistics constraints caused some retailers, primarily in North America, to order earlier to ensure popular sets and products would be on counter for holiday. We estimate that this contributed approximately 1.5 points to our first quarter sales growth that otherwise would have occurred in the second quarter. The inclusion of sales from the May 2021 DECIEM investment added approximately 3 points to reported net sales growth and currency added just over 2 points.

From a geographic standpoint, organic net sales in the Americas climbed 27% as COVID restrictions eased throughout the region. Brick-and-mortar retail grew sharply across all formats compared to the prior-year period when many stores were temporarily shut down.

Distribution in Kohl's with Sephora and in Target with Ulta Beauty began its phased rollout to initial stores and online in mid-August, with minimal impact on net sales growth for the quarter. With the strong resurgence of brick-and-mortar traffic, online organic sales growth in the Americas declined single digits against a sharp increase last year, while organic online penetration remained solid at 31% of sales. The inclusion of sales from DECIEM added about 9 points to the overall reported growth in the region.

In our Europe, the Middle East and Africa region, organic net sales rose 19%, with virtually every market contributing to growth, led by the emerging markets in the Middle East, Turkey and Russia as well as the UK. Most markets throughout the region saw COVID restrictions lifted and some tourism resume during the peak summer months.

By channel, the region saw more balance between brick-and-mortar and online growth. All major categories grew this quarter and the region saw the strongest growth in Fragrance and Makeup as social occasions increased.

Our global travel retail business grew double digit as China and Korea continue to be strong. Internal travel restrictions during the quarter in China slowed Hainan sales temporarily, but restrictions lifted in early September and traffic rebounded. Retailers also responded to the August dip by driving post-travel consumption online. Summer holiday travel in Europe and the Americas picked up, but international travel still reached only 40% of pre-COVID levels.

In our Asia Pacific region, organic net sales rose 10%, driven by Greater China and Korea. The region overall experienced higher levels of COVID lockdowns this quarter compared to last year's quarter due to the rise of the Delta variant, although online remained strong. Sales growth in mainland China was somewhat slower due to COVID restrictions during July and August, and the pace of online sales growth slowed following the successful 6.18 programs last quarter and in anticipation of the 11.11 Shopping Festival.

As we've mentioned before, these key shopping moments have created some additional seasonality in our business in this region. More than half of our brands and virtually all channels rose double digits in Mainland

China. Hong Kong and Macau were bright spots this quarter. They benefited from strong new product launches from La Mer and Jo Malone and successful marketing campaigns from several other brands.

From a category perspective, net sales growth in Fragrance jumped nearly 50%. Virtually every brand that participates in the category contributed to growth, with exceptional double-digit increases from Tom Ford Beauty, Jo Malone London, and Le Labo. Perfumes and colognes led the category growth and bath, body, and home fragrances continued to perform well.

Net sales in Makeup rose 18% as markets in the Americas and Europe began to recover from COVID shutdowns. We are encouraged by the sequential improvement in Makeup versus pre-COVID levels. However, Makeup sales in the quarter were still 19% below two years ago. Nonetheless, Estée Lauder foundations continued to resonate strongly with consumers and M·A·C leaned into the Makeup recovery with a number of fun and compelling campaigns.

Skin Care sales remained strong during the quarter. Organic net sales grew 12%, and the inclusion of sales from DECIEM added 6 percentage points to reported growth. Nearly all of our Skin Care brands contributed to growth, although Estée Lauder had a tough comparison with the prior-year launch of its improved Advanced Night Repair Serum.

Our Hair Care net sales rose 8% as traffic in salons and stores in the US and Europe began to return. Both Aveda and Bumble and bumble saw growth in hero products as well as continued strength from innovation.

Our gross margin declined 100 basis points compared to the first quarter last year. The positive impacts from strategic pricing and currency were more than offset by higher obsolescence costs for both basic and holiday product sets and the inclusion of DECIEM.

Operating expenses decreased 240 basis points as a percent of sales. Our strong sales growth was partly due to earlier orders from some North America retailers concerned about logistics constraints and costs related to these sales are expected to be incurred in our second quarter. We do continue to manage costs with agility, realizing savings from our cost initiatives, while also investing to support a continued brick-and-mortar recovery as well as our strategic initiatives.

Our operating income rose 32% to \$941 million and our operating margin rose 140 basis points to 21.4% in the quarter. Diluted EPS of \$1.89 increased 31% compared to the prior year. During the quarter, we used \$81 million in net cash flows from operating activities, which was below the prior year. This reflects a more normalized first quarter, where we typically have seasonally higher working capital needs.

We invested \$205 million in capital expenditures as we ramped up our investment to build the new manufacturing facility in Japan. And we returned \$749 million in cash to stockholders through both share repurchases and dividends. We also announced this morning an increase in our quarterly dividend.

So, now let's turn to our outlook. We are encouraged by the green shoots we are seeing around the world even in the context of an environment of increased volatility. Our strong performance reflects our ability to navigate through the volatility, while leveraging our multiple engines of growth. At the same time, we are mindful that recovery is tenuous and likely to be uneven. Nevertheless, we are cautiously optimistic and our assumptions for fiscal 2022 remain consistent. We continue to expect an emerging renaissance in the Makeup category as restrictions are safely lifted and social occasions increase.

We welcome the resumption of some travel in the Americas and EMEA in the first quarter and as intercontinental restrictions are lifted, we expect international passenger traffic to build toward the end of the fiscal year. We began taking strategic pricing actions in July and overall pricing is expected to add at least 3 points of growth, helping to offset inflationary pressures.

On the cost side, we plan to continue to increase advertising to support our brands and drive traffic in all channels. Selling costs are expected to rise to support the re-opening of brick-and-mortar retail. We also continue to invest behind key strategic capabilities like data analytics, innovation, technology and sustainability initiatives.

As you are all aware, global supply chains are being strained by COVID and its related effects in some markets resulting in port congestion, higher fuel costs, and labor shortages at a time when demand for goods is rising. This is causing us to experience inflation in freight and procurement, which we expect to impact our cost of goods and operating expenses beginning next quarter. Based on what we see through October, the expected benefit of pricing combined with good cost discipline elsewhere are enabling us to maintain our expectations for the year.

For the full fiscal year, organic net sales are forecasted to grow 9% to 12%. Based on rates of \$1.163 for the euro, \$1.351 for the pound, and [ph] 6.471 (00:27:43) for the Chinese Yuan, we expect currency translation to be negligible for the full fiscal year. 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 \$0.04 of accretion from currency translation and \$0.03 accretion from DECIEM. In constant currency, we expect EPS to rise 11% to 14%. At this time, we expect organic sales for our second quarter to rise 8% to 10%. The net incremental sales from acquisitions, divestitures and brand closures are expected to add about 3 points to reported growth and currency is forecasted to be neutral.

Operating expenses are expected to rise in the second quarter as we support holiday activations and the continued recovery of brick-and-mortar retail around the world. Additionally, the prior-year quarter included some benefit of government subsidies which are not anticipated in the current-year quarter. We expect second quarter EPS of \$2.51 to \$2.61. Both currency and the inclusion of DECIEM are expected to be immaterial to EPS. Notably, our EPS forecast also reflects a 23% tax rate compared to a 15.9% in the prior year when we benefited from certain one-time items.

In closing, we are pleased with the terrific start to the year and are proud of the continued efforts of our global teams. We remain confident in our corporate strategy with its multiple growth engines to drive sustainable profitable growth.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for your questions. [Operator Instructions] And our first question today comes from Erinn Murphy, Piper Sandler.

Erinn E. Murphy

Analyst, Piper Sandler & Co.

Q

Great. Thank you. Good morning. I guess my question is around the supply chain, Tracey, for you, if you talk a little bit more about your ability to get product to the end markets in a timely manner into holiday. And are you seeing any major shifts in product launches? And then maybe if you can share as you think about the higher OpEx, how you're balancing air freight versus ocean freight currently? Thank you so much.

Tracey Thomas Travis

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

A

Yeah. Hi, Erinn. We are seeing some supply chain impact as I said in our prepared remarks. We have experienced some air freight and we have experienced some delays. But by and large, we're in very good shape for holiday.

Our holiday sets, we had anticipated some of the supply chain challenges earlier in the year when clearly our supply chain and more publicly there were discussions about supply chain challenges. And so we did order some products early. We produced some products early and we landed many of our gift sets early. And that set us up pretty well for Q2.

So, we are experiencing some inflation in transport. We're managing it as best we can. One of the things that certainly we have the benefit of is we are a luxury company, so we do have pricing power. And we have pricing power not only in our in-line products but also in our innovation as well. So, we do have the opportunity and have taken the opportunity to offset some of the cost inflation with some of the pricing that we've taken this year.

Operator: And our next question is going to come from the line of Lauren Lieberman with Barclays.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Great. Thanks so much. Good morning. I'm really curious to hear a little bit more about M-A-C. I would certainly have expected it to be key in the beginning of this Makeup resurgence. But was curious what you could tell us in terms of progress on brick-and-mortar footprint in North America and EMEA, how that interacts with the online presence, and how you think about the profit model for that brand or maybe from the Makeup category going forward. We're one quarter into the beginning of a recovery, so I recognize that looking at operating margins for the division isn't fair game yet, but interested to hear how you think that can evolve over the next whatever the appropriate timeframe, 12-plus months or so.

Tracey Thomas Travis

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

A

Yeah. Hi, Lauren. So, you faded out at the very beginning. Your question is about what specifically?

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

About M·A·C.

Q

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

M·A·C, yeah, okay.

A

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

M·A·C and how the brick-and-mortar footprint, where you've gotten to so far, how that [ph] fits (00:32:55) with online presence and how you're thinking about the business model going forward and what that means for profitability.

Q

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

Yeah. No, as we announced last year in our Post-COVID Acceleration Program, we did take the opportunity last year to close some stores and some additional stores will close this year. And not only free-standing stores but there are some counters as well that M·A·C has pulled out of.

A

We were encouraged at the end of last year and encouraged through the first quarter with M·A·C performance in both the Americas, so both North America as well as Latin America and also EMEA. So, we really – with a return to brick-and-mortar, as we had indicated before, we saw higher productivity of the remaining brick-and-mortar doors that we had open. And we saw a bit of softness more in North America than in EMEA, but a bit of softness in online as traffic returned to brick-and-mortar. We think that will normalize out a bit in Q2 and we'll see a bit more balance. But as I think all of us can imagine, I think consumers were very excited about going back to brick-and-mortar stores in markets where restrictions were lifted and people felt more comfortable going out and socializing.

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

Yeah, and just I can add that also M·A·C has been a good start in the Ulta-Target experience is a great start in the preparation of the holiday season and the brand is doing very well online and is one of the brands that is benefiting from the service acceleration online both in US and in EMEA. So, overall, very good progress on M·A·C, obviously, as you would expect in the context of the Makeup acceleration for consumers in general.

A

Operator: Thank you. Our next question comes from the line of Nik Modi with RBC Capital Markets.

Nik Modi*Analyst, RBC Capital Markets LLC*

Yeah. Hi. Good morning, everyone. I had a question on consumer behavior. Just on online, what you're seeing there in terms of stickiness, retention, obviously that's an important channel from a profitability standpoint and consumer engagement. So, just wanted to understand that.

Q

And then also, Fabrizio, when you think about what happened during the pandemic as consumers were migrating to well-known brands, exploration kind of came down a bit, but I suspect that that's starting to happen now as

consumers are getting back out and exploring different brands. I just wanted to get your perspective on that dynamic, if that's what you're seeing. And how does Estée better prepare in the future to deal with all of these upstart brands that are starting up on social media? Thank you.

Fabrizio Freda

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

A

So, I think there are two questions. First of all, what we see online, obviously online is doing pretty well. On a two-year stack, we have doubled it, and so, it's a very strong acceleration versus two years. And we see the progress to continue and the growth to continue. Obviously, in the moment where there was the opening of brick-and-mortar, the amount of growth online has slowed down, but the continuous growth is what is really encouraging.

So, the most important part of your question is what happened to the consumers' behavior. So, what we saw during COVID that the consumers that were already online before like younger consumers continued to be online even more intensively. But there were many new consumers that just appeared online during the COVID period that were more the ageless consumer, the more adult consumers. Now, this consumer really enjoyed it, so they are staying online. And so that's what showed that the online continues to grow even when brick-and-mortar opens up. But obviously the two channels' growth get rebalanced in these situations. So, very optimistic for online.

The other thing that online continues to grow is that there are very different channels with different level of growth. And we are growing in every single channel. And we are growing in 3PP, we are growing in brand dot-com, we are growing in retail dot-com, we are growing in the pure-plays, and these are very different by region because in every region one of this channel is stronger than the others. So, the combination of the global online growth is – continue to be pretty exciting.

And we count on this to continue even when brick-and-mortar will be fully, fully recovered. And as a result, we have reached already 28% of our business in online and this will gradually continue to grow over time. So, very strong. In term of – sorry, your second question? Because it was a separate question on consumer behaviors in Asia? Can you repeat it?

Nik Modi

Analyst, RBC Capital Markets LLC

Q

Yeah, it was around exploration, kind of died down during the pandemic. Are you seeing consumers explore new brands again and what is Estée doing to try to make sure that doesn't become too much of a risk going forward?

Fabrizio Freda

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

A

I think the exploration of newness in the world of beauty will continue. It will never stop. And personally I don't have any data point to suggest it was dependent on COVID. The exploration is not only about new brands but the exploration is about the newness of the existing brands. In fact, our percentage of newness continues to be very, very high. And our innovation program continues to be super exciting. We continue to be in the 30% of new products per year, which is extraordinary and has been a huge progress in the last years. So, we continue to see consumers to be interested in innovation and we continue to make our innovation program one of the best drivers of growth globally.

Operator: Thank you. Our next question is going to come from the line of Dara Mohsenian with Morgan Stanley.

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

Hey, guys. Good morning.

Q

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

Good morning.

A

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

Good morning.

A

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

So, just a question on guidance. Clearly, you came in better than expected in terms of fiscal Q1. You mentioned some green shoots. Obviously a Makeup recovery, Americas recovery, Asia some softness with some of the government lockdowns inter-quarter but sounded like that's getting better. And so, I'm just trying to understand the unchanged local currency top line guidance for the year. Is there something specific that's giving you more caution as you look at the balance of the year? Is it more just some conservatism given it's early in the year? How do you sort of think about that relative to the Q1 top line delivery and some green shoots? And maybe specifically also you can touch on the 11.11 Shopping Festival in China and what you're seeing there in terms of initial signs heading into that festival. Thanks.

Q

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

Yeah, thanks, Dara. So, in terms of – we are encouraged obviously as we should be by our Q1 performance. We're still only a quarter in as you mentioned it. We did have some early shipments in the quarter that obviously came out of the second quarter. So, some of the growth, as we mentioned, about 1.5 points was related to that. But as we look at the balance of the year, we are also – while we're seeing encouragement, there's still a lot of volatility in the market.

A

We did have some markets unexpectedly that were shut down in the first quarter. We are still managing through this pandemic, and so, we are – we believe that certainly, as you look at Q2 on a two-year stack basis, it is – and really versus pre-pandemic, it's really quite strong. And again, you're seeing some of the seasonality related to 11.11 continue to impact Q1 and that's reflected in the – Q2 and that's reflected in the guidance that we've provided. But we feel that the guidance that we've given for the year is incredibly strong.

The only difference between the guidance that we gave last time and this time is currency, our outlook on currency is a bit less. So, that's the 1-point change in the guidance that you see. And then from a reported EPS standpoint, our guidance actually, on a constant currency basis, has improved quite a bit. So, we – I would say we are seeing green shoots. We are expressing confidence in the guidance that we are providing quite a bit when you actually look at it from an EPS standpoint even with all of the things that we're navigating through as it relates to transport, et cetera. And that goes to the choices that we're making as an organization in terms of where to invest and where not to invest along with the pricing actions that we're taking as well.

Operator: Thank you. Our next question is going to come from the line of Steve Powers with Deutsche Bank.

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

Q

Yes. Hey, thanks. First, just to clean up, I apologize if I missed it, but were the early holiday sales in North America that you mentioned in the first quarter skewed at to any particular brand or product category? That would be helpful. And what I really wanted to ask about sort of picking up on something Dara mentioned but I'm not sure you addressed, Tracey, was just the relative softness in China, Hainan, and Asia that you experienced in the quarter against the curtailed mobility backdrop versus the improvement that you saw in September, and what I hear is enthusiasm entering December and around the 11.11 holiday. So, maybe you can just expand a little bit on how trends evolved through the September quarter and then what you're expecting in that Asia Pacific region as we go through fiscal 2Q. Thank you.

Tracey Thomas Travis

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

A

Yeah. No. So, Steve, in terms of the early shipments, obviously our larger brands would have comprised most of the larger – most of the sales dollar volume in terms of those shipments. But it was really across the board. And again, both we and our retailers wanted to make sure that we had our holiday programs as well as some of our basic product in store, recognizing the severe constraint that is being projected as it relates to transport during this holiday season. So, we feel very good about that.

In terms of Asia Pacific, inclusive of China, but other markets as well, we did see some intermittent shutdowns in Asia, and that did include some traffic to Hainan being a bit curtailed in the July and August timeframe and a bit into the early part of September. We saw, as we mentioned in our prepared remarks, Hainan pick up quite a bit when those travel restrictions were lifted almost immediately. So, that is a positive sign. And we are still quite encouraged with respect to China and the performance that we expect to see certainly for the balance of the year, both in China and mainland China and with Chinese consumers wherever they shop.

Operator: Thank you. Our next question will come from the line of Stephanie Wissink with Jefferies.

Grace Menk

Analyst, Jefferies LLC

Q

Hi. Good morning. Thank you for taking my question. This is Grace Menk on for Steph. I'm wondering if you could talk a little bit about the trends that you're seeing in Fragrance and just touch on the sustainability there. Is there anything assumed in your guidance for Fragrance? And then also on a similar vein if there is anything assumed for the Makeup recovery in the second half in guidance? Thank you.

Fabrizio Freda

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

A

Yeah. We see, obviously, a very strong Fragrance market and we see great growth in every single region. So, it's good. We see particularly strong Fragrance traction in the high-end fragrances in what we call the luxury artisanal part of our portfolio. This is really outstanding. So, brands like Jo Malone, Tom Ford, Le Labo, Kilian, Frederic Malle, and this is – we believe this will continue. This is a trend we have identified some years ago. And we are focused, the growth of our portfolio and our innovation on this kind of highly sophisticated Fragrance experiences. And while we are seeing that during COVID, this trend has accelerated. The consumers are even more interested.

The other interesting thing is during COVID, the element of our Fragrance brand that were, for example, home like candles or personal [indiscernible] (00:46:33), pampering parts of the lineup beyond the Fragrance, also was accelerating. And this acceleration continues. So, the positives that consumer have learned also the possibility of the pampering in house element of products that these brands provide, they continue to buy them also after the COVID period or [ph] this – the COVID thing (00:46:58). So, the entire Fragrance brands are strong, the Fragrance category is strong, and we expect to have a good holiday season in this area, we expect continuous growth over time.

Operator: Thank you. Our next question comes from the line of Andrea Teixeira with JPMorgan.

Andrea Teixeira

Analyst, JPMorgan Securities LLC

Q

Thank you. Good morning. And congrats on your results. Can you comment on the cadence of the quarter in Asia Pacific and how you exited? It seems that you had a pick-up in China consumption towards the end of the quarter, and, Tracey, you mentioned that in your prepared remarks and I think to Dara's question, but is that acceleration in the fiscal second quarter a function of normalizing the pull-forward or more how conservative you're seeing things happening and then, obviously, you have the seasonality that you have been calling for 11.11? So, if you can just kind of elaborate more on that, I would appreciate it. Thank you.

Fabrizio Freda

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

A

Yeah. I mean, we achieved double-digit growth in China this quarter, and so very strong double digits also on a two or three-year stack basis, so despite the restrictions that we saw in July and in August. So, the Chinese consumer are really strong, and we are serving them also with a variety of locations, meaning in every channel. We see the growth online, we see the growth in brick-and-mortar, we see the growth in Hainan. And our key idea is to serve the Chinese consumers wherever they are and to serve them in the best possible way.

So, we manage this with agility, and depending what is the commercial model that is emerging in China, we focus more on when China [indiscernible] (00:48:46) also depending by the season and by the moment.

Also Skin Care, which I think is a great sign of strength, Skin Care grew strong double digit despite the very tough comparison with previous year, where in our case we launched the Advanced [ph] Night Repair relaunch (00:49:02). So, it was a very big innovation in the base period.

So, brick-and-mortar in China also saw very strong growth. And our business online grew double digits despite the fact that in quarter one online is a bit normally sandwiched between the 6.18 big event and the 11.11 big event. But despite that, we grew double digit.

And the long-term fundamental on the market in closing, namely the large and growing middle class with increasing spending per person, they remain – all these remain intact. And so, the key idea is to be able to focus on the Chinese consumer in whatever channel they choose to shop in depending on the moment to the year. And that's what we're doing, and that's why we remain very confident for the remaining of the fiscal year.

Tracey Thomas Travis

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

A

And, Andrea, as it relates to the rest of APAC, we are expecting a pick-up in the second quarter, so we are not anticipating as many of the restrictions to be in place in the rest of APAC that we saw in Q1.

Operator: Thank you. Our next question is going to come from the line of Olivia Tong with Raymond James.

Olivia Tong

Analyst, Raymond James Financial, Inc.

Q

Great. Thank you. I just want to talk a little bit about some of the new brands like The Ordinary. And if you could just give a little bit of commentary around things that you've learned since the majority stake that you've taken, and how that could potentially be influencing other brands in our portfolio with respect to where you could potentially invest going forward, what retailers might your other brands work in, that you may have not have thought about earlier. Thank you.

Fabrizio Freda

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

A

Yeah. First of all, DECIEM is extraordinary company, and The Ordinary is a brand with enormous success and traction. And so, first of all, we are collaborating with the management team of DECIEM to continue building both The Ordinary and to continue building the overall DECIEM company with their extraordinary incubation capability they have in new brands that they are creating for the future, so both of these activities.

So, the big learning is obviously the ability to create buzz and interest and the relationship between The Ordinary brand and the consumer is really extraordinary. Obviously, we can learn a lot from this. But apart from learning, we can support them in the implementation of the global commercial strategies in increasing the reach of the brand and obviously in leveraging the powerful connection with the consumer in the best possible way in supply chain, in R&D, in many, many areas. So, we can learn and we can support, and this exchange has proven to be very successful.

Then on top of The Ordinary, there are other brands, they're building other ideas and creating for the future. So, what we are learning is also the power of the creative incubation and the creation of new brands. And this will have an influence on our future ability to continue developing brands and definitely we will leverage the strength of DECIEM also in this area.

Operator: Thank you. Our next question will come from the line of Mark Astrachan with Stifel.

Mark Astrachan

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks. And good morning, everyone. I wanted to ask about Hainan growth. I think you've mentioned this on some previous calls in terms of where the growth is coming from, meaning that you weren't necessarily sourcing it from sales in the mainland. I guess I'm curious if that's still the case and kind of how you think about what has driven the growth, especially as it seems like some of the duty-free operators are paying the duties to deliver product to mainland customers. So, if that's true, kind of how do you think this all plays out in time in terms of having mainland and Hainan or kind of local duty-free work together?

Fabrizio Freda

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

A

Yeah. I mean, keep in mind that in China, our most distributed brand, which is Estée Lauder, is in 140 cities, where today with the strong social media and with the strong aspirational values of our brand, as we speak, we can – we have demand in more than 700 cities. So, there are many, many consumers in China that can only buy either online or traveling, and traveling domestically today and historically also traveling internationally. And so,

there is just the market, the – commercially the market is designed to have a very limited overlap between the mainland China and the Hainan.

Hainan serves an enormous amount of consumers that comes also from Tier 3, Tier 4 cities, areas where there is not a lot of brick-and-mortar distribution. And so, Hainan can attract this consumer in this moment, also is a place where people go for holidays, as part of these holidays, there is a lot of the pleasure of shopping, the pleasure of discovery. So, the business in Hainan is proving to be a great trial builder more than in a cannibalizing business. And it's building trial of people that otherwise would not be able to try out our product and then will repurchase them, will repurchase them maybe again in the future travels, but most of the times in their everyday life in mainland China.

So, obviously, there is commercial competition. The market is becoming very competitive. There is a lot of players commercially. There is and will continue to be intense competition. But there is – every channel serves frankly a very different role. And so, our strategy is to be able to leverage each one of these channel in the best possible way with the idea of maximizing the coverage and the service to the total consumers in China that are interested in beauty and over time to be able to better differentiate the scope of the channels and how the consumer will be served by the different channels.

Last thing I wanted to say, Hainan had, at least the last number I've seen, over the 80 million visitors in the last year. So, if you think that Hainan serves the entire middle class because it's domestic travel, you don't need to have a passport. So, today, is our knowledge about 12% of Chinese consumers have their passports, even when international travel will restart, there will be even limited cannibalization versus international travel because Hainan would serve many consumers that do not plan to travel internationally. So, we are very positive on the long term and very positive on the ability to serve the consumers using different channels, which is our strategy.

Operator: Thank you. Our next question comes from the line of Wendy Nicholson with Citi.

Wendy C. Nicholson

Analyst, Citigroup Global Markets, Inc.

Q

Hi. Two things, if I can. When you were running through the brands and what's growing for you and what's doing especially well, I think you called out La Mer first. And I just wanted to clarify how much of La Mer's growth is coming from China and travel retail or is the brand also growing strongly in the US and Western Europe non-travel retail? So, that's my first question.

And then second thing, I know you said, Tracey, that there was only minimal sales in the first quarter from the pipeline fill into Target and Kohl's, but now that we're kind of already into November, can you comment a little bit about what you're seeing there? And especially, I'm curious what percentage of the sales that you're getting from Target and Kohl's are in Makeup as opposed to Skin. I'm just wondering that if those two channels really take off for you, what kind of mix effect that might have on your North American business. Thanks.

Tracey Thomas Travis

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

A

Thanks, Wendy. So, in terms of La Mer, La Mer is growing in pretty much every market. It's incredibly strong. The brand does a fantastic job of innovating and so, we're seeing growth from both new innovation as well as a continued expansion of new consumers with some of the strategies that the brand is deploying. And we see very high loyalty and repeat with La Mer. So, it is all around even during this pandemic it has been one of the

constants in terms of the performance in our portfolio. And the La Mer team is just an absolute fantastic team. So, the brand is doing incredibly well.

As it relates to Kohl's and Target and Ulta within Target and Sephora within Kohl's, we have seeded the initial doors. We certainly expect during the upcoming holiday season that we will see increased growth obviously and contribution from the distribution that we have and we're pleased thus far with the partnership. We're seeing more Skin Care growth than Makeup at the moment. But, again, I expect that we will, certainly with some of the strong gift programs that our Makeup brands have, we expect that we'll see more Makeup growth in the second quarter.

Fabrizio Freda

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

A

Yeah, I just wanted to add that our North America growth this quarter, which has been extraordinary, is a result of many factors. It is definitely not yet the impact of Ulta, Target, or Sephora, Kohl's, that was just at the beginning and only in the last months of the quarter. So, is the result of many other very positive signs. Also we've been gaining shares in all categories during the quarter in Clinique, in M-A-C, in La Mer, in Bobbi, in Tom Ford, in Jo Malone. So, it's a very broad growth across. We're really ready with our innovation with the strong marketing programs. We had anticipated the comeback on Makeup will strengthen our program in what we call the Makeup renaissance in anticipation on the return to back to school or back to work, and we had amazing programs with that. We have added obviously The Ordinary, which is the number four brand in Skin Care in prestige US to our portfolio.

So, it's a combination of factors of improvement of the strategy and improvement of the execution in our North America organization. So, a terrific quarter and we do expect the Ulta, Target and Kohl's Sephora to contribute more in the next quarters and was not the key contributing factor in quarter one.

Tracey Thomas Travis

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

A

Yeah, I think this quarter really represents the diversification that we have within the business that we've talked about and certainly the North America performance to Fabrizio's point represents that as well.

Operator: Thank you. And with that, that will conclude today's question-and-answer session. If you were unable to join for the entire call, a playback will be available at 01:00 PM Eastern today through November the 16th. To hear a recording of the call, please dial 855-859-2056 and enter pass code 6086324. Again, pass code is 6086324. That concludes Estée Lauder conference call. I'd like to thank you all for your participation and wish you all a good day.

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