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# The Estée Lauder Companies, Inc. (EL)

Q2 2023 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good day, everyone, and welcome to The Estée Lauder Companies Fiscal 2023 Second 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 the 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 organic net sales growth also excludes the non-comparable impacts of acquisitions, divestitures, brand closures and the impact of foreign 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.

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## Fabrizio Freda

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

Thank you, Rainey, and hello to everyone. It is good to be with you today.

Turning to results, for the second quarter of fiscal year 2023, organic sales fell 11%, which was within our outlook despite the incremental pressure of COVID-19 resurgence in China. Many developed and emerging markets globally outperformed our expectations to offset the COVID-related impacts of significantly reduced retail traffic as well as limited staffing in beauty advisor in domestic China and travel retail in Hainan in November and December.

Adjusted EPS fell 49%, while a steep decline, this was meaningfully better than our outlook, driven by both disciplined expense management and moderation of the stronger US dollars. Importantly, we continue to prudently invest for growth launching sought-after innovation and increasing A&P as a percentage of sales.

For fiscal year 2023, we are lowering our outlook for organic sales growth and adjusted diluted EPS primarily for two reasons. First, inventory levels in Hainan remain somewhat more elevated than we expected due to the disruptions in travel and in-store staffing levels in November and December. Second, the recently announced potential roll-back of COVID-related supportive measures in Korea duty free are creating a near-term transitory pressure to our business with our Korea duty free retailers.

In the third quarter, this is more than offsetting the initial positive impact from the resumption of international travel by Chinese consumers as well as favorable trends in our second quarter, including outstanding performance across many developed markets in Western Europe and Asia Pacific as well as many emerging markets globally and a better-than-expected currency environment. All told, our return to growth has shifted from the third quarter to the fourth quarter, which Tracey will discuss in greater detail.

We remain focused on investing in our brands, including for innovation, advertising, strategic entry into new countries, and expanded consumer reach to fuel our multiple engines of growth strategy. Our growth engines in the second quarter were many among categories, regions, and channels. And we anticipate the gradual return of more growth engines across the second half of fiscal year 2023.

Beginning with categories, Fragrance extended its long-running double-digit organic sales growth streak in the second quarter, rising 12%. We are inspired by the growth prospects still ahead for the luxury and artisanal segment of the category as consumer [ph] pull sought (00:04:42) unique, distinct and long-lasting scents of the highest quality. Many of today consumers seek to build in occasion-based collection to express oneself differently across seasons, time of the day or events. Our portfolios of Jo Malone London, Tom Ford Beauty, Le Labo, Kilian Paris, Editions de Parfums Frédéric Malle is ideally positioned for this accelerating fundamental shift.

As demand increases globally, we are excited about our plans to bring these brands to new markets and channels in the coming quarters. Innovation will also continue to be a key growth pillar. For example, Tom Ford Beauty outstanding launch of Noir Extreme Parfum in the first half will be followed by the Cherry collection in the second half, building on the success of regional hero Lost Cherry.

Makeup grew organically in the Americas as well as in the – as domestic markets in EMEA and across Southeast Asia in the second quarter. Our brands are indeed realizing the promise of the category renaissance as professional and personal user educations resume and accelerate with [ph] en pointe (00:06:02) innovation, alluring marketing campaigns on new platforms and best-in-class artistry.

M·A·C was a standout success. The brand growth engines were many. Freestanding doors excelled, welcoming consumers with expert services delivering double-digit organic sales growth globally. Across channels, blockbuster innovation, hero products and holiday merchandise proved highly sought.

Clinique further fueled Makeup across subcategories led by lipstick as the brand has created a hero franchise with crowd favorite Almost Lipstick in Black Honey. Estée Lauder Double Wear foundation had exceptional success with its My Shade My Story campaign in Western Europe. Virality on TikTok drove strong new consumer acquisition and the franchise strengthened its number-one ranking foundation with prestige beauty share gains.

Looking ahead, we are excited for the launch of Estée Lauder Pure Color lipstick in the second half. The brand reinvented its iconic franchise to capitalize on lipstick revival and integrates skin care benefits for lips. Designed to flatter all skin tones across matte, cream and luster finishes, the line package in [indiscernible] (00:07:24) to the brand original lipstick from the 1960s.

In Hair Care, our brands extended the category organic sales growth streak to eight consecutive quarters. For the second half, Aveda launch last July in Mainland China will be complemented by the brand recent entry into travel retail in Hainan as we continue investing for the vibrant growth opportunity of prestige hair care with the Chinese consumers. Moreover, Aveda became a certified B Corporation, joining Le Labo in our portfolio in achieving this important third-party validation, as the brand deepened its decades-long commitment to social and environmental responsibility.

Skin Care organic scales fell sharply in the second quarter. There were few headwind with the biggest challenge being COVID-19 in travel retail in Asia and with the Chinese consumer, given the category's exposure. Amidst the tough landscape for Skin Care, The Ordinary was a striking success. Its organic sales growth accelerated from high-single digit in the first quarter to strong double digits in the second quarter.

The brand's hero product excelled as did the blockbuster innovation of Multi-Peptide Lash & Brow Serum, while The Ordinary also realized outstanding performance in the specialty multichannel, it gained momentum from its exciting launch in India in the fourth quarter of last year. We are focused on returning Skin Care to growth globally, with sequentially improving trends from the third quarter to the fourth quarter as a transitory pressure from travel retail abate.

To that end, we have an incredibly rich innovation pipeline primed to launch. Here are few among them. Already out from M·A·C is its new Hyper Real franchise as the brand leveraged its expertise to create an artistry-approved skin care line of products, which are purposely designed to perform also with makeup. La Mer revamped moisturizing soft cream arrived this month, with powerful new clinical results to reverse and resist visible signs of aging. Thereafter, Clinique will bring Moisture Surge SPF to market, extend its popular hero product to meet consumer desire for hydration and sun protection with the lightweight texture that has made Moisture Surge 100H an icon. With these launches, we aim to reach new consumers demographic and tap into high-growth subsegment.

Let me now turn to geographies. While the US and domestic China were challenged in the second quarter, with sales folding single digit organically in each market, we believe both will be growth engines in the second half. For the US, we are optimistic for a return to growth given sequentially improving monthly trend in each of organic sales and retail sales performance throughout the second quarter. Building on this momentum, the market is equipped with numerous growth drivers, including an exceptional innovation pipeline across brands, rollout of new Clinique counters to select doors after a successful pilot of Clinique Lab in Macy's Herald Square and launch of exclusive products by many brands in specialty multi.

We are also progressively modernizing numerous freestanding stores as they are primed to be an important contributor to growth following rationalization of the footprints. Moreover, our enhanced omnichannel capabilities are also primed to contribute to growth in the US as consumers who engage with our brands online and in store drive consistently higher value from upsell and cross-sell. This was especially true during holidays in the second quarter.

For domestic China, we are confident in a vibrant recovery for our business following the relaxing of COVID restriction as the economy is well-positioned to rebound and Chinese consumers are passionate for prestige beauty. We enter this phase with momentum having expanded our market share of prestige beauty in China during the second quarter, driven by gains on all of Skin Care, Makeup, Fragrance and Hair Care demonstrating the desirability of our aspirational brand portfolio and the excellent go-to-market strategies of our local team.

While the third quarter is set to be a more variable because of the high level of COVID cases, we now anticipate even stronger organic sales growth as of the fourth quarter as recovery evolves. We expect online to continue its strength and anticipate a gradual return to more fulsome brick-and-mortar traffic by the end of the fiscal year.

Online organic sales rose single digit in the second quarter, fueled by many brands and led by Le Mer double-digit growth. We achieved excellent results for 11.11 as the Estée Lauder brand realized top ranks across platforms. Moreover, our retail sales growth in online channel meaningfully outpaced the industry in the quarter for strong prestige beauty share gains.

Beyond the US and China, we realized outstanding organic sales growth in many large developed and emerging markets around the world. Our local team have been executing with excellence to deliver broad-based sales gains. Western Europe, led by the UK, prospered while Japan and Australia contributed strongly in Asia Pacific. India, Brazil, Turkey and Malaysia are among the stars of our emerging markets, with each posting strong double-digit organic sales growth, led by India, rising nearly 50%.

We are very encouraged with the excellent performance we are delivering in emerging markets. As these emerging markets evolve in recovery from the pandemic, we foresee compelling long-term growth opportunity arising from the expanding middle class trading up into prestige beauty. We enter this important phase of recovery from a position of strength as we hold leading prestige beauty share in many of these markets. For example, in India, Mexico, South Africa, we are the number one ranked company in both prestige makeup and skin care while we lead in prestige makeup in Malaysia, Thailand and Turkey.

Let me now turn to the strategic deal we announced in November to acquire Tom Ford. This transformational luxury acquisition will make Tom Ford an own brand of Estée Lauder Companies, enabling us to manage the brand's intellectual property and equity. Staying true to our focus as a pure player in prestige beauty, we have also reached agreements with luxury companies Zegna Group and Marcolin to license the brand's fashion and eyewear businesses, respectively.

We first partnered with Tom Ford over 15 years ago, and its singular vision on modern luxury is beyond compare. Together, we have elevated Tom Ford Beauty into the top echelon of high-growth luxury beauty. Impressively, Tom Ford Beauty is expected to achieve \$1 billion in net sales annually over the next couple of years, and we have promising profitable growth opportunities ahead.

Before I close, I want to recognize the start of Black History Month in the US and thank our employees to have created an engaging calendar of events for colleagues and consumers to celebrate and honor the black experience while we continue to focus on accelerating our commitment to racial equity and the collective accomplishing of our equity goals year round.

In closing, while we are lowering our fiscal year 2023 outlook to reflect the additional transitory pressures affecting our travel retail business, we are encouraged by both the strong underlining trends in many other areas of our business and improving market returns. Inflation has stabilized in many markets globally. The strength of the US dollar has moderated. And the return to mobility of the Chinese consumer, both domestically and international travel, is happening earlier than expected.

Moreover, in the first half of fiscal year 2023, we made exciting progress on several strategic initiative to drive growth and resiliency in our business. We significantly strengthened our capabilities in innovation, manufacturing and distribution and we opened the China Innovation Labs, our first plant in Asia Pacific, our new DC in China while we also announced our brand portfolio with Tom Ford and BALMAIN BEAUTY.

All told, we have great confidence that we will emerge from this volatile transitional year even better positioned to realize the long-term growth opportunity of global prestige beauty. To our employees, our future is bright because of your creativity, passion and wisdom. I extend by deepest gratitude for your significant contribution to our long-term success.

And now, I turn the call over to Tracey.

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## Tracey Thomas Travis

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

Thank you, Fabrizio, and hello, everyone. As Fabrizio mentioned, our business in the second quarter continued to be pressured by the external headwinds of COVID-related impacts, including the rising number of COVID cases in China, lower shipments of replenishment orders in the US and the stronger US dollar. Our second quarter organic net sales declined 11% and earnings per share decreased 49% to \$1.54. Tighter expense management and a slightly improved currency impact contributed to our better-than-expected EPS results.

From a geographic standpoint, organic net sales in the Americas declined 3%. We saw healthy demand for our holiday offerings as consumers gravitated to our in-store and online promotions. However, we also experienced lower shipments of replenishment orders due to both retailer inventory tightening as we anticipated and a later improvement in retail trends post-Christmas.

In Latin America, organic net sales rose double digits, reflecting continued growth in nearly all markets, the evolution of recovery in Makeup as consumers returned to stores and the strength of our Fragrance portfolio. Organic net sales in our Europe, the Middle East and Africa region declined 17%, including the negative impact from foreign currency transactions in key international travel retail locations of 3%. The decline was driven by travel retail as expected while growth from nearly every market in the rest of the region was strong.

Our global travel retail sales were significantly pressured by the ongoing COVID-related impacts. Despite stores being open throughout the quarter, travel to Hainan remained largely curtailed and as a result, shipments of replenishment inventory remained low. Elsewhere, we experienced strong sales growth in travel retail, reflecting increased international tourism as travel restrictions in many countries lifted from the prior year.

The ongoing pressures in Asia travel retail more than offset the growth we experienced in the rest of the EMEA region, including both developed and emerging markets such as the United Kingdom, France, India and Turkey. We continued to see various stages of recovery across the region that coupled with a strong resumption of tourism fueled brick-and-mortar growth during the quarter.

Organic net sales in our Asia Pacific region fell 7% primarily due to the ongoing COVID-related impacts in Greater China. This affected brick-and-mortar sales in Greater China and Dr.Jart travel retail in Korea. Online sales continued to grow in mainland China due in part to the expansion of our online presence with the recent launches on JD and Douyin as well as solid performance during the 11.11 Shopping Festival. Most of the other markets in the region continued to progress in recovery as the return of brick-and-mortar traffic led to high single-digit or double-digit growth in Japan, Australia, Malaysia and the Philippines.

From a category standpoint, Fragrance continued to lead growth with organic net sales rising 12%. Strong holiday demand for our beautiful line of fragrances from Estée Lauder and double-digit growth from both Le Labo and Tom Ford Beauty propelled the category's growth in every region during the quarter.

Organic net sales in Hair Care rose 4% and declined 3% in Makeup, the latter driven primarily by the COVID restrictions in China as solid performance from both M.A.C. and Clinique drove growth in both the Americas and in domestic markets in EMEA.

Organic net sales in Skin Care declined 20%. This category continues to be the most affected by the COVID restrictions in China, particularly in Asia travel retail and mainland China, where Skin Care accounts for a large majority of our business.

Our gross margin declined 430 basis points compared to last year. The positive impacts from strategic pricing in this quarter were more than offset by inflationary pressures in our supply chain, region and category mix and higher costs due to promotional items.

Operating expenses increased 500 basis points as a percent of sales, driven primarily by the reduction in sales. This also reflects our investments in areas such as advertising, promotional activities and innovation, which increased 150 basis points compared to last year. Operating income declined 46% to \$768 million, and our operating margin contracted 930 basis points to 16.6% in the quarter.

During the quarter, we recorded \$207 million of impairment charges related to the three brands, primarily reflecting lower-than-expected growth in key geographic regions and channels, given the pressure on consumer demand from the impacts of COVID.

Diluted EPS of \$1.54 decreased 49% compared to last year. The impact from foreign currency translation and foreign currency transactions in key travel retail locations negatively impacted diluted EPS by 5% and 4%, respectively.

During the quarter, we generated \$751 million in net cash flows from operating activities compared to \$1.8 billion last year. The decline from last year reflects lower net income and the negative impact from changes in working

capital, primarily due to the timing of payments. We invested \$419 million in capital expenditures, and we returned \$708 million in cash to stockholders through both dividends and share repurchases. As we expected, our first half performance was pressured by ongoing external headwinds. Let me now turn to our outlook for the remainder of fiscal 2023.

For the second half of fiscal 2023, we are encouraged by the easing of COVID restrictions in China and the expected return of travelers throughout Asia and around the world once more stabilization occurs with outbound flights and visas as well as COVID entry and testing requirements. In Hainan, we are starting to see increased positive signs already as traffic level declines have moderated in recent months. However, retailer inventory levels are still somewhat elevated, reflecting the impact of the lengthy store closures as well as the rapid reduction in traffic and in-store staffing levels in November and December.

And in Korea travel retail, an incremental headwind has emerged since the last outlook we provided in November. The recently announced potential roll-back of COVID-related supportive measures in Korea duty free is creating a near-term transitory pressure to our business with our Korean duty free retailers, which is pressuring our third quarter outlook.

We now also expect more moderate net sales growth near term in our China business as the rise of COVID cases in November and December slowed expected brick-and-mortar retail traffic and social usage occasions, which continued in January during the pre-Lunar New Year shopping timeframe.

Collectively, we expect these impacts to create greater headwinds in the third quarter than we originally anticipated. As a result, we are updating our outlook to reflect a shift in the start of the travel retail recovery in Asia from the third to the fourth quarter of fiscal 2023 due to the normalization of inventory levels in Hainan, the uncertain pace of recovery of travel retail traffic in Korea and a more moderate acceleration of growth in China.

The momentum from our other developed and emerging markets in EMEA and Asia Pacific in the first half is expected to continue as those markets progressively evolve in recovery. We are also cautiously optimistic and expect our North America net sales performance to improve as our retail growth trend in the region has already increased, particularly in January. And we have a supportive innovation pipeline planned for the second half, as Fabrizio mentioned.

As it relates to our operating income, while these external headwinds have introduced a high level of volatility that has had a meaningful impact on our financial results this fiscal year, we remain confident in the ongoing strength of prestige beauty, our business strategy and our ability to reaccelerate long-term profitable growth. We, therefore, plan to sustain the strategic investments imperative to that growth, including innovation, advertising and continued geographic expansion for many of our brands. These investments also support the continued strengthening of our multiple engines of growth as we invest in emerging markets and faster growth channels that are already progressing well in their recovery.

As a result, we expect to see pressure on our operating income in the third quarter, with an accelerated improvement in the fourth quarter as the sales recovery in travel retail, mainland China and Skin Care start to materialize more meaningfully.

The negative impacts from foreign currency that we anticipated in our previous guidance have improved due to the recent weakening of the US dollar, however, currency is still expected to be a meaningful drag to our reported sales and diluted EPS growth for the third quarter and full year. Our outlook is now based on December 30 spot

rates of \$1.067 for the euro, \$1.207 for the pound, \$6.964 for the Chinese yuan and [ph] \$1,263 (00:28:03) for the Korean won.

So, with that backdrop, our guidance is as follows. We expect organic sales for our third quarter to decline 10% to 8%, primarily reflecting the pressures to our travel retail business that I mentioned previously. Currency translation is expected to be dilutive to reported net sales by 3 points, and the impact of certain foreign currency transactions in key international travel locations is not expected to be material.

The impact of sales from certain designer fragrance license exits are expected to dilute reported growth by approximately 1 point. We expect third quarter adjusted EPS of \$0.37 to \$0.47, for a decline between 81% to 75%. Currency translation is expected to be dilutive to EPS by \$0.04 such that constant currency adjusted EPS is expected to decline between 79% to 73%. This includes the negative impact from certain foreign currency transactions in key international travel retail locations of approximately 1 percentage point.

For the full year, assuming a reacceleration of travel retail in the fourth quarter, we expect organic sales to range between down 2% to flat. Currency translation is expected to dilute reported sales growth for the full fiscal year by 4 percentage points, and we expect an additional 1 point of dilution from the impact of certain foreign currency transactions in key international travel retail locations. The impact of sales from certain designer license exits are expected to dilute reported growth by approximately 1 point.

We expect full year operating margin to be approximately 15.1%, a 460-basis-point contraction from the prior-year period, primarily due to the geographical and category mix of sales and foreign currency impacts as well as the sustained investments to support recovery, as previously mentioned. We now expect our full year effective tax rate to be approximately 25.5%, reflecting in part the change in our estimated geographical mix of earnings.

Diluted EPS is expected to range between \$4.87 and \$5.02 before restructuring and other charges. This includes approximately \$0.29 of dilution from currency translation. In constant currency, we expect EPS to fall between 29% and 27%, which includes a negative impact from foreign currency transactions in key international travel retail locations of approximately 4 percentage points.

Regarding the Tom Ford brand acquisition, we expect to complete this transaction in the fourth quarter and to fund it through a combination of cash, debt and deferred payments. In anticipation of closing this transaction, in January, we increased our commercial paper program by \$2 billion. We also estimate a slight EPS dilution to the full year outlook that I just provided due to the final purchase accounting inclusive of transaction costs.

While this year has undoubtedly been a perfect storm of unforeseen macro pressures on our business and the transition to accelerated recovery has indeed been longer than we anticipated, we have navigated through the challenging environment and strengthened the company in the process, thanks to our amazing employees, our company values and our multiple engines of growth strategy. We are encouraged by the many signs of improvement in the overall environment and the progress our incredible teams have made in preparing us for a strong recovery. Our fundamentals are solid and intact, reinforced by the actions we have taken over the past few years.

From the acquisition of the majority interest in DECIEM in fiscal 2021 to the recent announcement of our agreement to acquire the Tom Ford brand and the BALMAIN license agreement, we are expanding our brand portfolio at both the entry and luxury levels of prestige beauty. We've taken strategic actions to enhance our go-to-market capabilities, supply chain agility and local relevance through our new innovation, production and distribution facilities in Asia. We've enhanced our digital marketing capabilities and continue to progress on our

ESG initiatives. These actions and many more demonstrate that we remain confident in the long-term sustainable profitable growth of our business. And that concludes our prepared remarks.

We'll be happy to take quite sure questions at this time.

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## QUESTION AND ANSWER SECTION

**Operator:** The floor is now open for questions. [Operator Instructions] To ensure everyone can ask their questions, we will limit each person to one question. Time permitting, we will return to you for additional questions. [Operator Instructions] Our first question today comes from Lauren Lieberman with Barclays. Please go ahead.

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**Lauren R. Lieberman**

*Analyst, Barclays Capital, Inc.*

Q

Great. Thanks. Good morning. I was hoping – and this is probably more for you, Tracey, if you could walk through with us how your – I guess, the length of the supply chain works for supplying both Hainan and mainland China currently, knowing it's shifting, because as we think through the change forecast in demand and knowing what I believe is a pretty lengthy supply chain, how you're managing production versus shipments and if that's sort of informing why there's so much visibility seemingly on 4Q? And I guess we should see inventory spike up on your balance sheet in 3Q, if that's right.

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**Tracey Thomas Travis**

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

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Yes. You're correct, Lauren, that we do expect that we will – two things. One, inventory levels are still coming down in Hainan. They are almost at the level that we would expect sales to accelerate. So, yes, you would – should start to see an inventory build related to the shipments that we expect to see in Q4.

In Korea, again, the pace is a little bit more uncertain given the transitory nature of what's going on right now. So, we do anticipate, as I mentioned in the prepared remarks, that we will start to see resumption of travel in Korea. And depending on the pace of that resumption, that will depend on the amount of shipments that we have in the quarter. But we have taken, obviously, an assumption there.

We are sitting on a decent amount of inventory even in our own warehouses to supply the sales that we expect to see in the fourth quarter.

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**Operator:** The next question is from Dara Mohsenian of Morgan Stanley. Please go ahead.

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**Dara Mohsenian**

*Analyst, Morgan Stanley & Co. LLC*

Q

Hey, guys. Good morning.

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**Fabrizio Freda**

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

A

Good morning, Dara.

**Dara Mohsenian**

*Analyst, Morgan Stanley & Co. LLC*



So, to sort of extend that question a little bit, right, we have a lot of quarterly volatility in terms of Q3 versus Q4. Q2, there's a difference in shipments versus underlying retail sales, obviously COVID impacts in China. So, it's hard to get a great underlying sense of retail sales here and how the business is doing. So, for retail, maybe you can just give us a little bit of an update on retail sales by region.

I'm particularly interested in category growth and any macro impacts in the US and Europe and then how you're thinking about Asia Pac and China versus the rest of the region, less so on near-term results here but more how results came in in the quarter versus what you originally expected and that might inform the revenue trajectory as you look out over the next couple of years and how you think about it. I think you touched on a lot of aspects of that, but it would be helpful to get a general overview.

**Fabrizio Freda**

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



Yeah. No. Absolutely. With pleasure. Let me start with China, first of all. And so, China, the results in the quarter were pretty good. We built significant market share. So, the overall market in China was negative double digits. Our net sales were – in our retail was negative single digits. And we built market share in every single category. So, in moisturizers, we built market shares, in Makeup, in Fragrance, in Hair Care and in every aspect.

Now, this for us is a very important sign that the – our brands are really working. The aspirational value of our brands remains very, very strong, which in the moment of reopening is a very strong position to be. So, excellent performance relatively to market.

Some of our brands were shining. La Mer in Skin Care was the brand that was gaining the best market share. Tom Ford Beauty in Makeup and Jo Malone London in Fragrance was really leading the share gain. The other important reading of China is that during 11.11, our net sales were up 10.9% and our retail sales were up 11.9% and holding the number-one ranking across various categories. And there was a lot of great success on the brand creative activity, on live streaming, on innovation.

And so, the way – when the consumers are back in this very difficult volatile period like a situation like 11.11 where there is obviously high traffic, our brands respond enormously. And obviously, when the consumers are not back or don't travel or are sick at home is when, obviously, we have seen some issues. So, in total, China is developing the way we planned. And from a market share standpoint, recovering also, and is definitely going in the right direction.

In terms of the future, the potential of China, we continue to see now the opening to create again traffic in mainland, in brick and mortar. We see the continuation of the online success. And we see, the obviously, the reopening on Hainan, and so the Chinese consumer on all fronts. Also, we see the fact that the Chinese consumer is starting to travel internationally, and this will gradually increase as the governments will agree visas and models of growth. In this moment, there are parts of the world we already opened. Others we will open soon.

Japan, we understand, has been in agreement but is not yet open. Will be soon. Korea is the one where the agreement is not yet finalized. But we are optimistic that in the future this also will be resolved. So, that's another very important trend. This will have a positive impact, obviously, in our retail channel but also in the countries of destination, like it's always been historically happened.

In term of categories in China, obviously, the most important thing that will happen as the China accelerate on all fronts will be that Skin Care will accelerate for us. And so, the acceleration of travel retail Asia, the acceleration of China, the acceleration of international travel of Chinese, which we have in front of us in part in quarter four, but in part in fiscal year 2024, this will generate a substantial improvement of our skin care trends that in turn will have a positive impact on our margin mix. So, that's obviously an important element to the program.

Then other regions of the world, as I commented in my prepared remarks, has been very strong in Europe, where we have built market share in most of the European markets. Very strong in the rest of Asia, particularly strong gains in Japan and Australia, as I commented already. And in Korea, excluding the travel retail inputs that are particularly heavy on our Dr.Jart brand, which has a big percentage in travel retail. Excluding that, also Korea started progressing very well. So, good progress in all the other regions.

Then North America. Now, North America, obviously, we also continue to lose share in the quarter. And overall, we would like to accelerate our plan of share recovery. But the good news is there has been very strong progress in quarter two. Every single month, October, November and then December, there was progress in top line sales acceleration. First of all, in retail, the quarter in the US ended at plus 2%, so on the positive. But December was plus 6.57%, so in line with our goals of acceleration. So, we see the US progressing.

Now, the next six months, there is an even stronger plan. In the US, we have a strong acceleration of innovation. I mentioned already some in the prepared remarks, like, Estée Lauder Pure Color lipstick, Moisture Surge on Clinique, Hyper Real on M.A.C., Soft Cream on La Mer, Cherry collection on Tom Ford.

So – and then we have some important distribution improvement. We are deploying more distribution in department store of our high-end fragrances in Macy's, in Dillard's, The Ordinary is entering some doors in Nordstrom's. We are deploying in Ulta and in Sephora new doors, incremental new doors and incremental expansion of our key brands in these doors. And we are renovating 100 freestanding store, opening 8 new freestanding store and continuing to improve our omnichannel capabilities on all fronts. So, we see an acceleration of our progress also in the US.

So, in summary, when – I should add, but Tracey also underlined, that at the same time we have improved our capability behind this program. Our digital marketing is stronger. Our supply chain is shortened and faster. Obviously, we have done progress in our factory in Japan. Our R&D is opened, our R&D center in China, that will increase the amount of local relevant innovations in Asia in an important way in the next fiscal year – starting next fiscal year in a significant way. And we have opened the new distribution, one that serves travel retail in Switzerland and one that serves obviously China, within China as we discussed also in the last call. So, there are all these investment and progresses and capability to make us ready for the reacceleration in the future.

And so, this fiscal year, in summary, has been a year where really we suffered about the COVID lockdowns, particularly in Asia, and then the high level of infections during the reopening and the impact of the strengths of the US dollar that was particularly big in our high-profit, high-important channels like travel retail like China, travel retail Asia because on Korea and China the dollar was particularly impactful. So, it was really a perfect storm kind of situation.

But all the rest, apart from these three areas, really progressed, and in some cases very successful in market share gaining. So, that's my overview. I hope the answer your question that of having an overview of the situation. But I would say is very, very encouraging for the recovery period.

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**Operator:** The next question is from Peter Grom of UBS. Please go ahead.

**Peter Grom***Analyst, UBS Securities LLC*

Thanks, operator, and good morning, everyone. Hope you're doing well. So, Tracey, I wanted to ask about the implied outlook for organic revenue growth in the fourth quarter, which is quite strong and better than expected. And I know we're still a few months away from fiscal 2024 here, but is the implied exit rate in the 4Q guidance a fair way to kind of think about the potential top line recovery looking out to next year? Or are there kind of these timing-related impacts given what you're forecasting in 3Q that could be driving that much stronger growth? Thanks.

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

Thanks, Peter. So, look, we are expecting a stronger fourth quarter than probably you anticipated and us as well, given a few months back. And part of that, as we said in our prepared remarks, is because of the shift of recovery expectation, certainly in terms of some of travel retail.

I would just remind you that I – and I know you're well aware of this, that we are also anniversary last year's some pretty significant shutdowns. So, this volatility that we are speaking about actually started at the end of our fiscal 2022 in the fourth quarter, and we're coming up on the anniversary of that. So, the numbers look particularly large from a growth standpoint because we are anniversary some lockdowns in China and in travel retail in Hainan in particular, which was the part of some of the problems that we have anticipated on this call today.

I think we are anticipating for fiscal 2024, and we're not giving fiscal 2024 guidance right now, but given that in the fourth quarter, all markets are anticipated to be open and remain open and traveling will gradually resume, and again, uncertain about the pace of that resumption, but we've certainly seen encouraging signs in many of our markets that fiscal 2024 will be a strong year for us. So, I wouldn't take the Q4 implied growth and apply it to fiscal 2024, Peter, if that's what you're getting at, but certainly we expect that we – there will still be volatility in fiscal 2024 but the volatility related to the pandemic and some of the things that we've experienced this year should be much more moderate than certainly what we've experienced this year. And if you have any predictions on currency, certainly do let me know.

**Operator:** The next question is from Michael Binetti of Credit Suisse. Please go ahead.

**Michael Binetti***Analyst, Credit Suisse Securities (USA) LLC*

Hey. Thanks for taking our question here. Tracey, maybe I could just dovetail on that a little bit. You've told us a few quarters back that 20% margin was a North Star. As you think out to next year and many of the moving parts of your business finally start to come back online, is that – is there any – I don't know, there might be some pull-forward revenue that leaks into the first half of the year. I don't know, obviously, you give us the fourth quarter here but as you look out to next year, is 20% an appropriate North Star for next year given the revenue drivers back online?

And then, I guess, for retail, can you help us size the travel business a little better since it's such a big swing factor in the model here going forward? I think it was about 15% of sales pre-COVID, half of it China. You spoke a little bit about the shape of it at a conference in December that the pre-COVID, the Chinese traveler was largely a tier one international traveler. I think you've said Hainan has only – has completely replaced that but it's a different customer, maybe a lower-tier customer. Just because this was the model around so much, can you help us just

think about how big that business is today in the non-China markets, Hainan, non-Hainan China to help us think about the model?

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**Tracey Thomas Travis**

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

**A**

So, let me just – and Fabrizio will pick up on your questions on travel retail but travel retail actually was larger. If you're remembering, Michael, our online business was 15% pre-pandemic. Travel retail was more like 26% pre-pandemic. But in terms of the operating margin for fiscal 2024, as you can imagine with some of the more recent events, we are still going through what our expectations are for fiscal 2024, and we'll certainly provide guidance as we normally do in the August timeframe. I think 20% is a little ambitious right now for fiscal 2024 based on what we're seeing, but some of that has to do with how currency moves, which was my previous comment in terms of if you have projections on currency let me know.

But certainly, in terms of the business fundamentals, the growth, we would expect, obviously, more margin expansion that is in our normal algorithm for fiscal 2024 because of the recovery of volume. And obviously, when you're down in volume as we are this year, as much as we protect the strategic investments but also make choiceful discretionary investments as well. Volume solves a lot of sins. And so, we would expect more leverage on our expense base next year certainly than we're able to get this year practically because of the volume trends and as well as the shocks in terms of when those hits have occurred and how fast we can react to them.

So, again, we are expecting a certainly progressive fiscal 2024. And with all of the things that we spoke about in the prepared remarks as it relates to the investments that we made that will come online, we'll have a new factory operational in Asia that will make our time to market shorter. We'll have the new innovation center, which will start to contribute to the development of product for us in the future, et cetera. So, all of those things that we said in the prepared remarks should also support the acceleration of growth in fiscal 2024.

Now, for more on your TRAVEL RETAIL question, I'll turn it to Fabrizio.

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**Fabrizio Freda**

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

**A**

Yeah. Thank you, Tracey, and also I want to add on the margin [indiscernible] (00:51:54) that first step on normalization of our margin that Tracey is describing, on top of volume is also – will depend on which volume because obviously if you assume that a normalization of business will be in travel retail in China, then you are assuming that the normalization will be in Skin Care that tend to be higher margin, so there will be a moment of recovery and normalization. And then from there, we will restart our normal algorithm and, obviously, we will see how the normalization trends evolve and how long they will take, but that will be the way we will maneuver back.

In term of the travel retail question, as Tracey clarified, 26% before and then even more during COVID. But the – you are asking about the – what are the key dynamics in travel retail. So, the dynamics in travel retails will be, first of all, Hainan is now established. Yes, I said that when the international travel of the Chinese consumers will restart, Hainan will not be cannibalized in a big way. Hainan is now well-established vacation place for Chinese for internal travel. Yes, there are different target groups. The Hainan travel is obviously more affordable, easy, doesn't require a visa, doesn't require a passport, by the way. Keep in mind that at least before COVID – I do not have the last information now that everything is changing on the visa model. But before COVID, it's less than 20% of Chinese had a passport, and so there is anyway 80% of Chinese that will go to Hainan. They will not travel internationally in this model. So, Hainan will continue to develop.

The addition will be the international travel, which is coming back in an important way. And then obviously, the Korea and rest of Asia, so Korea has always been a very [ph] big business (00:53:57) as you know, Hong Kong, Macau, Japan were all very important travel retail businesses that now will improve. And so, there will be different levels of growth obviously in all of this.

Now in term of categories, because of the prevalence of Chinese consumer and Asia travelers in general, as percentage of the total global travel retail, Skin Care is a very important category. So, the travel retail acceleration in the future will carry, as I was saying before, Skin Care. And so, this will be a double positive impact on marginality and profitability. That combination is powerful.

And then by category, we see in travel retail strong acceleration of the Fragrance category, particularly the high-end Fragrance category, which is again profitable and very interesting category for the consumers in this moment. We observed many travel retail partners around the world making more space for the high-end Fragrance development in the future of travel retail. So, that's another important positive.

And then the last point I want to make is keep in mind that the travel retail is driven by increased traffic and by increased conversion. The numbers that were available before COVID in a normalized way in 2019 were depending which part of the world, the travelers to buyers conversion was between 10% and 15%. We know also that when there is pretail like in China and Korea, so where people can buy online before they go to the airport, this conversion number increased substantially. And there is a lot of pretail business that has developed very well in Asia, particularly linked to Hainan. And so, the amount of conversion of these travelers is increasing.

And the last thing I want to say is that the comeback of Chinese consumers in international travel is very good news because the Chinese consumer, when they travel, use to have much more purchase per person than the other travelers from different regions. So, the increasing mix of Chinese travelers is very good news for global travel retail as well. So, in the post-COVID world, when it'll be really post-COVID, I think we are going to see some years of exciting opportunity globally in the travel retail developments.

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**Operator:** We have time for one more question. It is from Mark Astrachan of Stifel. Please go ahead.

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**Mark S. Astrachan**

*Analyst, Stifel Financial Corp.*

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Yeah. Thanks and good morning, everyone. Wanted to ask about the sustainability of growth in some of these categories which benefited from reopening like Fragrances, Makeup and expectations for Skin Care improvement, it sounds like you're obviously talking to improving Skin Care trends globally, obviously China as well. And then I wanted to ask the same question around China. So, should we expect a similar reopening trajectory? Or are you expecting a similar reopening trajectory in China that we've seen around the rest of the world in terms of growth and in terms of the categories which benefit? Thank you.

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**Fabrizio Freda**

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

A

So, the reopening of China is – in China, today, the level of sales online is the biggest percentage of the world. So, to be clear, the reopening on China will mainly impact the reopening of brick and mortar, so will impact 50% of the business in China about, will be very positive impact by the reopening. Obviously, during the period like the one we just lived, meaning since mid-November to mid-January, where the level of infections in China of COVID were super high, 80% of families had somebody with the virus, et cetera, so the implications were enormous.

In this period, you see also a reduced consumption – everything, reduced consumption online, reduced interest for sure in Makeup or in other categories. So – but that's temporary, obviously. So, your question is more what happened when all this is regular. The only thing I want to clarify, there has to be regular not only the ability to purchase in stores, but also, frankly, to be free of COVID, really free of COVID, when consumption come back.

So, when people will be free of COVID as a disease, when they will go back to the brick and mortar, we will see at least half of the business in China increasing dramatically some traffic. And we will see a continuous acceleration, a gradual continuous acceleration of the online, which is already very strong. There are many new platforms online that are being opened in China as we speak, which are promising, which are doing success. In our case, our success on JD or Douyin has been very, very strong. It's one of the reasons behind the market share growth and the success of the amazing Tmall events, particularly 11.11 or June 18, have been extraordinary. So, there are a lot of good potential levers of growth. That will be activated by the comeback of consumers.

Then you were asking about the categories that will [indiscernible] (00:59:42). First of all, Skin Care will be the biggest beneficiary for the simple reason that Skin Care is the biggest percentage of beauty business in China. To be clear, that's not the case in Europe or in US, where there are other categories, which have bigger percentage of the total business. So, there's a unique profile of the Chinese consumer, where Skin Care will be the biggest – benefiting the biggest from the normalization of the consumption patterns and of the purchase patterns of the consumer.

Second, Fragrance is on a roll in China. Fragrance was already growing before COVID, has been growing during the period, where China is at lower COVID levels than the rest of the world and will continue to grow with the reopening because there is a clear passionate development of this category.

In China, the Fragrance category is developing bigger percentage at the high end, where we are focused. So, the high-end Fragrance is actually a much bigger percentage of the total market than in the rest of the world, which is great news for the development of this category.

Makeup will also – Makeup is the category which is most affected by COVID situation. So, now is the most affected. By the way, it's been the most affected everywhere in the world by the COVID situation, not only in China. And so, the resurgence on Makeup that we are seeing in this moment in US, in Europe and some of our brands, particularly M.A.C., is benefiting from this very well, will happen also in China when COVID will normalize.

And last, we have launched Aveda in China for a reason, that we have seen the clear signs of development of luxury Hair Care. Obviously, Hair Care is a category super well-developed among the Chinese consumers but is mainly developed in mass. Is the beginning of the journey of the development of a luxury Hair Care, sustainable Hair Care product. And so, that's really also exciting and is in front of us for the future development.

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### Tracey Thomas Travis

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

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And in terms of Fragrance [audio gap] (01:01:56), continue to expand our fragrance portfolio. We're certainly seeing a pick-up and expecting a pick-up in travel retail as it relates to Fragrance. And Fragrance is still a growing category in Asia. So, certainly, during the recovery we expect that Fragrance trends will continue to grow, particularly in the markets that are reopening now.

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**Operator:** That concludes today's question-and-answer session. If you were unable to join for the entire call, a playback will be available at 1:00 PM Eastern Time today through February 16. To hear a recording of the call,

please dial 877-344-7529 and use passcode 694-7935. That concludes today's Estée Lauder Conference Call. I would like to thank you for your participation and wish you all a good day. You may now disconnect.

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