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The Estée Lauder Companies, Inc. (EL)

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone and welcome to The Estée Lauder Companies' Fiscal 2025 Third Quarter Conference Call. Today's webcast is being recorded.

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-Finance and Strategy & Head-Investor Relations, The Estée Lauder Companies, Inc.

Hello. On today's webcast are Stéphane de la Faverie, President and Chief Executive Officer; and Akhil Shrivastava, 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 will find factors that could cause actual results to differ materially from these forward-looking statements.

To facilitate the discussion of our underlying business, the commentary on our financial results and expectations is before restructuring and other charges and adjustments disclosed in our press release. Unless otherwise stated, all organic net sales growth also excludes 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.com sites and through third-party platforms. It also includes estimated sales of our products through our retailers' websites. Throughout our discussion, our Profit Recovery and Growth Plan will be referred to as our PRGP. During the Q&A session, we ask that you please limit yourself to one question, so we can respond to all of you within the time scheduled for this webcast.

And now, I'll turn the webcast over to Stéphane.

Stéphane de la Faverie

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

Thank you, Rainey, and hello to everyone. It is great to be with you today to review our third quarter results, share the progress that we are making on our Beauty Reimagined strategic vision, and discuss our fiscal 2025 outlook.

Amid elevated macroeconomic challenges, our commitment to transforming our operating model to be leaner, faster, and more agile as the most consumer-centric prestige beauty company globally from Beauty Reimagined has only deepened. The executive team, our board of directors, and the organization remain committed in restoring sustainable sales growth and achieving a solid double-digit adjusted operating margin over the next few years.

First, let me briefly review our fiscal third quarter performance. Organic sales declined 9% as expected. Our business, excluding travel retail, decreased 3% organically, a sequential improvement from the 4% decline in the second quarter. Travel retail declined 28% organically and it continues to shrink as a percentage of our business towards the low-teens. Diluted earnings per share decreased 33%, far better than we anticipated in our outlook, showing disciplined expense management.

Gross margin was a bright spot, expanding over 300 basis points to the fourth consecutive quarter as the PRGP continued to deliver meaningful benefits. Operating margin of 11.4%, contracted 270 basis points, driven by increased consumer-facing spending, as volume deleverage from the decline in travel retail was offset by PRGP benefits.

We struck a good balance between reducing certain SG&A expenses and increasing consumer-facing investments. We pivoted quickly as volatility increased, choosing to spend less than what we expected towards incremental consumer-facing dollars, showing new discipline in how we're operating our business, as we focus on higher ROI opportunities.

We've been laser-focused on improving our retail sales trends and delivering a sequential acceleration in global retail sales growth, excluding travel retail. We outperformed in the US, China, and Japan, and a couple of emerging markets in Southeast Asia to gain share. This marks the first share gains in the US in many, many years.

For China, we have now gained share in three of the last four quarters. And for Japan, it is our fourth consecutive quarter of share gains, showing the tremendous strength of our brands in these key markets. Clinique, The Ordinary, and Bumble and bumble drove gains for the US. Clinique now has gained share in 11 consecutive months through March.

La Mer, Estée Lauder, and TOM FORD fueled China, while Le Labo, La Mer and Estée Lauder gained share in Japan. Through the Beauty Reimagined framework, we are focused on expanding gains in these key markets, while also reigniting share gains in many more markets, including the UK, Korea, and Mexico, we have a lot – where we have a lot more work to do.

Next, let me turn to Beauty Reimagined and discuss our progress across the five action plan priorities beginning with the first, accelerate best-in-class consumer coverage. If the consumer has endorsed a retailer and provided it is brand building, we are moving there without debate. We will not let evolving channel preference to be a disruptor to us, like it has been in the past.

During the third quarter and through April, we moved quickly across brands and platforms. Let me give you a few examples. The Ordinary launched in the US Amazon Premium Beauty Store and the UK TikTok Shop. The Ordinary also expanded in Thailand, China, and Turkey. In Southeast Asia, more brands launched on Shopee and TikTok Shop across various markets. As a result, in the third quarter, online organic sales grew mid-single digit, driven by pure play and third-party platforms.

Across pure players, our new brand storefront on the US Amazon Premium Beauty Store propelled growth along with JD, Notino and Zalando. For third-party platforms, strong performance on Douyin and Tmall in China was further amplified by TikTok Shop and Shopee's strength globally. We are incredibly pleased by the results we are delivering across Amazon Premium Beauty Stores in the US and Canada, as well as TikTok Shop in the US, UK, and Southeast Asia. We are exploring expansion with these and other retailers, so more to come with this action plan priority.

Moving to our second action plan priority, create transformative innovation and innovate across prestige price tiers to reach a wider audience. In the third quarter, we introduced innovations aimed to new consumer acquisition at both the lower and higher end of our brand portfolio. Among the innovations, Clinique new Moisture Surge Active Glow Serum strategically priced to recruit at the time when consumers are more price-sensitive. Demand of the new serum contributed to Clinique's significant share gain in the US Prestige serum subcategories.

Estée Lauder new Double Wear Concealer realized strong uptake, benefiting from and further amplifying the popularity of its namesake foundation, such that the franchise delivered share gains across the facial subcategory of US Prestige makeup. M·A·C had a blockbuster commercial innovation with the Nudes Collection, bringing back fan-favorite shades in lip, along with creating new ones and drove significant gain in US Prestige makeup lip subcategories.

For our Luxury Brands, La Mer successfully expanded its nighttime portfolio with a new Night Recovery Concentrate to capitalize on its highly sought after Rejuvenating Night Cream. TOM FORD's new Slim Lip Color Shine lipstick at entry luxury pricing proved highly compelling to drive new consumer acquisition. This innovation by La Mer and TOM FORD fueled double-digit organic sales growth in China for each brand.

In the fourth quarter, we are working hard to keep the momentum going. Already out in China is newness from La Mer and TOM FORD. Building on the iconic success of La Mer's Treatment Lotion, the brand is launching The Balancing Treatment Lotion, designed for oily skin, capturing the multi-generational consumer.

TOM FORD Architecture Soft Matte Blurring Cushion Foundation achieved the top rank for new product launches in Cushion Foundation on Tmall in April. This month, Jo Malone London is introducing a body spray for Cypress & Grapevine to build upon the strong global momentum of its scents with men through new formats. M·A·C

repositioned Studio Fix Powder Plus Foundation. We strategically lowered its suggested retail price in the US and UK to get the hero product in more consumers' hands at a more competitive pricing with the indie brands.

Too Faced new Ribbon Wrapped Lash Mascara pioneered an AI-driven marketing launch, delivering a typical six-month creative process in just 16 days. This is one example of many where we are hardwiring AI throughout the organization. The Ordinary is soon to launch UV Filters SPF 45 Serum as it reenters the high-growth sun care subcategory of skin care.

Our third action plan priority, boost consumer-facing investment to accelerate new consumer acquisition. We increased consumer-facing investment at a greater rate of growth in the third quarter versus the second quarter. We concentrated our incremental investment primarily in China and the US. In China, this contributed to return to growth organically and at retail, while in the US, we deployed multiple strategies, of which some worked better than others. We are taking our learnings and holding our strategies in the fourth quarter.

And we continue to invest in our freestanding stores, which drive brand equity and act as valuable media channels. We opened nearly 10 net new stores globally, led by Le Labo in the US and China. Le Labo leveraged this investment, especially well with strong double-digit organic sales growth, owing to both like-door growth and expansion.

Our fourth action plan priority, fuel sustainable growth through bold efficiencies. In the third quarter, we made significant progress in the PRGP, which Akhil will describe. As of late April, as part of the PRGP's restructuring plan, we have approved initiatives to reduce over 2,600 net positions. With these actions, along with natural attrition, we are streamlining our middle management position by 20% versus February 2024.

Likewise, through our new flatter and more streamlined executive team, we drove a 30% reduction in expense, while also announcing it with new capabilities needed for the future. For procurement and outsourcing, which were two new PRGP initiatives announced in February 2025, we are moving swiftly to transform our sourcing models to drive efficiencies of scale with top suppliers and to leverage external partners for select back office functions.

Our final action plan priority, reimagine the way we work. Our new executive team with reduced layers has been in place since April 1st. Brand now own global strategy and innovation, while regions drive planning, scaling, and go-to-market execution and function enable both. Beginning of fiscal 2026, the P&L will be owned by the regions, creating a greater degree of accountability and simplification. Since February, we cascaded our Beauty Reimagined vision, strategized and aligned on the work ahead through global and regional town halls, in-person leadership team meetings, and market visit in the US, Western Europe, and Asia/Pacific.

Before I close, I want to speak briefly about our fiscal 2025 outlook. We expect the headwind we faced in our travel retail business in the third quarter to be even greater in the fourth quarter. Outside of travel retail, we expect organic sales decline to moderate further and retail sales growth to continue. One of the primary driver of the gap between organic and retail is weakened consumer sentiment in the US and areas of Europe, and prolonged weak consumer sentiment in China and Korea. This is resulting in tighter inventory management, as retailers manage their working capital.

With the strategic reset of our travel retail business well underway to better reflect recent industry trends and market conditions, and provided there is a meaningful resolution of the recently enacted tariffs to mitigate potential related negative impact, we are confident in our ability to return to sales growth in fiscal 2026.

Regarding the new tariffs, outsourcing and manufacturing are strategically regionalized around the world. Supply chain agility has always been and will remain a priority. This is a valuable asset, although there will still be pressures. Our supply chain footprint afford us decision-making flexibility, and we've been working since last November on how to best leverage our existing regional capabilities under multiple scenarios to partially cushion the direct impact of tariffs on profitability.

We already increased North America production of US demand from its already high level. And we also accelerated plans to increase volumes levels at our relatively new manufacturing facility in Japan to service our business in Asia/Pacific. Our plant in Japan is our ninth manufacturing campus globally, as we have five in North America and three in Europe.

In closing, we are moving decisively and building momentum, as we bring our Beauty Reimagined strategic vision to life across its five key priorities. To our employees around the world, thank you for making Beauty Reimagined a reality through your significant contribution.

I will now turn the call over to Akhil.

Akhil Shrivastava

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

Thank you, Stéphane, and hello, everyone. Thank you for joining us today. We remain focused on long-term value creation and are determined to better position the company for sustainable long-term growth, margin improvement, and cash productivity.

Encouragingly, we are starting to see progress on Beauty Reimagined priorities, reflected in the share gains in some key markets, gross margin expansion, CapEx optimization, and the execution on PRGP restructuring program to become a leaner and more agile company. Looking at our third quarter results, organic net sales declined 9% and was within the outlook range we gave in February. We delivered \$0.65 EPS, exceeding our outlook and operating margin was 11.4%.

Now, let me take a few moments to highlight the progress we have made across key areas, and then I'll walk you through our full year outlook. For results by product category and geographic region, please see a press release issued this morning. On the top line, we are encouraged by the share gains we saw in the US, China, and Japan this quarter, and we are committed to doing this more sustainably and broadly in more markets around the world.

On margins, for the quarter, we again expanded our gross margin by 310 basis points compared to last year. This reflects net benefits from our PRGP and was driven by operational efficiencies, the reduction in excess and obsolescence, and benefits from our strategic pricing actions.

Over the course of the fiscal year, we have pulled down production in response to a decline in sales volume. As a result, we triggered a requirement this quarter to recognize certain manufacturing costs in-period, rather than deferring them until the products are sold. You may recall that we took a similar in-period charge in Q3 of last year. The charge recognized last year was greater than the one we recognized this year, resulting in a year-over-year net favorable impact of 140 basis points.

Moving to operating expenses. OpEx increased 580 basis points as a percent of sales during the quarter. This reflects continued investments to fuel growth in key areas of the business. This resulted in a 480 basis points increase in consumer-facing investments.

With our PRGP, we also made progress to reduce non-consumer-facing costs year-on-year, but this increased as a percent of sales due to our sales deleverage. Operating income decreased 27% to \$403 million and our operating margin contracted 270 basis points to 11.4% compared to 14.1% last year. Our effective tax rate for the quarter was 30.8%, up from 30.5% last year. Diluted EPS declined to \$0.65 or 33% from \$0.97.

Proceeding now to our PRGP restructuring program. As of March 31st, we have recorded \$498 million of cumulative charges under the program, primarily in employee-related costs. On the overall PRGP, we are executing with excellence and are making solid progress on initiatives that targeted pressure points in our business.

The plan's net benefits drove gross margin expansion every quarter. We are building momentum and driving progress to reduce non-consumer-facing costs through OpEx efficiencies and our restructuring program. And given the heightened macro and geopolitical volatility, we are exploring additional PRGP savings to help mitigate some potential risks.

Moving now to our cash generation. For the nine months, we generated \$671 million in net cash flow from operating activities, compared to \$1.471 billion last year. This decrease is due to the decrease in earnings adjusted for non-cash items, greater restructuring payments, and an unfavorable change in operating assets and liabilities. This includes the fact that last year, we made a very significant year-on-year reduction in our inventory, which drove very strong CFFO in the base period.

We invested \$395 million in capital expenditures, down 44% compared to last year. The reduction was primarily driven by the prior year payments relating to the manufacturing facility in Japan. It also reflects a very strong focus on optimizing capital expenditures this year, as we are determined to improve our free cash flow.

Before I turn to outlook, let me first address uncertainty around evolving trade policies and tariffs that is adding volatility to an already complex global landscape. As you know, we have been investing in the regionalization of our supply chain for the last several years, and we are using this new flexibility to help mitigate some of the impacts of the higher tariffs.

To provide some context on our exposure, about 75% of what we sell in the US is either sourced from our manufacturing plants in the US and Canada, or covered under existing trade agreements. Roughly 25% of what we sell in China is currently sourced from our manufacturing plants in the US, but we have strategies to potentially reduce that to below 10% including leveraging products made in our manufacturing plants in both Japan and Europe. Similarly, in EMEA, about a quarter is sourced from our manufacturing plants in the US.

As Stéphane mentioned, our task force is closely tracking developments and evaluating a range of scenarios to help mitigate some of the impact of tariffs. Scenarios include optimizing a regionalized and third-party manufacturing networks, leveraging available trade programs, and executing further mitigation strategies over the next 12 months, including expanding our local sourcing.

Based on what we know today and given our deferral period for certain manufacturing costs, we do not expect a material impact to fiscal 2025 profitability. However, unless meaningful resolution of trade negotiations is achieved, we do anticipate the high rate of tariffs to have a material impact in fiscal 2026. We are also exploring additional PRGP savings and strategic pricing to help further mitigate some of these impacts. We are working to give you a comprehensive update on our tariff mitigation plans during our August earnings call.

Given that context, let me walk you through our specific outlook for the full year. We want to acknowledge the risks associated with the geopolitical landscape, specifically tariffs and the uncertainty of their impact on consumer sentiment. If conditions worsen, particularly regarding Chinese consumer sentiment and the potential pressure on sales during the 6/18 Mid-Year Shopping Festival, the negative impact on our financial performance could exceed what we have factored into our current assumptions. In that case, achieving the outlook we are providing today may not be possible.

In February, we indicated that growth in our travel retail business would decline strong double digits in the second half of the fiscal year, and that we would maintain appropriate trade inventory levels. Retail softness has persisted since then, and we expect a steeper decline in net sales in the fourth quarter compared to the 28% we saw in the third.

However, despite this pressure, we continue to align shipments with demand and still expect to end the year at appropriate inventory levels. Our assumptions for the full year are, total organic net sales to decrease in the range between 9% to 8% compared to last year. This reflects the continued softness in our global travel retail business, as well as ongoing pressure in Asia/Pacific, despite the recent improvements we saw in our Mainland China third quarter results. Currency translation is not expected to materially impact reported net sales. Gross margin of approximately 73.5%, an effective tax rate of 38% compared to 31% last year, and EPS of \$1.30 on to \$1.55. Currency translation is expected to dilute EPS by \$0.03.

In closing, we are proud of the meaningful progress we are making in executing our strategic priorities and remain confident in our Beauty Reimagined vision to restore sustainable sales growth and to achieve a solid double-digit adjusted operating margin over the next few years.

To our talented employees around the world, thank you for your leadership and dedication. Together, we are better positioned to become the best consumer-centric company and a leaner, more agile business.

That concludes our prepared remarks. I'll now turn it over to the operator to begin the Q&A session.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for questions. [Operator Instructions] Our first question today comes from Steve Powers with Deutsche Bank. Please go ahead.

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

Thank you very much. Good morning, everybody.

Q

Stéphane de la Faverie

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

Good morning, Steve.

A

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

Good morning, Stéphane. I think this question is probably targeted for Akhil, but maybe for both of you. Just picking up on the commentary late in your comments that you were targeting trade inventories exiting fiscal 2025 to more or less aligned with consumer takeaway, that's obviously been an ongoing project, and it's become increasingly difficult. So, can you talk about whether you expect that to be true kind of across all categories and geographies or whether you see outliers, and then also kind of frame the risks around that outlook? You mentioned the June – the 6/18 variable, but just in general, your level of confidence that you can actually achieve that alignment exiting the fiscal year? Thank you.

Q

Akhil Shrivastava

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

Thank you, Steve. Overall, we have made significant progress, as we communicated in the last quarter as well. And specifically, our biggest challenge was in travel retail, and we have significantly improved our position there. We exited last fiscal at elevated levels of inventory which, by December, we had reduced significantly. And, Stéphane and I committed that we will maintain those levels and continue to work upon that. So, frankly, on travel retail, we are in a much stronger position. Now, given the retail ups and downs, this is a constant monitoring, which we are doing on a weekly, monthly basis.

A

Secondly, around the world, we are seeing retailers tightening their inventory. So, we are adjusting accordingly, specifically in North America with some of the retailers having challenges and that is reflected in our outlook. So, I would say that trade inventory is a challenge. A large part of it is significantly behind us. And in every guidance we are giving, we are trying to include the best of our knowledge and shipping to retail.

The other point I would make on 6/18 is that, look, we have given a broader range for quarter four for a reason, given the volatility we are seeing, and it's prudent. And it is very difficult to make a specific call on day to day on what the volatility will bring. However, we feel that, based on what we see today, our guidance should reflect what we are seeing on the ground.

We are seeing – we saw very strong results in Q3, specifically in China which Stéphane covered in detail in his commentary. And we believe that, even as we are seeing April come through, we are seeing strength in our

business there. So, while we have given a broader range, it recognizes everything we see today. At the same time, it's hard to comment.

Stéphane, would you like to add?

Stéphane de la Faverie

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

A

No, no. I think, Akhil, I think you said it all. I think also, Steve, I think one of the things that is important to take into consideration is the significant and the gradual improvement of our retail sales quarter-over-quarter when you exclude travel retail. That allows us also like to deplete significant level of inventory, and to rebalance it to the level that we've committed to be.

And, therefore, like Akhil said that we are confident that we just – obviously, what we are guiding today, it's always our ambition to just go after it and just to deliver the number. And more importantly, to be able to realign retail next year and to resume the growth, as I mentioned into my opening remarks.

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

Q

Very good. Thank you, both. Appreciate it.

Operator: And your next question comes from Bonnie Herzog with Goldman Sachs. Please go ahead.

Bonnie Herzog

Analyst, Goldman Sachs & Co. LLC

Q

All right. Thank you. Good morning, everyone.

Stéphane de la Faverie

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

A

Good morning, Bonnie.

Bonnie Herzog

Analyst, Goldman Sachs & Co. LLC

Q

Good morning. I had a question on your FY 2026 planning assumptions. While I recognize it's pretty early to talk about detailed guidance, I was hoping you could just talk through a little further some of the moving pieces as we start to think about think about modeling the year? And I'm thinking about in the context of retailer inventory destocking headwinds that as you just touched on are weighing on the second half trends this year. And then thinking in China, broader concerns around US consumption, I guess, ultimately, do you see end market trends improving relative to the second half of this fiscal year? Or is it reasonable to assume similar trends persist, even as we think about your return to growth in the year? Thank you.

Stéphane de la Faverie

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

A

No, thank you, Bonnie, for the questions. So, let me take it from the top because, obviously, it's a pretty large question because of what we see in the market and what we see on our performance. I think, just let me start with really, again, [ph] anchoring (00:32:39) the fact that we are really confident in returning to positive growth territory in fiscal 2026 and that's what we are committing, and we are saying for several reasons.

The first thing is that we are seeing significant market share gain in key market where we decided to focus. The US, China, Japan, obviously, we've continued great success. And we are gaining share not on few brands. We are gaining share on multiple brands in this market, as in the US, but also in China and in Japan. So, we are aiming – in this market, we are returning into positive territory. That's really like the most important thing.

In net sales, we're having sequential improvement from Q2 to Q3. Travel retail has been de-risked. I mentioned in my opening remarks that travel retail is now in the mid- to low-teen, which is basically like taking 10 points of the mix of business that travel retail represented to our high period. Think about it, this is really taking a lot of volatility out of our business. And this is one thing that we've done strategically in the course of like the past few months to just make sure that we can manage accordingly and really reflecting the consumer demand.

I would say also, very importantly, the way we are driving the PRGP, you heard like Akhil and I in our prepared remarks, we're making a lot of progress on the gross margin improvement, from reduction of our employee workforce, especially in the middle management, we are accelerating our outsourcing project, we are accelerating our procurement project. So, all of that has just created a lot of efficiency in the model.

And then, I would say like the tariff, obviously, is something that we are monitoring very carefully and we are expecting meaningful resolution. But as a team, we are taking really a lot of proactive decision to just make sure that we are mitigating as much as we can. And obviously, we don't know what yet the mitigation will be from the outside world, but we are taking the proactive action of what we can control. And we believe at this point, we have a lot of great action in place, and we will continue through the PRGP to look at additional efficiencies.

And then the most important thing, I would say, Bonnie, is like through Beauty Reimagined, I think I hope in my prepared remarks, you saw how quickly we are moving to new channel, how we are accelerating innovation, how we are making sure that we are investing in consumer-facing in a much more efficient way. And our team is really looking at everything from a media standpoint on how we make sure that we go for the highest ROI, the best efficiency, and then we have like just obviously, we are meeting the consumer and recruiting new consumers in the best way.

I think as a result, we see all of the world, the desirability on our brand being very strong in China, in the US, in Japan, in many markets. We know that we have some progress to make, like I called out, in the UK and in many of our emerging markets. And we are laser-focused with what we are learning and what is working in this key market to take some of the recipes and to just apply it everywhere around the world. So, with all of these elements in place, I would say, we are really confident.

Now, there are certain number of things that are not under our control. Their consumer confidence is continuing to be subdued in China, is actually reduced in the US and in some areas of Europe. So, we are monitoring very carefully what are the outside conditions versus what we can do. But showing in this moment in time, despite consumer subdued confidence in China and reduction in the US, for instance, our brands are moving in the right direction. You saw things like Clinique, 11 quarter of double of market share gains in the US.

In China, we have Estée Lauder, La Mer, Clinique, Le Labo, and I can go on, brands that are gaining market share. So in China in the last quarter, we've gained market share in all four categories, and that's been a long time that we haven't been in this position. In the US, we've gained market share in three of the four categories in the last quarter. So, all of these things are the elements that gives us confidence that we can return to growth next year. Obviously, we are monitoring what is happening outside and we are putting mitigation plan in place as we go.

Bonnie Herzog

Analyst, Goldman Sachs & Co. LLC

Okay. Thank you.

Q

Stéphane de la Faverie

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

Thanks, Bonnie.

A

Operator: And your next question comes from Lauren Lieberman with Barclays. Please go ahead.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Great. Thanks. Good morning. I know you talked about...

Q

Stéphane de la Faverie

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

Good morning.

A

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

...good morning, that you're assuming some significant change in the kind of current tariff regime, but I thought it'd be helpful just to get a little bit more perspective on. First, when you think you can be below 10% of products sourced from China in the US? I know, of course, you've got many plants around the world, but just curious the timeline to get there?

Q

And the other thing was, the other 25% of US, where that's sourced from? [indiscernible] (00:38:08), where is the other 25% from? And then the plan to get the China sourced from US to sub-10% when that's expected to be the case? Thanks.

Stéphane de la Faverie

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

Yeah. No, thank you, Lauren. Good to hear from you. So, from China, we are confident by the end of the fiscal year, this fiscal year, we will be able to just be around the 10% coming from the US going to China. So – and obviously, this will be – the 90% plus will come from our ability to just accelerate the output from our newly opened factory in Japan, Sakura which is like up and running.

A

Obviously, we are obviously continuing to just have product coming from Europe and from Canada, which obviously will just like be servicing China, for instance, when you have like a product coming from The Ordinary. And when it comes to the US, the majority of the 25% are really coming from Europe. So it's not that we have anything coming from – if the question is, do we have anything that is coming from China to the US? Is very minimal. It's just not material and basically like the total.

So, in that sense, we believe that we are in a position today, thanks to these nine campuses that we have around the world, to mitigate the best we can. Obviously, I'm talking here about like finished goods. We have a certain number of things that we need to work, from component and raw materials. That is different. But from a finished

goods standpoint, we are in a place today, and by the end of the fiscal year, where we can mitigate a large part of this tariff.

To give you a sense, Lauren, since we started this task force in November from where we saw when it was announced to where we are today, we've mitigated in excess of 40% of the initial impact of the tariff, and we continue to work through it. This task force is not going to go away. Obviously, there's a certain number of tariffs that we don't know where they will end up and we are monitoring that daily. And we are very diligent with the team on just like doing the right thing on that front.

I don't know, Akhil, if you want to add anything?

Akhil Shrivastava

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

A

Yeah. The only thing I would add, Stéphane, is that – hello, Lauren...

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Hi.

Akhil Shrivastava

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

A

...We – our value that would be tariffable in the situation, as Stéphane explained, would be quite low because of our network. We are having exposure probably in the industry, one of the lowest cross-border. Of course, the high rate of tariffs creates the exposure. And with all the trade talks going on, we do – like everybody else, we are hopeful that there should be some resolution from that high-level rates that we are seeing right now.

But in terms of minimizing the flow and putting it in the right places so that they are regionalized, we are actively working that. And we've been working that for four, five months, as our supply chain team has been looking at multiple scenarios, including all the way to componentry. So, not only the finished good flow, we are looking – we have multiple dealers/suppliers, so we can – for many of our key products. So, we can definitely do that in addition to what Stéphane explained. So, we remain confident in what we can control and, of course, are hoping for some continued resolutions as we are hearing more positively.

Stéphane de la Faverie

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

A

Just one additional thing, Lauren, also what is important is, with the work that we are doing on the PRGP of improving the gross margin, that gives us also more additional pricing power. So, we also can and put in place some mitigation through not only what we are doing from an inventory sourcing standpoint, and where the finished goods are coming in our manufacturing network, as you can tell, it is very agile and diverse today to serve this moment in time. But pricing power remains something that is under our control, thanks to all the work that we've done on gross margin. And then we are looking to additional PRGP savings to obviously mitigate whatever other exposure that we could have.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Thanks so much.

Stéphane de la Faverie

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

Thanks, Lauren.

A

Operator: And your next question comes from Filippo Falorni with Citi. Please go ahead.

Filippo Falorni

Analyst, Citigroup Global Markets, Inc.

Hi. Good morning, everyone. I wanted to ask about the PRGP, and broadly, what are your expectation for savings for fiscal 2025 relative to your total program?

Q

And then, as you think about fiscal 2026, Stéphane, you mentioned that you're evaluating other PRGP plans. So, give us a little bit of sense of what other areas you will be looking in terms of potential savings? And then, from a reinvestment standpoint, can you give us a sense of how much of the reinvestment is expected on a net basis for the savings? Thank you.

Stéphane de la Faverie

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

Yes. Hi, Filippo. So, Akhil and I will tag team on this one, so we can just like add a little bit more flavor. So, obviously, like I said, and like we both said in our prepared remarks, we are very pleased, obviously, of the progress that we are making in the PRGP. If you remember, there was two phase to the PRGP, what we so called internally the PRGP 1.0, and obviously, the expansion of the PRGP. On the PRGP 1.0, we are very confident that we are like on target for the year that is both. You've seen fourth quarter – sequential quarter, sorry, improvement on gross margin like 300 basis points.

A

And, Akhil mentioned like the target of 73.5% on our gross margin, which really positioned us into the right place. And we will continue, obviously, like to do some improvement. Obviously, we are being mindful of what is – could happen with like the tariff as we just discussed with like Lauren a few minutes ago.

Also, from an employee standpoint, we are delayering significantly the organization. I mentioned it in my remarks, over 2,600 positions have been eliminated and will be – at least 85% of this positions will be leaving the building by the end of the fiscal year. And obviously, we continue to do so. So, I think from a fiscal 2025, we are really on target, delivering our internal objectives and what we've committed to you from a PRGP standpoint.

Now, when it comes to the expansion of the PRGP that will go into fiscal 2026 and beyond to create a lot more efficiency, we are laser-focused in accelerating all the work that we are doing from an outsourcing, and we will come to you more into most likely the August earning calls to just give you more detail of how we are doing it.

But today, we are looking – we have like key potential external partners on how we are looking at different services, from HR services to financial services to marketing services and I could name them all. So there's no stone that we are leaving unturned when it comes to how, and we can operate in the company in a much more agile and leaner way.

And also, we are launching – we've launched actually a major procurement project that will give us a lot more efficiencies, but also cost saving from anything that will impact like our direct and indirect materials through the organization. So, in that sense, I'm really confident that we are in the right place to deliver the PRGP 1.0, and we have all the tools, all the partnerships, and all the teams that is really laser-focused on accelerating it.

The end result, Filippo, is the same one, which is to deliver a solid double-digit operating margin in the next few years, and we'll do it. This is our commitment. I said it in the last call. I'll reiterate it now this time today again because of everything that we are putting in place. Akhil?

Akhil Shrivastava

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

A

Yeah. No, thank you, Stéphane. So, Filippo, hello there. And two things, right. We are really leveraging this to fuel Beauty Reimagined, which is the growth agenda and a solid double-digit margin. So, we are really thinking all of those things in those terms. Gross margin, we have already seen progress. And we believe there is more room to go there and that's our goal, based on the zero waste that Stéphane talked about and what we have already demonstrated this year.

Then, of course, the next big area is everything else, other than COGS, which is OpEx, which you can do the math that, if we are at about 8% margin, mid-73% gross margin, we do have a significant amount of OpEx where the optimization is being worked on. The reason you are not seeing enough movement there because, even though we are dropping the dollars year-on-year, we are seeing sales deleverage. And as Stéphane pointed out, that as we return to growth, barring some of the tariff context we talked, we should start to see, with dollars already dropping on those OpEx, a significant movement on OpEx margins.

So, with the program touching all the way from discounts, just as a reminder, on the sales, gross margin on operational excellence, which we are driving, which you have seen the results, and all employee cost, we had doubled the restructuring, so we had communicated extra restructuring of benefits of \$350 million to \$500 million when we communicated to you last time and significant work on procurement for non-employee costs. So, between all of that, we are committed to our solid double-digit margin progression. And as you can see, there is room, both in gross margin and OpEx. And with a little bit of sales growth that we see, we should start to see this work translate into – in that direction in a very meaningful way.

Filippo Falorni

Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you very much.

Stéphane de la Faverie

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

A

Thanks, Filippo.

Operator: And your next question comes from Peter Grom with UBS. Please go ahead.

Peter Grom

Analyst, UBS Securities LLC

Q

Thank you, operator. Good morning, everyone. Hope you're doing well. So, I just wanted to ask around the commentary regarding sales growth in fiscal 2026 should there be a resolution related to tariffs. I know this is a bit specific, but is that a full year comment, or is that just that you would anticipate returning to organic sales growth at some point in the year?

And then totally getting that this is probably hard to answer, just given the many moving pieces, should the tariffs remain in place, just can you provide any guardrails in terms of how this may impact your ability to return to growth? Thanks.

Stéphane de la Faverie

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

A

Yeah. So, I'll take the first one, then Akhil can take the second one. So – hi, Peter. Yeah, obviously, the comment on the return to positive growth is fiscal 2026 comment. So it's too early for us to just like give you a comment specifically by quarter. Obviously, we'll just give you a lot more visibility when the August call will be when we close this fiscal year and going to next year. But the comment is a full year.

And again, I just want to reiterate, because we are seeing the sequential improvement on our net sales from Q2 to Q3, but also because we are already in positive retail territory when you exclude travel retail. And if you remember, Peter, also, we're kind of – while we are resetting our travel retail business to just be less volatile in the total business, we are also [ph] anniversarizing (00:50:12) some pretty low base when we are going to go into 2026 for travel retail.

This is why it's giving us some – actually a high degree of confidence that we are just going to go into fiscal like 2026 growth. But obviously, this is a yearly comment, and we are laser-focused to do it on the key regions. Obviously, the US, China, Japan, as I mentioned, are already moving in the right direction with market share gain, and we have a lot more work to do.

I'm not yet pleased of the progress that we are making in the UK and in emerging market [ph] and so, others (00:50:46), but we have really clear task force with our team to just make sure that we [ph] turn their morale (00:50:50), and we invest in every type of green shoots that we have into the market. But obviously, there is some external risk factors that are linked to, at this moment in time, more to the tariffs, and the tariffs having an impact on consumer confidence.

And maybe, Akhil, [ph] do you just want to – just on the (00:51:09) materiality of the tariff today.

Akhil Shrivastava

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

A

Yeah. Absolutely. So – hi, there, Peter. So, overall, just to start from the top, right, markets are growing, ex-TR. Our retail is growing, ex-TR, and we are starting to grow share. So, that augurs well for the top line that Stéphane talked about. And we are definitely basing some of the last periods of very difficult TR comparisons.

From a tariff perspective, of course, the biggest watch out is, for everybody, it's not – we are not unique in that, is consumer sentiment, consumer sentiment in US, consumer sentiment in China, which is hard to predict. But what we are seeing is that our brands are continuing to be very strong. They are some of the most desirable brands in both – in China and around the world. So, we feel good in terms of – and frankly, the talk has been more positive and more constructive, even on the tariff area and those negotiations. So that gives us confidence.

On cost side of tariff, of course, at these high rates, for any company doing any cross-border business, the impacts are not going to be small. And we did say in our prepared comments that they can be material. However, we are looking at three big things, and I'll just – I think it's important to reiterate what Stéphane just said. We are looking at, one, making sure that the flow of goods is in the most least tariff lanes, and we have the capability to do that.

Second, we are looking at pricing opportunities. We do have opportunities there. And while being very surgical and keeping consumer confidence in mind, we will take action on that, but we will do that if it's necessary, and that's not counted yet.

Thirdly, we are looking at more PRGP opportunities as was asked, because as we have executed well so far on PRGP, this is a new muscle organization has built and Stéphane is driving this across the whole company internally and externally with other partners. So, we see more opportunities to do things there, as we build this new muscle which we have really progressed on in last year. So those would be some of the things we are looking at and some guardrails around how we will navigate.

Peter Grom

Analyst, UBS Securities LLC

Q

Thank you so much. I'll pass it on.

Stéphane de la Faverie

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

A

Thanks, Peter.

Operator: And your next question comes from Dara Mohsenian with Morgan Stanley. Please go ahead.

Dara Mohsenian

Analyst, Morgan Stanley & Co. LLC

Q

Hey, good morning, guys.

Akhil Shrivastava

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

A

Good morning, Dara.

Stéphane de la Faverie

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

A

Good morning, Dara.

Dara Mohsenian

Analyst, Morgan Stanley & Co. LLC

Q

You mentioned the share gains in the US, China, and Japan in the quarter. Clearly, there are also some areas of weakness; travel retail, the UK, as you mentioned, some emerging markets. So, I was just hoping you could spend some time on how you think about your market share performance as you look out to fiscal 2026. What are the most important building blocks in your mind to get back to better market share performance consistently across the organization? And how much progress you think you can make in share, particularly in some of the laggard areas that haven't seen a recovery yet? Thanks.

Stéphane de la Faverie

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

A

Yeah. No, thanks, Dara, for the – so, let me just give you a little bit more flavor of also what is happening in the US, China, maybe like in Japan. So, it's – because it's very important, I think I mentioned it briefly earlier. We are

in a situation where we haven't gained market share in the US in many, many years, like I said in introduction. Now, we are resuming with market share gain, and we did it on three of the of the four categories.

Clinique, I mentioned it, 11 consecutive months of market share gain. We have the number one and the number two brand in skin care and makeup in US on the quarter. The Estée Lauder brand gained share in skin care and makeup for the second consecutive quarter. The Ordinary is back into market share gain also in the US, but frankly, like in many markets around the world, and The Ordinary is the number two brand in skin care in the US, like behind Clinique.

And I want to say also which we are very pleased with some of the progress that M·A·C is making and gain share and is the number two brand in makeup in the US behind Clinique. So, you have like Clinique number one and M·A·C number two in makeup, and you have Clinique number one and The Ordinary number two in skin care. So, very, very strong position.

Our intent, once you think about fiscal 2026, is to maintain and to accelerate this position. In the US, we know we have a lot more work to do on fragrances. We have an amazing portfolio of Luxury Brands, from Jo Malone, TOM FORD, Le Labo, and so on, and Le Labo is going from strength-to-strength, gaining market share in pretty much every market around the world.

We want to just make sure that it's reflected on the total category also, for instance, in the US the way we've been able to do it in the last quarter in China, where we are gaining share in skin care, makeup, fragrances, and hair with at least eight brands that are gaining market share. And I'm talking about not only some of our smaller brands, but I'm talking about La Mer, I'm talking about Lauder, talking about TOM FORD, Jo Malone, and so on and so forth that are all brands that are gaining share.

What is giving me also some confidence is, when I look at Japan and Korea, we are the number one group in fragrances, all of them. So, when you talk about Prestige and Luxury, we've become number one last year in Japan for calendar 2024. And now, we have three consecutive quarter of number one position in Japan, and we also have this position of number one in Korea.

So, we know how to just like bring them. We are taking the learnings from what we are applying in Japan and in Korea, we're bringing them to the US. We're taking the learnings of what we are doing in China, and we are bringing them to the emerging markets, where in the emerging markets, we've been somehow disrupted by the earthquake in Thailand and some issues of shipment from Q3 to Q4 in India.

That being said, if you exclude these two market, we are flat in the emerging market. I'm not satisfied yet and we are like going to put a lot more action in place. And one of the big market that we are now laser-focused with the new leadership in place is the UK. And frankly, here, we have so many great learnings of how we've turned around the Clinique, how we are accelerating Estée Lauder, how we are like putting M·A·C in the right position to take exactly the learning and to deploy them into the UK.

I have to say, I'm not taking basically the few weeks as an indicator for the quarter, but the beginning of April with what we see in retail is actually strong in the US, is actually even stronger in China, and it's showing some positive momentum in the UK and in some emerging markets. So, we are taking these learnings, and we are putting them into acceleration.

Now, obviously, your last piece of the question is travel retail. Travel retail, we are still [ph] anniversary (00:58:34) some really big numbers, and there's a high-double digit like negative. That being said, if I look at Hainan, we are

seeing some – not positive momentum, but momentum above the department, meaning that there's indication that we are going back into some market share gain within Hainan by being focused on driving retail.

We have a new leadership organization in place in travel retail, which is doing a fantastic job that is really laser-focused on driving retail through eventing. Just to give you an example, last month – actually, the month of March, or two months ago, we drove massive amount of event with the Estée Lauder brand that is still one of the leading brand in Hainan today. And we are – like we were doing – providing services on the floor, and we were doing that for over a week for more than 200 services a month. So, we've shifted the focus to be a retail organization and meet the consumer demand where it is around the world.

And the last point that I would put like, Dara, is our ability to now move quickly. And I say, there is no more debate. We move where the consumer is going. The move that we did on Amazon Prestige Beauty, the move that we've done on Shopee, the moves that we are doing on TikTok Shop like around the world, is also another indicator of our ability to just put our brand where the consumer is and really recapture our fair share of the market.

Dara Mohsenian

Analyst, Morgan Stanley & Co. LLC

Great. Thanks, guys.

Q

Stéphane de la Faverie

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

Thanks, Dara.

A

Operator: We have time for one more question, and it will come from Bryan Spillane with Bank of America. Please go ahead.

Bryan D. Spillane

Analyst, BofA Securities, Inc.

Hey. Thanks, operator, and good morning, everyone, and thank you for a lot of disclosure today, which is really helpful and just trying to understand the story as it evolves. I had a question about how you're balancing the margin target, the margin aspiration over the next few years and some of the incremental actions you're taking, like increasing the size of the restructuring versus just making sure it doesn't interfere with a reacceleration and sustained acceleration on revenue.

So, there's a lot of moving parts to your story right now, and especially trying to reboot some brands, refocus kind of the center of equilibrium geographically, and at the same time, chasing a margin target or, I would say, pursuing a margin target. So, can you just kind of give us some sense of how you're thinking about the choices that are involved in that, and really safeguarding at the end of the day that we've got a model that will grow revenue, which ultimately is more important than the margin target? Thank you.

Stéphane de la Faverie

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

No, thanks, Bryan. Very good question obviously. This is the one that ultimately is going to the right balance of the transformation that we are into our PRGP, and at the same time, being able to just like resume with growth and the solid double-digit operating margin in the next few years.

A

And thank you for acknowledging also the fact that we're giving a little bit more visibility. And our intent, I want to be very clear, is to give you more visibility as we go. There's a lot of volatility out there, but I think we are also much clearer, and we are gaining, hopefully, as you see today, some positive momentum in many areas.

Look, at the end of the day, one of the things I've said in my remark is the big transformation that I'm driving with the team is also the clarity of who does what in the organization. And I think you've helped me say clearly what is role of the brand, which is obviously driving the overall strategy that comes from the strategy from the company, but obviously, how do you apply it for every brand, an accelerated number of innovation in the market.

So, we are laser-focused on having our own stimulus innovation plan by brand that meets the consumer for trial and for long-term acquisition also. But at the same time, what is basically the role of the regions and the affiliate ecosystem really to just really do the planning, the execution, and really meeting the consumers where they are.

I think one of the biggest – the function, obviously, remains and will always be the enablers of this strategy and this execution. And I think we are making a lot of progress through PRGP to just make sure that this – all our functions are much more leaner, faster and much more agile as the way we described it, hopefully, in our supply chain, and how we are operating, and we can just like navigate this moment in time.

But I think the biggest challenge is where the responsibility of the P&L is ultimately and that will simplify and being able to just go much faster today to really deploy and allocate the fund appropriately where we have successes. And I think, today, obviously, we have a certain number of guardrail and we're putting it in place.

We couldn't change it in the middle of the cycle. But when it comes to July 1st, the beginning of our new fiscal year, we are accelerating with this new model. So, I would say, as we are pushing the transformation, we are layering the organization, we are moving with outsourcing with speed, we are cutting costs through the organization through the procurement project, we are clarifying who does what.

And I have spent personally with my new executive team countless hours and days, if not weeks, traveling around the world with like town halls. From the moment we did the last call beginning of February, two weeks ago, I think my feet haven't touched the ground, basically like really making sure that we are very close to the organization to make sure saying, what do we retain on our culture that makes us so unique, but what needs to be evolved?

And a lot of things that I'm putting the accent on is this need to be ambitious to go for the new consumers through Beauty Reimagined, the consumer coverage, accelerating our innovation, and making sure that we are very much more agile in the way that we are boosting investment.

I'm all for boosting investments throughout, but I want to just make sure that I'm driving the need to have like the highest and best ROI through everything we do. And then, at the same time, what needs to change? And this is the work we'll tell you a lot more when we come into August and beyond, which is all the projects that we are driving with outsourcing, which is going to fundamentally give up access to some of the best tools that are available and to just make sure that this company becomes the most agile and – the linear and the most agile company to really meet the consumer demand where they are around the world.

So, I'm highly confident and I'm seeing it with our team. I know the executive team is behind this vision. I know the team is behind the vision. I know the board of director is behind the vision. And we are basically like going with one mission, is to reignite growth, as I said, now, which is new as of next year, and obviously, resume with strong double-digit operating margin in next the few years.

And Akhil will want to add a few things.

Akhil Shrivastava

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

A

Yeah. Thank you, Bryan. That's a great question, and Stéphane really covered it well. I wanted to give you just a few points to close it out. Stéphane and I, as we are meeting our people around the world, we are very clear, it's growth, margin, cash, and growth being a very large part of the driver of TSR.

I think if you look under the hood, as we explained today, we are starting to see already the green shoots of growth. Yeah. Our business in China grew. We are starting to see share growth in places where we haven't seen share growth. So, we are starting to already tap into what's possible terms of growing the company, which is why it gives us the confidence that, barring the things we talked about external, we are poised to grow.

Secondly, from the cost standpoint, our work has been massive. We out-executed the PRGP program we put for ourselves. It's, of course, not visible because of some of the deleverage we saw in travel retail this year, but a lot that is getting cycled out.

Thirdly, Stéphane is fundamentally changing how we work. If you walk the hallways of a company and you look across, and especially the announcement on very clear delineation between brand, region, and functions, that frees up resources because the way we work. So, there is opportunity to drive margins and fuel the business, but be very effective in this new way of speed, agility and clear empowerment and accountability.

And then thirdly, as we work to find the best processes with our external partners that we are discussing and Stéphane has shared that on shared services, et cetera, there is a significant opportunity to improve our working processes. So, there is opportunity on the cost side, and we are starting to see growth come through. And our hierarchy of value creation is very clear. It's growth, margin, cash. So, you will see us invest without any apology when the idea is right and drive that ROI. So, hopefully, that gives you the clarity on the playbook we are following.

Operator: That concludes today's question-and-answer session. If you were unable to join for the entire webcast, a playback will be made available at 1:00 PM Eastern Time today through May 15th. Please visit the Investors section of the company's website to view a replay of the webcast. That concludes today's Estée Lauder conference call. I would like to thank you all for your participation and wish you all a good day.

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