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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to The Estée Lauder Companies Fiscal 2019 Fourth Quarter and Full Year Conference Call. Today's call is being recorded and webcast.

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

Laraine A. Mancini

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

Good morning. 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 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, the net gain on liquidation of an investment in a foreign subsidiary, goodwill and other intangible asset impairments, changes in contingent consideration, the finalization of provisional charges related to the U.S. tax law enacted at the end of calendar 2017, and the new accounting standard for revenue recognition, all net sales growth numbers are in constant currency. You can find reconciliations between GAAP and non-GAAP figures in our press release and on the Investors section of our website.

During the Q&A session, we will ask that you please limit yourself to one question, so we can respond to all of you within the time scheduled for this call.

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

Fabrizio Freda

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

Thank you, Rainey, and good morning, everyone. We delivered another outstanding performance in fiscal year 2019, as our strategy based on multiple engine of growth continue to be a winning model. We have created more investment opportunities and improved our ability to quickly reallocate resources among different growth engines. Improved data analytics combined with our long-standing creativity fueled our successful product innovation and digital marketing, which led to double-digit gains in net sales and adjusted earnings per share in all four quarters.

For the year, sales grew 12%, once again, above the rate of global prestige beauty, further strengthening our industry leadership. EPS climbed 21%, our second consecutive year of EPS growth over 20%. We finished the year with strong fourth quarter results, driven largely by the same geographies, brands and channels that fueled our performance in the previous quarters. We also had a modest improvement in trend in our U.S. business despite a tough environment.

In fiscal 2020, we expect another year of strong above-industry sales growth, margin expansion and double-digit EPS gains. We believe global prestige beauty will remain one of the most exciting consumer product areas,

driven by strong demographic trends and desirable products, and we will remain completely focused on this sector.

Our performance was not worthy considering the volatility and challenges in some of our most important markets. As you know, they included trade tensions, uncertainty surrounding Brexit in the UK, a difficult environment in North America with increased competition and slowing beauty sales overall, and certain department store challenges both in the U.S. and the UK.

Thanks to excellent execution, our talented employees worldwide managed through this environment to deliver strong results. Our broad-based gains reflect diverse growth drivers, the desirability of our high-quality products, compelling marketing and innovation successes.

In fiscal 2019, we continued to execute against our strategic priorities, which powered our higher sales. Our skin care category was outstanding across brands, markets and channels. The growing number of middle-class consumers in China and other emerging markets embraced prestige beauty and they were avid users of our brands. We prioritized (sic) [prioritized] (00:04:32) investment in the fastest-growing channels, and travel retail and online continue to grow strong double digits.

Our direct-to-consumer business accelerated. Sales from new product innovation reached an all-time high. And our digital marketing and social media divisions were highly effective. In addition, our sales growth was supported by more than \$380 million of cost savings, and our Leading Beauty Forward initiative enabled us to invest more in advertising and other brand building areas. Tracey will give more details about this initiative in a few minutes.

Now, I will highlight some of the factors that drove our improvements. Our 10-year Compass forecasted continuing strong demand for skin care and we matched our innovations to the biggest opportunities across consumer segment and channels. One of our strategic priorities is to reach a wider range of consumers, and several skin care launches including Clinique iD attracted younger and more diverse shoppers.

Our brands also attracted more diverse consumers through elevated marketing. Our Estée Lauder brand created locally relevant bilingual communications to attract Latina consumers in key U.S. markets. During one such campaign for the brand's Revitalizing Supreme+ moisturizer, sales to Latina consumers rose significantly and led to a 35% jump in sales for that product.

Looking at our geographies, our strategy of serving the growing middle class in many emerging markets with locally relevant products was highly successful. Sales rose in virtually all our emerging markets worldwide, led by China, India, the Middle East including Turkey, and Southeast Asia countries and as a group, they grew over 30%. Our growth in China was outstanding. All categories and channels grew and virtually all brands posted double-digit gains. Our online sales rose significantly in China and we introduced our Tom Ford Beauty and Jo Malone London brands on Tmall. Tom Ford was our biggest launch to date on the platform.

We continued to expand our business in the fastest-growing channels. During calendar 2018, our company became number one in prestige beauty in travel retail worldwide. And throughout fiscal 2019, we had broad-based growth across our top brands, regions and categories in the channel. Growth was primarily driven by robust like-doors gains and expanded targeted reach also contributed.

The pretail business where passengers can order products online and pick them up at the airport upon their departures or return has taken off strongly. Pretail is centered in Asia for now, but is expected to grow worldwide. Our online growth was also broad based and as brand sites, retailer sites and third-party sites all grew double

digits. We increased our brand presence on select third-party malls and sites, yet our brands entered new markets.

The priority of our online business comes from our three largest markets, the U.S., China, and the UK. However, in total, our smaller online markets have become an increasing meaningful contributor to growth. Our online sales in countries such as Spain or Greece, Israel and India are expanding rapidly and hold great promise for the future. Our online sales grew, at least, double digit in every one of the approximately 50 markets where we have by now e-commerce operations.

Our brand sites are more than a platform to sell products. They are valuable media properties. They collectively attracted this year more than 400 million visits, allowing our brands to engage with consumers to reach storytelling, elevated assets and high-touch experiences. This builds equity and loyalty which creates value that extends to sales in other channels. Data-driven marketing will make these sites even more compelling as we tailor our messages to different consumers.

Our brand sites together with third-party platform and our freestanding stores in brick and mortar comprise our direct-to-consumer business, which rose sharply. The three channels combined had approximately 1.3 billion visits last year and we are leveraging them as equity building platforms. Our product innovation was powered by capabilities we have developed in data analytics and consumer insights. Combining data with our creative process resulted in terrific innovation success.

Our new product launches reached a record penetration, about one-third of net sales. In addition, the number of success launches increased, as did our speed to market. Our innovation was focused on bigger, more impactful products, in large part, supporting our hero franchises. We continue to focus our advertising spending on digital marketing and social media to strengthen brand equity, drive repeat purchase and generate trial.

Digital now comprises nearly 75% of our media spend, and was highly effective. For example, in China, the Estée Lauder brand was ranked a Genius brand for the third straight year, and La Mer was number one in global engagement in luxury skin care.

By making progress across our strategic priorities, we drove higher sales throughout our portfolio. For the year, brands representing more than 80% of our total net sales posted increases, as they attracted new consumers and improved retention rates. Three of our four largest brands, each with sales well over \$1 billion, grew strongly globally.

Fueled by its popular hero franchises, our largest brand, Estée Lauder, had terrific success. Our sales rose more than 20% for the second year in a row, with double-digit gains in skin care and makeup. It posted highest sales in all regions and virtually all channels. La Mer products and digital communication attracted many new consumers and generated double-digit growth in every region. In Asia/Pacific, it was the fastest-growing top 10 brands in prestige beauty.

Strong innovation in product and marketing accelerated M-A-C's global growth, and its makeup offering were particularly well received in travel retail and all over in Asia. Clinique focused its innovation on moisturizers, a high usage and high loyalty sub-category, which drove the brand's skin care business higher in every region. Two key launches were Clinique iD, a breakthrough innovation that led consumer customize their moisturizer; and Moisture Surge Eye Concentrate, which helped the Moisture Surge franchise grow very strongly.

We also strengthened our portfolio of small and mid-sized brands. And our luxury brands resonated strongly. By focusing on developing high-quality products, communicating our brands' authenticity and strengthening our repeat purchases rates, we successfully scaled our brands and added \$1.2 billion in incremental sales to the top line. Strong demand enable us to raise prices across our portfolio, which contributed 2 percentage points of sales growth.

During the year, we also committed to delivering greater value through our citizenship and sustainability programs. We announced new goals at our Investor Day and are continuing to incorporate our efforts throughout our brands, regions and functions, as well as on corporate level. Recently, we added a Corporate Responsibility Scorecard on our website to track our initiatives. We have been recognized for our achievements, including being named number one on Forbes list of the Best Employers for Women and included in Barron's Top 100 Sustainable companies. We celebrated 25 years of M-A-C VIVA GLAM campaign, which has cumulatively raised \$500 million to help people with AIDS and HIV in more than 100 countries.

Finally, with our strong cash position and financial success, we raised the dividends by double digit for the 10th consecutive year. Fiscal year 2019 was a fantastic year, yet even more significant is the progress we have made since we launched our current strategy a decade ago.

Let me recap some of our key accomplishments. Since 2009, our net sales more than doubled from \$7 billion to nearly \$15 billion, rising on average 8% a year, which is the top of our long-term goal. EPS growth averaged 21%, two-and-a-half times our sales growth. Our share of global prestige beauty reached 15.3%, up 2.3 points, making us the clear global leader. Our total shareholder return topped 1,100%. Total cash returned to stakeholders exceeded \$10.5 billion, and cash flow from operations skyrocketed from \$700 million to \$2.5 billion.

In addition to these financial results, we further diversified our business and built a more flexible financial model. We develop processes to drive more collaborative teamwork and invested in human capital, including recruiting external talent to bring fresh perspectives. Our workplace is now more diverse and inclusive, and we amplified our family values. These changes have created a more streamlined, integrated organization and a stronger foundation that we believe will enable us to continue our growth trajectory.

As we start fiscal year 2020, we are continuing to adapt our strategy to reflect a continuously changing environment. We plan to fuel our strengths in the brands, categories, channels and geographies that are performing well, accelerate growth in areas that are underperforming to turn them around, and with the guidance of our Compass in utilizing data and technology, anticipate new opportunities and trends as they emerge and act on them quickly.

Our overarching goal is to reach diverse global consumers of all ages and reinforce our connection with loyal users. To do this, we will prioritize (sic) [prioritize] (00:16:47) growth in emerging markets and fast-growing channels, strengthen our hero franchises and create new ones, engage throughout social media and reach digital assets, and expand our omnichannel capability to seamlessly connect our online and offline businesses. In addition, we are striving to stabilize our North America business despite the current soft environment.

We believe our creativity and innovation will continue to attract and retain consumers. Our innovation program is focused on expanding our hero franchises across our categories. In our largest one, skin care, some new products include Clinique Smart Clinical MD, a moisturizer that visibly re-sculpts and re-volumize and a reset concentrate in Estée Lauder Advanced Night Repair line. The luxury segment in skin care is among the fastest growing, which is why our high-end Tom Ford Beauty brand is launching a skin care collection to complement its

very popular makeup and fragrance lines. And La Mer is launching a Neck and Décolleté Concentrate and updating The Regenerating Serum.

We expect continued strong growth in China and in other emerging market, including India, Turkey, Southeast Asia as we tap into the growing middle class with our desirable brands. We will expand online in these markets to reach consumers who don't have brick-and-mortar distribution options and offer more locally relevant products. We believe China's growth will remain strong, although we expect some deceleration from the rapid pace of the last two years. But as China's growth moderates, we expect other emerging markets to contribute more.

Likewise, we expect our travel retail business to continue to be a growth catalyst, but we are anticipating our growth rates to moderate. We also are intent on turning around the parts of our business that aren't performing to our expectations. Prestige beauty in North America and the UK remains somewhat soft, especially makeup where we are a leader. That said, we aim at improving our performance this year as we further rebalance our channel mix and win in key sub-categories. We will build on our leadership position in prestige beauty by targeting a broader range of consumers within local areas and creating compelling campaigns.

As we embark on the second decade of our strategy, we are focused on winning today, while at the same time continue transforming our business to lead in the future. Maintaining our leadership in such a dynamic industry require constant reinvention, which has been a hallmark of our company for decades. We are optimistic about the outlook for prestige beauty and foresee continued healthy growth, thanks to favorable demographics, especially in emerging markets and a continued shift from mass to prestige. As the best diversified pure player in prestige beauty, we are in a unique position to capture greater global share. Nonetheless, we are cognizant that in the short term economical, social and geopolitical uncertainties could impact our results.

In closing, I want to thank our leadership team and our highly talented employees all over the world for delivering such a terrific year. Throughout our brands and function, our employees excelled in their roles and successfully navigated difficult environments. This skill differentiate our company and our people, it give us a competitive advantage. We are proud that we have much to celebrate and, more importantly, we are excited about our bright future ahead.

Now, I will turn the call over to Tracey.

Tracey Thomas Travis

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

Thank you, Fabrizio, and good morning, everyone. As a reminder, my commentary today is adjusted for the items that Rainey mentioned at the beginning of the call. And now for the quarter results. Net sales for the fourth quarter rose 12% with strong growth in our international regions and growth across all product categories. We saw a continuation of the outstanding growth in China and travel retail that we saw throughout the year, and North America improved slightly.

Our Asia/Pacific region continued its strong net sales growth this quarter, up 23%, with all product categories rising double digits. Nearly all markets grew, and more than half of the markets grew double digit. Regarding China, the continuation of robust growth reflects the superb execution of new innovation along with strong digital advertising campaigns. Nearly every brand rose strong double digits in China, as did all channels. Among the other large markets in the region, Hong Kong rose double digits and both Japan and Korea rose mid-single digits.

Net sales in our Europe, the Middle East and Africa region rose 20%, led by a strong double-digit increase in global travel retail. International passenger traffic remained strong, particularly in Asia, and our travel-themed

collections sold particularly well. The EMEA region also benefited from strong growth in emerging markets, led by Russia, Turkey and India.

The Middle East rose sharply following an inventory rebalancing in the prior year quarter. Growth in Western European markets was mixed. Increases in Italy, Greece and France were partially offset by modest declines in the UK and Benelux.

Net sales in the Americas declined 4%, reflecting a slight improvement in North America trend compared to our prior third quarter. Prestige beauty overall in North America continued to be soft, particularly in the makeup category. We achieved double-digit net sales growth online with contributions from both retailer and brand sites, but were challenged in brick-and-mortar retail.

Latin America net sales declined, as growth in Brazil, Colombia and Peru was more than offset by declines in Mexico, Chile and Venezuela. Skin care again led product category growth this quarter. Net sales grew 19% with continued strong increases from the Estée Lauder and La Mer brands globally. Estée Lauder sales were driven by success in our hero franchises, notably Advanced Night Repair, Nutritious, Perfectionist and Micro Essence, where the franchise benefited from the launch of its Micro Essence with Sakura Ferment in Asia. La Mer had success from the relaunch of the concentrate and garnered increased awareness through its global Blue Heart campaign supporting clean oceans.

Net sales in makeup grew 8%, led by strong demand in Asia and travel retail. Many brands contributed to growth, particularly Tom Ford Beauty, M·A·C and Too Faced. Tom Ford lip and eye makeup drove growth, and the brand launched a cushion compact foundation in China, supporting foundation as another strong pillar of growth for the Tom Ford brand. Tom Ford Beauty's recent launch on Tmall also contributed to makeup growth. M·A·C resonated well across Asia, several EMEA markets and travel retail, and grew sharply in the Middle East due largely to anniversary an inventory reset in the prior year quarter.

Too Faced's growth was broad based geographically, driven by the successful launch of Damn Girl mascara. The brand also continued its global expansion, adding doors in travel retail and Hong Kong during the quarter.

Fragrance net sales rose 3%. Higher sales of Tom Ford, Jo Malone and Le Labo fragrances were partially offset by declines in certain designer brand fragrances. Tom Ford's signature fragrances maintained good momentum. Jo Malone London launched frangipani fragrance with its Blossom collection, and Le Labo continued to selectively expand its global reach, while maintaining strong like-door growth.

Our hair care net sales rose 1%. Higher net sales from Aveda Shampure, Rosemary Mint, and Cherry Almond lines, select new doors in Italy, and strong growth online were mostly offset by soft U.S. sales from Bumble and bumble.

Our gross margin decreased 230 basis points compared to the fourth quarter last year and increased 10 basis points excluding the change in accounting. Favorable pricing and mix impacts were mostly offset by higher obsolescence and shipping costs to support the strong growth in Asia.

Operating expenses as a percent of sales improved 240 basis points, or 50 basis points excluding the impact of the new accounting standard. Increases in advertising to support new initiatives were more than offset by savings in selling and store operations.

Operating income rose 10% and operating margin increased by 10 basis points. Excluding the impact of the new accounting standard, operating income rose 17% and operating margin improved by 60 basis points. This was achieved even while making strategic investments to support a strong start to fiscal 2020.

Diluted EPS of \$0.64 increased 5% compared to the prior year and grew 8% in constant currency. Earnings per share for the quarter included \$0.02 of unfavorable currency translation. Diluted EPS, excluding the impact of the accounting change, was \$0.68, an increase of 12% compared to the prior year, or 15% in constant currency. So, that concludes remarks regarding our fourth quarter.

Let me now discuss a few highlights of our full year results. Net sales grew 12% in constant currency. Growth was broad based, as you have heard from Fabrizio. Aside from the diverse growth by brand, market and product category, our sales in virtually all channels grew. Travel retail and online continued to deliver strong double-digit growth, further diversifying our overall distribution mix. These channels now represent 23% and 15% of sales, respectively.

Department stores globally represent 35% of sales today, with North America department stores now 13% of our global sales mix. Our gross margin declined 200 basis points to 77.4% but rose 10 basis points excluding the impact of the accounting change. Favorable pricing and mix were partially offset by increased obsolescence. Operating expenses as a percentage of sales improved 300 basis points, or 70 basis points excluding the impact of the accounting change. Significant savings and efficiencies in our selling model allowed us to increase digital advertising, social media and influencer outreach.

Our full-year operating margin rose 90 basis points to 17.5%. This margin included 20 basis points of favorable impact from the accounting change, offset by 20 basis points of dilution from currency translation. Our Leading Beauty Forward initiative and ongoing cost savings initiatives contributed more than \$380 million in savings, which fueled the strategic investments that will support our future growth.

We have continued to create more flexibility in our cost structure to reinvest in areas that support profitable growth, mitigate risk and deliver margin expansion through greater leverage of our cost base. Our effective tax rate for the year was 21.5%, an improvement of 80 basis points over the prior year, primarily driven by the lower U.S. statutory rate. Net earnings grew 17% to \$2 billion, and diluted EPS rose 18% to \$5.34. Earnings per share was negatively impacted by \$0.19 from currency translation and positively impacted by \$0.04 from the accounting change. Excluding both of these items, earnings per share rose 21% for the year.

In fiscal 2019, we recorded approximately \$190 million after-tax, or \$0.51 per share, in restructuring and other charges for our Leading Beauty Forward initiatives. As of June 30, we concluded the approval of all major initiatives under the program, and we expect to substantially complete all of them by the end of fiscal 2021. We now expect to incur charges of between \$950 million and \$990 million before taxes and achieve annual net benefits of between \$425 million and \$475 million before taxes.

Leading Beauty Forward has been an unqualified success. The scope of the program grew over time to approximately 70 initiatives and encompassed most of the organization. Some examples of the transformation achieved by Leading Beauty Forward include improved global customer care that leverages new technology and enhanced customer data to deliver a seamless across channel brand experience and more personalized care; integrated shared services across the business through our OneSource service center. OneSource delivers a suite of services across HR, legal, finance and point of sale support. Services are delivered through a mobile-friendly portal for ease of use by employees around the world.

Modernizing the North America field organization to provide best-in-class consumer services and experiences and exceptional retail partnerships. New centers of excellence, together with new tools, enable our field teams to spend more time in store to drive sales and coach talents. And expanding indirect procurement efforts to new categories of spending and using enhanced technologies to accelerate our savings opportunities. These are just a few of the key wins to date and they are not only producing expense savings but changing the way we work to drive sales and improve the customer experience.

Moving on to cash flows, cash generated from operations was slightly below last year at \$2.5 billion, reflecting our earnings growth and offset by higher inventory to support the rapid growth and longer lead time international markets, the timing of other working capital components and higher cash paid for taxes. We utilized \$744 million for capital improvements primarily for consumer-facing counters, gondolas and e-commerce support as well as supply chain improvements in IT.

We returned cash to stockholders at an accelerated pace. We repurchased 11 million shares of our stock for \$1.6 billion, twice as much as the prior year. We paid \$609 million in dividends reflecting a 13% increase in our dividend rate. So, as Fabrizio said, we are obviously pleased and proud of our fiscal 2019 results and the momentum our overall business had throughout the year.

Looking ahead to our expectations over the next few years, global prestige beauty has been exceptional in recent years and we expect it to rise again in the range of 6% to 7% annually over the next few years, driven by a growing middle-class globally with increasing disposable incomes. Our net sales goal is to grow 6% to 8% annually with possibly 1% of the growth over three years coming from acquisitions. Over the next three years we continue to target average annual margin improvement of approximately 50 basis points and double-digit EPS growth.

Now let's take a look at our expectations for fiscal 2020, full year and first quarter. As we enter our fiscal 2020, we must consider the escalating macro issues that could have an impact on our business. The ongoing tension and unresolved trading terms between the U.S. and China, the looming concern and consequences of a hard Brexit in October and recent protests in Hong Kong and other markets are all examples of factors that could impact our fiscal 2020 results. For the year, net sales are forecasted to grow 7% to 8% in constant currency at the upper end of our long-term goal of 6% to 8%. Pricing is expected to contribute approximately 2 points to growth, expanded targeted consumer reach is expected to add 2 to 3 points of growth and the strength of our existing business will account for the remainder.

Strong growth in travel retail in China is expected to continue yet moderate as we anniversary two years of extraordinary growth and with the increasing macro and geopolitical uncertainty. We also aim to stabilize the brands in regions that were more challenged in fiscal 2019 and position them for future growth. All product categories are expected to grow again with greater balance and growth among the categories.

Based on June 28 spot rates of [ph] \$1.14 for the euro, \$1.27 for the pound, and \$6.88 for the won (00:35:03), we expect currency translation to have a negligible impact on reported sales for the full fiscal year. This will obviously change if the currency market become more volatile.

We expect to deliver productivity savings of between 2% and 2.5% of sales including benefits from Leading Beauty Forward and our ongoing cost-containment efforts. These savings give us the flexibility to invest more in digital marketing and advertising to support innovation, recruit new consumers and drive brand awareness as we expand our developing brands into new markets and focus more heavily on emerging markets outside of China.

With the leverage from strong top line growth and our ongoing cost saving programs, we are well positioned to make needed investments for the future while also delivering margin expansion.

We estimate that the fiscal 2020 effective tax rate will be approximately 23%. Diluted EPS is expected to range between \$5.90 and \$5.98 before restructuring and other charges. This includes approximately \$0.05 of accretion from currency translation. In constant currency we expect EPS to rise by 9% to 11%. In fiscal 2020, we expect cash flow from operations of approximately \$2.7 billion and capital expenditures of approximately \$900 million or 5% to 6% of sales as we invest more in our supply chain, enable enhanced consumer experiences and invest in facilities to optimize our workspaces.

Our sales in the first quarter are expected to rise 9% to 10%, both as reported and in constant currency. We expect first quarter EPS of \$1.56 to \$1.59, including \$0.01 of accretion from currency translation. EPS growth in constant currency is forecast to rise by 10% to 12% for the first quarter.

In closing, while we are cautious about the increased macro tension, we remain confident about the continued momentum behind global prestige beauty and our ability to execute on our strategic initiatives. We continue to create increased flexibility in our expense base to invest behind the greatest opportunities we have to continue to drive long-term sustainable growth. The flexibility in our P&L and our increasing cash flow generation also position us well to navigate a more volatile environment.

And with that, I'll conclude our prepared remarks and will be happy to take your questions at this time.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for questions. [Operator Instructions] Our first question today comes from Wendy Nicholson from Citigroup. Your line is open.

Wendy C. Nicholson

Analyst, Citigroup Global Markets, Inc.

Q

Hi. Good morning.

Fabrizio Freda

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

A

Good morning.

Wendy C. Nicholson

Analyst, Citigroup Global Markets, Inc.

Q

I guess my question has to do with the U.S. business, specifically. Everything else is just going so great, but it just seems that that business is stubborn in terms of turning around and growing for you. So, I guess, number one, specifically in your guidance for full year 2020, what are you expecting, what's baked in to your outlook for the U.S. business specifically, and what do you think it takes to get growth, not just for you, but the category overall? Are you taking too much pricing? Is there too much competition and you need to buy a bunch of smaller brands? Do you need to exit more department stores? What do you think fixes the problem there? Thank you.

Tracey Thomas Travis

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

A

Okay, Wendy. So I'll start with what's included in our guidance, and I'll let Fabrizio speak about what we're doing to improve the North America business. So in terms of our guidance, we are expecting a slight improvement from fiscal 2019 in terms of North America. Remember that part of the challenge we had in North America in fiscal 2019 was the closure of Bon-Ton, so that certainly cost us about a point of growth in North America. And we continued throughout the year to work on a number of different changes in our organization in order to position ourselves well for future growth, but it's obviously a pretty dynamic environment in North America given the soft traffic.

So with that, I'll turn it over to Fabrizio.

Fabrizio Freda

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

A

Yeah. I think your question, Wendy, is what was the – the issue is still that we have 50% of business in North America in a part of the market which is under pressure in term of low traffic and declining business. And so what is happening is that the swing to the high-growth areas is taking time. Particularly, it's taking time because the overall environment is very soft as you heard from everyone in North America. Just to give you an example, even our global travel retail business, which is growing fantastically well in Asia and in Europe, it is flat to declining in the U.S.

So it's really the U.S. environment overall which is under pressure, and that's why it's taking a bit more than what we wanted. So what we have in mind for fiscal year 2020 is a stabilization of our business. We believe, first of all, we have seen some progress already in quarter four where we started investing particularly on M·A·C and Clinique we have seen some sequential improvement.

Also, I want to underline that the launch of Damn Girl of Too Faced in the U.S. make Too Faced grow nearly 30% in a very tough quarter for makeup in the country, so showing the power of this brand and are many other positive sign in the strategy we already explained in the past, meaning our strategy to work more online, which is growing, by the way, very well, continue to build our specialty channel, and obviously invest more in innovation which is specific to the subcategories which are relevant in the U.S. And we are doing this very well with some initial success.

So, in net, I'm very optimistic for the long-term ability to make U.S. a growing business for us. But it will be good one day to be helped by a less soft environment to accelerate the speed of that process.

Operator: Our next question comes from the line of Dara Mohsenian from Morgan Stanley. Your line is open.

Dara W. Mohsenian

Analyst, Morgan Stanley & Co. LLC

Q

Hey. Good morning, guys. So my question was around top line. First, I guess just short-term, you highlighted the top line guidance for fiscal 2020, included a number of exogenous risk factors in the U.S., UK, Hong Kong and China, yet you're still at the high end of your long-term sales growth outlook. So I was just hoping you could parse out a bit more detail for what you've assumed along those risk factors, given some of them look like they could be sizable, and perhaps directly comment on Hong Kong so far this quarter, since that's played out to some extent.

And then second from a longer-term strategic standpoint on top line, we've clearly seen very strong growth rates for prestige beauty in China, but a couple years ago, we had seen an acceleration in the U.S. prestige beauty market particularly in makeup behind social media, e-commerce sales, et cetera. Now that looks like it's rapidly dissipated, so I'd just love to get your view on sustainability of the key growth drivers of prestige beauty in China, and understanding the U.S. is a very different market, if that might have some [ph] application in (00:43:24) China as you think about the growth rates longer term. Thanks.

Fabrizio Freda

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

A

Yeah. Let me start answering the second question is – I mean I think you made the point that the world of makeup and skin care, I think, is relative volatile, meaning that depending on consumer trends you could see growth in a certain category or in other in a given market or in other. So the strengths of our strategy is exactly what we have defined as multiple engines of growth. So our ability to fast allocate resources and strengths to whatever is growing in a given moment.

So when U.S. was growing strongly in makeup, we leveraged that growth at that time with M·A·C particularly and other brands. Now we are leveraging the growth of skin care in Asia, and as these trends will evolve gradually over the years, we will be able to focus on the fastest-growing growth elements. So that's exactly at the heart of our strategy and at the heart of our resource reallocation strategy.

Said that, the growth of skin care in Asia is here to stay for the long term. And again, there could be moments of volatility here and there depending on the situation around the markets, but it's definitely a very strong long-term trend because Asian consumers are very heavy users of skin care, they are very interested in high-quality products. And most importantly, the Asian consumer use skin care, much younger. And so each consumer you conquer in skin care in Asia has a much higher life value than what happens in other markets of the world. That's why this is definitely a long-term trend.

As far as the makeup situation in the U.S., the makeup situation is that the explosion on makeup in the U.S. some years ago was also driven by the explosion of social media and by the enormous availability of how-to-do videos and other – all of a sudden online to millions of consumers. Now this phenomenon has calmed down and reached a plateau and stabilized. That's why now makeup will need to continue growing based on the historical trends, by the way, are the strongest trends we have, which is quality of product, quality of innovation and continuous brand building. So, in summary, I believe that the sustainability of the growth that you see is there, and that's why we believe that our 6% to 8% overall long-term growth is sustainable and will be sustainable for the long term.

Tracey Thomas Travis

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

A

And I would just add, Dara, in terms of how to think about our guidance for the year, China and travel retail are expected to still grow double digit, just not as strong a double digit as they've grown in the last couple of years. So again, reflecting some moderation.

The comfort that we have in guiding at the higher end of our range is recognizing now everything that Fabrizio just said in terms of the middle class and the growth of the middle class and the consumption behavior as it relates to prestige beauty. The fact that emerging markets now and faster-growing channels are a higher percentage of penetration of our business. So we are benefiting more from the momentum of those markets and we are less exposed to some of the slower-growth channels in particular than we have been historically. So yes, while a moderation is certainly the right guidance for us this year given everything that's going on in the environment, we're still very comfortable with the 7% to 8%, top line growth.

Operator: And our next question comes from a line of Caroline Levy from Macquarie. Your line is open.

Caroline Levy

Analyst, Macquarie Capital (USA), Inc.

Q

Thank you so much. Good morning, and congratulations on an exceptional decade.

Tracey Thomas Travis

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

A

Thank you, Caroline.

Caroline Levy

Analyst, Macquarie Capital (USA), Inc.

Q

Fabrizio...

Fabrizio Freda

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

A

You too.

Caroline Levy

Analyst, Macquarie Capital (USA), Inc.

Q

...and team. Despite everything that's been going on in China and Hong Kong, it's just unbelievable to see this mix management that's just driving your business and I'm wondering, Fabrizio, if you could help us understand some of the actions you're taking within China and Hong Kong to protect against any negative fallout from what's going on at a high level because – it obviously looks a little out of control from this side but your Hong Kong data was phenomenal, everything looks great in your business. So, just a little help on that would be great.

Fabrizio Freda

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

A

Yeah, I mean we are learning from what we see and how we manage volatility. Let me take the Hong Kong examples. Hong Kong had another moment of protest and crisis a few years ago as you remember. In that moment coming out of the moment we realized that our Hong Kong business was a bit more exposed to tourist and not having enough high penetration on local. In the last years, during the recovery of Hong Kong, we have actually readjusted that.

Today, our business in Hong Kong, which by the way Hong Kong including travel retail is less than 4% of our business globally at this point. This is also because of the strong growth of China and the others, that's the percentage today and is much more local than used to be. So, for example, how we are mitigating Hong Kong protest in this moment, first is that we have seen that when the tourist don't shop, they shop somewhere else, so we are working to recover part of the potential lost on tourist in other markets.

Second, today we have a bigger share of local business and local business is less subject to this kind of protest because people still buy what they need to live in a normal way locally. And so, we are mitigating that with good local activity and local marketing and local relevant products. And in doing all of this, we also have today the ability to reallocate resources to the trends, meaning financial resources, invest more or less in a given category and even area. Even by area in places like Hong Kong, we have the flexibility to invest more or less by area.

To give you another example, Macau is not affected in this moment by the tour model on the business. So, that's the kind of things that make us more capable of mitigating volatility than we have been historically. And it's all been developed strategically. However, I want to close on my example [ph] of Hong Kong to (00:50:00) say our priority in this moment in Hong Kong is actually the safety of our employees and of our consumers and that's where we are focusing our effort and that's where we definitely manage our priorities in the market.

On China, I mean China, we have been investing in China for the long term and we are in China for the long term. We have over 6,000 employees, basically 99.5% Chinese. We are very local in everything we do. We are locally relevant. We have local activities. Like any other area of the world, we are a local relevant organization in everything we do. And so, we mitigate the risks with local presence, local relevance, and again with our ability to invest in the market. We are investing substantially in many emerging markets, particularly in China, and these investment are important to the countries we participate in. So, that's the way we are mitigating. We are a truly global company which are local in every market we operate in and very respectful of every kind of consumer and market dynamic we see around the world.

Operator: Our next question comes from the line of Steve Strycula with UBS. Your line is open.

Steven Strycula

Analyst, UBS Securities LLC

Q

Hi. Good morning, and congratulations on a good quarter.

Fabrizio Freda

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

A

Thank you.

Tracey Thomas Travis

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

A

Thank you.

Steven Strycula

Analyst, UBS Securities LLC

Q

So, quick question on the UK. We haven't spent as much time focusing in there. But for context, should we think about that being around 8% to 10% of company sales? What have you noticed, anything in terms of changing consumer confidence in the local marketplace? And how do you source the products and manufacture them for that region?

Fabrizio Freda

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

A

So, first of all, it's less than 10% to 8% of the company. It's more in the range of 5% of the company sales, our UK business. And the potential impact of the hard Brexit as of October, as Tracey has explained, is already included in our guidance. And that's, in fact, one of the risks that we see globally that we are including in our guidance and that has to do with the moderation of the growth in our guidance versus the current trend by quarter and in the last year. Then we are very well organized. In case of a hard Brexit, we are ready to operate, so we have done all the investment needed to make sure we are ready to operate our business in both situations.

And finally, we believe that the UK will continue to be mitigated by the fact that the hard Brexit risk, which has obviously a risk on local consumption, on the other side, has an impact on the currency that you all are seeing which is benefiting the tourism and our sales to tourist in the UK, which is an offsetting factor. That's why we forecast in moderation, but not a dramatic one.

Operator: Our next question comes from the line of Andrea Teixeira from JPMorgan. Your line is open.

Andrea Teixeira

Analyst, JPMorgan Securities LLC

Q

Hi. Hello, everybody, and I echo the congratulations to all on your results.

Fabrizio Freda

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

A

Great. Thank you.

Andrea Teixeira

Analyst, JPMorgan Securities LLC

Q

Could you please elaborate on the traffic and the conversion in travel retail, which I remember you discussed on the Analyst Day, the conversion has been very strong, but can you update us on the most recent trends? And as a follow-up to that, we also saw an increase in inventory, and I understand that you always wanted to increase the service levels, especially because of the growth in Asia. But is it also related to any deceleration or outpace the inventory level given the volatility there? Thank you.

Fabrizio Freda

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

A

So, you want to start?

Tracey Thomas Travis

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

A

Yeah, I'll start with the inventory. So, no, it's not related to any recent deceleration. It really is because of two years of outstanding growth that we've had and where much of that growth has come from, which is in Asia and travel retail. So, that certainly raises our in-transit inventory levels and certainly raises our inventory level.

Inventory is, and we've talked about it for a number of years, so the good news is we've been able to make quite a bit of progress in terms of cash generation and cash flow from operating earnings over a two-year time horizon, even without having benefits from inventory turnover. We've made a lot of progress in terms of the working capital elements of accounts payable, in particular, and you might recall that last year our cash flow grew over 40%. So, while it was flattish this year largely because of inventory, we have and are putting more sophisticated processes in place to improve the accuracy of our forecasting and certainly looking at supply as well in terms of getting supply a bit closer to demand in the future.

Fabrizio Freda

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

A

Yeah. And on travel retail is – first of all, our travel retail business has been growing very strongly, also last quarter we saw no slowdown in retail. And the growth has been, as I said before, very strong in APAC and EMEA, and actually there was a decline in the Americas. And the business is growing across all brands, and the most

important concept is that the same doors are the fastest-growing part of the business. So, our travel retail business is growing because we are winning market share in same doors. We are adding new distribution where relevant, particularly new brands that we are deploying to the channel and that the channel is requesting.

And importantly, as you said, we are increasing conversion of traveler into buyers, into shoppers. The conversion continue to improve, we are not going to give specific numbers on conversion, but continues to grow. One of the key driver of conversion is the success of the pretail system where consumers can order online and then take the products in the airports. This is growing very well in Asia, particularly for the time being, we forecast this will be a global methodology to buy in this channel in the future. This is obviously driving conversion because consumers, some consumer arrive to the airport late, arrive to the airport stressed, that doesn't want to shop, they want to go to a lounge, or they want to do other things and the fact that you can buy online before going and then get in the airport actually is increasing the amount of consumers which are willing to buy something in the airport. And that's one.

The other big thing that we are doing to drive conversion is the advertising in the airports and that's very important and drives obviously conversion. The most important of all drivers are the investment we are making in the country of origin of all of our products. The travelers that shop the best tend to be the one from emerging markets. So, Chinese as we know, Russian, Brazilians, Middle Easterns, and our new investment and accelerated investment in emerging markets have an indirect positive impact on the fact that those travelers when they travel, they also want to buy the brands in their visiting airports or in visiting countries where they go. So, the big driver is our increased investment in the country of origins, which is accelerating the sales of our travel retail business.

Operator: Our next question comes from the line of Ali Dibadj from Bernstein. Your line is open.

Ali Dibadj

Analyst, Sanford C. Bernstein & Co. LLC

Q

Hey, guys. So, if I look at your guidance, 7% to 8% constant currency for 2020 on the top line and then 9% to 11% constant currency core on the EPS line, and I compare that to fiscal year 2019 where it was 12% on the top line and a large gap 21% growth on the EPS line excluding ASC and odd stuff. If I go to 2018, it was 13% on the top line and then 24% on the EPS line. So, lots of leverage between the top line and the bottom line, the big gap in growth for 2018 and 2019, but less so for 2020. And I just wanted to get a better sense of why that might be. Is it being careful of changes in the mix of the categories or the geographies? Is it that you expect incrementally more investments, and if so where?

And I particularly ask that in the context of extraordinarily successful Leading Beauty Forward savings and continued ratcheting up there. So, that's kind of the shorter-term part of that investment question. But then the longer-term part is really just getting a sense of whether you think your current broad investment levels given how you've been able to kind of react more quickly to markets, whether the current investment levels you think are the right ones for your long-term aspiration of continued market share growth in the category as the prestige beauty industry evolves. Thank you.

Tracey Thomas Travis

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

A

All right. So, let me start and then Fabrizio can join in. Really the difference, Ali, between fiscal 2019 where we grew top line at 12% and our fiscal 2020 where we're guiding 7% to 8%, the incremental leverage that we get on the incremental sales, that 4 or 5 points of sales is highly accretive. And one of the things, to your point, that we've been working on under Leading Beauty Forward is make sure that incremental sales are more and more

accretive to the bottom line. So, that's really the difference in terms of the margin expansion that we saw in fiscal 2019 relative to what our guidance is in fiscal 2020.

As it relates to our investment levels, we certainly continue to invest to support – we have a portfolio of 30 brands, they're at all different stages of development and we also have emerging markets that we're investing in as well in terms of driving brand awareness with consumers. So, we certainly expect that we want to have the flexibility when the opportunity is there to invest behind those brands and behind those markets from a growth standpoint. But, as Fabrizio said, when the growth isn't there for whatever reason, we also have the flexibility to pull back, and we have more of that flexibility today than we have had previously.

But when you think about what we've done with our expense base over the last few years with our cost saving programs and with Leading Beauty Forward, we have significantly diversified our portfolio. We've expanded into new channels of distribution, and we've done that while continuing to drive margin. Those new channels of the distribution required investment. The same thing with new market as we've expanded brands into new markets, that too has required investment. So, all of the work that we've done over the decade that Fabrizio spoke about in his prepared remarks really has been quite remarkable in terms of our ability to manage to continue to drive margin, continue to allocate more investments in the right areas to drive top line growth going forward, and we expect that we will continue to be able to do that in the future.

Fabrizio Freda

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

A

Yeah, and just very clear. The only thing I would add on the investment side is that over time we have invested much more in advertising, and now I would say that every one of our brands has some investment depending on where they are and which part of investment. These investment are mainly now in digital. 75% of our investment now are in digital, social media influencers, and they're revealing to be highly productive.

And now they're highly productive because we are doing a very good job in advertising, quality on asset, in targeting, but frankly they're very productive because we have learned much better how to focus our investment where there is growth, because when you expose your investment to growth, they have a much better rate of return. And that's what is happening in this moment, and that's what we manage daily with the data accuracy that frankly we didn't have available in the past.

And also I want to underline that while we have increased our advertising, we have kept our promotion flat. And while we have increased our advertising and kept our promotion flat, we have delivered 90 points of margin improvements, showing that we have been capable of reallocating cost and taking cost out of the fixed areas into the variable areas, which again is one of the key driver of the flexibility I'm speaking about in resource allocation. So, in that I personally believe that what we have done with the advertising investment in our P&L is one of the key driver of our recent acceleration and is going to be one of the key driver of our sustainable success in the future.

Operator: Our next question comes from the line of Lauren Lieberman from Barclays. Your line is open.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good morning.

Fabrizio Freda

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

Good morning.

A

Tracey Thomas Travis

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

Good morning, Lauren.

A

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

I wanted to talk a little bit actually about Leading Beauty Forward, and then also other kind of ongoing productivity efforts which may not be under that bucket. But I guess, first would be that specific to Leading Beauty Forward, I think statements came in ahead of guidance this year. You've raised slightly the expected savings range versus what you even articulated at the Analyst Day. So, I wanted to hear a little bit about what's driving that upside surprise in Leading Beauty Forward.

Q

And then, you mentioned ongoing productivity also contributing in fiscal 2020. So, if you could talk about areas where that work is coming through, because I think for retail, all the points that you've just made around investing in new channels and new markets, there's also the other side of that equation, which is reaching a point where you can kind of take resources away from some of the slower or no growth areas of the business. So, I wanted to talk a little bit about that shift that I think is kind of at that inflection point. Thanks.

Tracey Thomas Travis

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

Okay. So, let me start. In terms of the upside from Leading Beauty Forward, really it's the addition of new programs. And so, we also took the cost of the program up, to your point, Lauren, along with the savings expectations. So, as I said in my prepared remarks, the momentum that Leading Beauty Forward has had over the three years that we've been managing the program has been quite strong. And as we look across our business and identify areas of further opportunity for transformation, that is really what has driven that success; everything from digitizing our creative process with some initiatives to the ones that I called out in the prepared remarks like indirect procurement, shared services, et cetera. So, that's really what has driven the upside surprise.

A

In terms of future programs, again, we still haven't reached the full potential of Leading Beauty Forward from a savings standpoint. Next year will be a big year for completion of a lot of programs and then with the tale being in 2021. And so, we'll see even greater savings that we'll realize from the program through those efforts.

Fabrizio Freda

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

And I just would like to add the point that you said on advertising is, where are we leveraging the cost? Well, we are spending more in advertising. And first of all, our selling line is going down. Our selling line is going down because we are doing some good work of rationalization, and also because our channel mix require less selling line spending and more advertising spending today than it was in the past. So, that's been a big – Leading Beauty Forward has supported this work in a very big way.

A

Second, in the past, our organization which is so focused on managing by brand, which is the right thing to do forever, because brands have to be authentic and distinctive. However, in the past, we have duplication in the back office cost that were not needed. So, we need to manage by brand the front, not necessarily the back. And so, we have then big improvement, thanks to Leading Beauty Forward, in rationalizing the back office cost and limiting or avoiding duplications.

The third bucket is advertising. As I said, the rate of return of our advertising given our ability to focus more on growth channel, et cetera, has increased and we spend a lot in A&P and the rate of return in A&P has improved. And finally, innovation; you have seen the great innovation and the return we are having in innovation, but our spending innovation is not increasing at the same pace of our success in innovation. So, our ability to use data – we have invested in creating the right data and I think our ability to focus innovation has created better rate of return of our innovation investment.

At the end, our company is really focused on delivering quality product to get high repeat rate. And I come back to the last point, which is our repeat rates are increasing. And when repeat rates of quality product are increasing, this is a great element of value creation over the long term, and they'll allow us to invest wherever we believe is appropriate to sustain future growth.

Operator: Our next question comes from the line of Rupesh Parikh from Oppenheimer. Your line is open.

Rupesh D. Parikh

Analyst, Oppenheimer & Co. Inc.

Q

Good morning. Thanks for taking my question. Also, congrats on a strong quarter.

Fabrizio Freda

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

A

Thanks.

Tracey Thomas Travis

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

A

Thank you.

Rupesh D. Parikh

Analyst, Oppenheimer & Co. Inc.

Q

So, I wanted to go back to your China business, and I just wanted to get a sense of what you guys are currently seeing on the ground in China and whether with all these headlines on some of the geopolitical concerns you're seeing more volatility in your business in China. And then related to that, just curious if you guys have been at all surprised by the continued resilience of the China business.

Fabrizio Freda

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

A

So, the short answer is no. We are not seeing any slowdown in China at this point in time. And in the fourth quarter China, as we commented in our prepared remarks, was very, very strong. And I'm not surprised. I mean, as I've been saying a lot and I believe we explaining, detailing at Investor Day, the fundamental for long-term sustainable growth with Chinese consumer are absolutely there and they're super strong. The middle class, the demographic, the fact that the young consumers in China spend more than the older one, the huge opportunity

we have in front of us on Tier 2 and 3 cities which is completely untapped – actually I should say Tier 3 and 4 cities which is completely untapped at least, numerically for luxury goods.

The fact that the system of – we are in 121 city, and then thanks to our online operations and Tmall, sales to 650 cities, this dynamic make China access consumers even when the productivity of that specific city is not ready. And, in fact, the productivity of our stores in China is the best in the world. And as you know, a lot of our profitability has to do with same-door productivity and with single-door productivity. So, all of these dynamics are here to stay. And then our market share is improving.

Just to be clear, importantly, we gained 80 points of share with significant increases on market share of M·A·C, La Mer, Tom Ford in China in the last year. So, it's clearly a very well-oiled system. Now, the question of the moderation beyond the point that there is now a higher base and we need to reflect reality on that, the question of the moderation is more about the questions out there in term of the economic situation in China, in term of the trade tensions and the impact that trade tension could have on consumption in China. So, there are economical and geopolitical reason why we expect moderation and also because we believe that now the base of growth is super strong and we need to be realistic about the future, but as Tracey already said, we are completely convinced that there are the fundamentals for double-digit growth in China with Chinese consumers for the sustainable future.

Operator: And our next question comes from the line of Bonnie Herzog from Wells Fargo. Your line is open.

Bonnie Herzog

Analyst, Wells Fargo Securities LLC

Q

All right. Thank you. Good morning.

Tracey Thomas Travis

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

A

Good morning.

Bonnie Herzog

Analyst, Wells Fargo Securities LLC

Q

I just had a quick question for Tracey on capital allocation. Just looking at some of your metrics, it really does seem like you're in an optimal position here to either continue to step up shareholder returns or maybe execute on M&A. So, curious as to which you potentially see as most attractive today given what you're seeing out there on the acquisition front. Thanks.

Tracey Thomas Travis

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

A

Yeah. No, Bonnie, thank you. So, in terms of capital allocation, yes, I mean it's a decision that we take along with our board every year in terms of the best uses of our very strong cash generation. Last year obviously we made the decision that we would step up share repurchase because that was the best return and certainly has proven to be the case for us. We did take a pause last year as it related to new acquisitions. A, I would say the valuations had gotten a bit lofty; and B, our strategy on acquisitions, we don't need acquisitions to grow. I did say in my prepared remarks that we would expect 1 point of growth to come from acquisitions over a three-year time horizon.

But the organic strength of our business is such that certainly it also has a tremendous amount of momentum. So, we have the benefit of looking for acquisitions that are strategic to our portfolio. We look for whitespace opportunities as it relates to acquisitions. I mean acquisitions that obviously we can get the right return on investment on. But again, the cash generation, if there isn't an acquisition that's out there, certainly we relook at our cash distribution across dividends and share repurchase activity and make a decision accordingly.

Operator: Our next question comes from the line of Steve Powers from Deutsche Bank. Your line is open.

Stephen Powers

Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Great. Thanks. Good morning. First, maybe just a bit of housekeeping and follow-up to, I think, Lauren's question. Leading Beauty Forward charges came in, I think, \$65 million to \$80 million higher for the year than what you had guided at the end of the third quarter. So, apologies if I missed it, but just if you could highlight some of the drivers there, that'd be great.

My real question is on your biggest brands and what you expect from them in 2020, maybe just a little bit more of a health check. I guess from my perspective, Estée Lauder, La Mer, even M·A·C seemed broadly healthy on a global basis, but I'd love a little bit more from you on how you're viewing them and any pockets of higher opportunity that you see. And then Clinique, which sounded like a point of relative optimism at your Investor Day back in March, it just still seems little bit softer. So, I'd love to get your views there as well and how you think the contribution of Clinique will compare in 2020 to the year just completed. Thanks.

Tracey Thomas Travis

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

A

So, starting with Leading Beauty Forward, as we came upon the end and the close of the program in terms of accepting new initiatives, we did have a number of new initiatives in the fourth quarter that were added to the program and, again, those initiatives expecting to generate an acceptable return, we have return thresholds underneath the program. So, some of those were in our retail area as we looked at retail rationalization as well as some strengthening of our freestanding store operations. And there were others as well that were added at the end of the year.

Fabrizio Freda

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

A

Yeah. In term of brands, we spoke about our top four brands in the year, when I said that three out of four were growing at 80% of sales, represented by brands we are growing. Quarter four was actually an improvement, so what we said to the Investor Day has actually happened in quarter four. In quarter four, all four of our largest brands had grown in constant currency and two rose double digits, and all brands representing over 94% of sales grew in quarter four. So, we are really on a roll on all our brands portfolio.

And as far as Clinique, I remain optimistic for the brand for stabilization and then growth in the future. As we said, Clinique is growing in steps and now the priority is skin care, which is the base, the fundamental also in term of profitability for the brand. So, we are first building moisturizer, skin care and then we'll pass to the rest and continue to build the brand using the same dynamic we're using on the other brands. Also, keep in mind for Clinique that Clinique is the most exposed of our brands to North America, and North America is the softest market overall, particularly in makeup. And, in fact, Clinique makeup is one of the area that we have not yet turned around for that reason. So, it's all very specific, very much. We are in line with our long-term goals in what's happening.

Then we have extraordinary brands, also, in the mid group. For example, Tom Ford or Jo Malone had a terrific year having a terrific performance. I personally believe they will be soon very top, top, big brands in our company, so meaning they will go from middle to big in the next years. And even in our small brands, the new brands, there are some highfliers. Take Le Labo, Le Labo is one of the really highfliers in our young brand portfolio.

So, we have an extraordinary brand portfolio, and I think we have learned how to continue building it. The Estée Lauder brand is on fire, as I said in my prepared remark. And we expect that the strengths of our brands will continue to operate in fiscal year 2020, and in fiscal year 2020 we expect some improvements in the areas which are still to be improved, as Tracey said, and namely is Clinique U.S. and M·A·C U.S., the two that we are focused on looking for improvements. But the rest is frankly on fire.

Operator: Our next question comes from the line of Erinn Murphy from Piper Jaffray. Your line is open.

Erinn E. Murphy

Analyst, Piper Jaffray & Co.

Q

Great. Thank you. Good morning. I guess my question was around Tmall. Could you just maybe reflect on what you think made Tom Ford's launch so successful on that platform? And then, with less than 50% of your portfolio on Tmall, any rollout plans in 2020 for other brands within your portfolio and how you think about it longer term? And then just, sorry, Tracey, one follow-up, I may have missed this. In the U.S., can you talk about what you saw specifically with specialty multi? Thank you.

Tracey Thomas Travis

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

A

Okay.

Fabrizio Freda

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

A

I start?

Tracey Thomas Travis

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

A

Yeah.

Fabrizio Freda

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

A

So, no, Tmall is an exceptional partner and we are having very good business with them. The strength of Tmall is that we control our business and the ability to deliver the right equity for the brands in the communication. The Tom Ford launch had an enormous amount of super outstanding quality creative assets produced for the launch of Tmall. That created a lot of traffic and a lot of conversion from digital to purchaser, and that's what was driving the success.

The creative assets that were done by the Tom Ford team together with the China team and, obviously, under the direction of Tom Ford personally, who is an amazing creative leader. This combination was very exciting for the Chinese consumers, and so the result was high traffic, high conversion, and that's what drove the success.

So, we are seeing more of this. I think we have learned, together with our Tmall partners, how to create the right level of traffic, interest, conversion on the Tmall platform also for the future. And to your question of do we plan to launch more brands, yes, in the future we will launch more brands. It depends also from the brands that we will launch in China in the future to continue building our Chinese portfolio.

Tracey Thomas Travis

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

A

And regarding specialty multi, Erinn, in the quarter in North America specialty multi was up about 1%.

Operator: And our next question comes from the line of Jason English from Goldman Sachs. Your line is open.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good morning, folks. Congrats on a strong year, and thanks for squeezing me in.

Fabrizio Freda

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

A

Morning. Thank you.

Jason English

Analyst, Goldman Sachs & Co. LLC

Q

You're welcome. Two quick questions. First, building off the question on Tmall, given the control you have there, out of curiosity, do you record the sales there at retail sales price or wholesale? And if it's different – if it is retail, is there a mix benefit you're seeing?

And then the second question is really on holistically looking at the margin profile for next year. At the midpoint, it looks like you're guiding to roughly 70 basis points or so of EBIT margin expansion based on my back-of-the-envelope math, not far off of, I think, the underlying 90 basis points that you achieved this year. But you're getting less productivity savings as a percentage of sales and you're expecting less leverage from the incremental sales, the 4 points, Tracey, that you highlighted, suggesting there's some other offsets there that are helping you to deliver that robust growth. Can you give us a little more context and quantification around those? Thank you.

Fabrizio Freda

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

A

I'll start from your first question, while Tracey will answer the second is – so we record retail sales of Tmall, and in my prepared remark I spoke about our direct-to-consumer business. Our direct-to-consumer business is all retail for us. And our direct-to-consumer business is our freestanding stores, it's our brand dot-com, like estelauder.com, and Tmall and other platforms, à la Tmall where we are in control.

And that part of the business is growing, and that part of the business I want to repeat that had 1.3 billion visitors in the year. So, imagine the amount of data that we have, the amount of equity building communication that we can do, and the positive impact of all of this on, in general, what the consumer decide to buy even in other channels and in other situation in the course of their year. So, it's a very powerful dynamic that helps also our wholesale business.

Tracey?

Tracey Thomas Travis

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

A

And as it relates to the productivity savings and the margin expansion, you're spot on, Jason, not surprisingly in terms of what we are initially expecting for margin expansion in fiscal 2020. Again, having top line sales growth of 7% to 8% versus 12%, we are seeing less leverage based on sales, but still some; some related to obviously our continuing cost savings and the ramping up more of Leading Beauty Forward savings along with other cost programs, and then a little bit of mix benefit as well in order to drive that 70 basis points.

Operator: And that concludes today's question-and-answer session. If you were unable to join the entire call, a playback will be available at 1:00 PM Eastern Time today through September 2. To hear a recording of the call, please dial 855-859-2056, passcode 9999544. 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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