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EL - Q1 2017 Estee Lauder Companies Inc Earnings Call

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OVERVIEW:

Co. reported 1Q17 net sales of $2.87b, net earnings of $314m and diluted EPS of $0.84. Expects FY17 sales to grow 6-7% in constant currency and diluted EPS, before restructuring charges, to be $3.38-3.44. Expects 2Q17 sales to grow approx. 5-6% in constant currency and EPS, before restructuring charges, to be $1.10-1.15.

CORPORATE PARTICIPANTS

Dennis D'Andrea *The Estee Lauder Companies Inc. - VP, IR*

Fabrizio Freda *The Estee Lauder Companies Inc. - President and CEO*

Tracey Travis *The Estee Lauder Companies Inc. - EVP and CFO*

CONFERENCE CALL PARTICIPANTS

Dara Mohsenian *Morgan Stanley - Analyst*

Olivia Tong *BofA Merrill Lynch - Analyst*

Steve Powers *UBS - Analyst*

Caroline Levy *CLSA Limited - Analyst*

Bill Schmitz *Deutsche Bank - Analyst*

Wendy Nicholson *Citigroup - Analyst*

Nik Modi *RBC Capital Markets - Analyst*

Lauren Lieberman *Barclays Capital - Analyst*

Mark Astrachan *Stifel Nicolas - Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to The Estee Lauder Companies' fiscal 2017 first-quarter conference call. Today's call is being recorded and webcast.

For opening remarks and introductions, I would like to turn the call over to the Vice President of Investor Relations, Mr. Dennis D'Andrea. Please go ahead, sir.

Dennis D'Andrea - *The Estee Lauder Companies Inc. - VP, IR*

Good morning, everyone. On today's call are Fabrizio Freda, President and Chief Executive Officer; and Tracey Travis, Executive Vice President and Chief Financial Officer.

Since many of our remarks today contain forward-looking statements, let me refer you to our press release and our reports filed with the SEC, where you'll find factors that could cause actual results to differ materially from these forward-looking statements. To facilitate the discussion of our underlying business, the commentary on our financial results and expectations is before restructuring and other charges. 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 section, we ask that you please limit yourself to one question, so we can respond to all of you within the time scheduled for the call. And I'll turn it over to Fabrizio now.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Thank you, Dennis, and good morning, everyone. In the first quarter of fiscal year 2017, sales grew in line with our forecast, and earnings-per-share growth exceeded our expectations, due to more prudent expense management, as we navigated through some of the macro uncertainty in the quarter.

Across our business, many brands, countries, and channels achieved double-digit sales gains. Our strongest performers were our small- and mid-sized brands, particularly those in the luxury tier; many European markets; and the online, specialty-multi, and travel channels. Yet as we had anticipated, our strong gains were partially offset by challenging market and economic conditions in certain countries.

In constant currency, our sales rose 2%, and adjusted EPS increased 5%. We manage our business with a full-year perspective, so even though the first-quarter top-line growth is starting off at a slower-than-usual pace, we are confident in our ability to achieve the solid sales and earnings growth we forecasted for fiscal-year 2017.

Our first-quarter growth was slower, primarily due to ongoing challenges in US mid-tier department stores caused by lower traffic; the market slowdown in the Middle East and difficult comparison in France and Germany; and the continued negative trend in Hong Kong. All these challenges were anticipated, and plans are in place to gradually accelerate our sales growth quarter by quarter and position us to deliver our full fiscal-year plan.

Despite headwinds there are expected -- we are expected to continue in some areas -- sorry, despite headwinds that are expected to continue in some areas, we have plans to further leverage our stronger brands, channels, and countries.

We have robust holiday programs and a strong innovation pipeline, exciting opportunities to reach new target consumers and geographies -- especially with our fast-growing brands -- and compelling programs to better engage shoppers.

By being well diversified and having multiple avenues of growth, we are able to activate the drivers that we believe will fuel stronger sales. These are expected to include a number of international markets, the makeup and fragrance categories, and targeted distribution opportunities.

We are reaffirming our previously stated goal of constant currency sales growth of 6% to 7% for fiscal-year 2017. This will come from a combination of factors. Our organic growth is expected to accelerate, mainly in makeup and fragrance, fueled by strong innovation in the second half and supported by greater social media initiatives for improved consumer engagement. We should have easier comparisons in several markets, since external events that impacted our results last year will be in our base. Also contributing to growth will be new points of distribution globally for our fast-growing, high productivity brands, with a higher concentration coming in the second half, as well as planned price increases.

Additionally, the planned acquisition of BECCA will provide incremental sales. As a result, we are also reaffirming our goal of adjusted constant currency EPS growth of 8% to 10% for the full year.

In the past several months, we have continued to make excellent progress on our strategic objectives. We believe that the industry's strong growth in global makeup sales will continue, so we are focusing on building and strengthening our makeup portfolio.

In the quarter, we achieved solid makeup growth in several brands. However, the total category was affected by declines in MAC in the United States, owing to fewer foreign tourists, particularly in New York City and Florida, and slow traffic in department stores.

MAC is a powerful and authentic brand that speaks to all ages, races, and sexes. And we expect its US business to deliver stronger results through the rest of the year. As of October, MAC US sales started to improve, thanks to the launch of its successful Selena makeup collection and the new range of lipsticks called Liptensity. The Selena collection was inspired by the late singer and her huge fan base and accounted for the highest online traffic in one day on the brand's sites.

MAC will bring back the Selena collection in January to meet continuing demand. It has other exciting collaboration and plans, including a Nutcracker-themed holiday collection and compelling social media programs that will leverage MAC's rapidly expanding fan base, which now includes 16 million global Facebook fans and 12 million followers on Instagram. The brand also has an active presence on YouTube, Twitter, and other popular digital platforms by now.

MAC's international business grew in line with global prestige makeup, fueled by double-digit growth in most European and Asian markets. Internationally we expect MAC to grow double digit in the fiscal year and gain share, driven by continued organic growth, stronger innovation programs, expansion of social media, and new opportunities to reach target consumers that don't yet have access to the brand.

Today, MAC is sold in a relatively small and select number of doors in each market, and there's an opportunity for us to further build its presence where it is underrepresented -- primarily in Tier 2 and Tier 3 cities in the EMEA region and in China. MAC doors are among the most productive of the entire industry.

Smashbox, our pure-play makeup brand, generated double-digit global growth for the quarter and we expect it to deliver strong double-digit increases for the fiscal year. The brand is focused on winning in the specialty-multi and direct-to-consumer channels and recently redesigned its US e-commerce site for greater consumer engagement.

Our Tom Ford brand had an outstanding quarter, with its makeup business nearly doubling, led by its popular new lipsticks. Makeup is expected to continue to be a major growth driver, and the brand should benefit from upcoming color collections inspired by the designer's runway fashions.

Fragrance represents the majority of this luxury brand's business and continues to generate strong momentum.

La Mer, our luxury skincare brand, just launched its innovative skin color collection, which includes 15 shades of foundation, a growing subcategory, plus powder and concealer. These products incorporate the brand signature miracle broth and are expected to capitalize on growing demand for products that bridge skin care with makeup.

The collection has increased traffic to the La Mer counters and websites. And the brand anticipates it will attract new consumers and provide incremental sales to its core products of moisturizers, eye creams, and serums.

We are also building on our global leadership in prestige makeup. Two weeks ago we agreed to acquire BECCA, a prestige makeup brand with a unique position that is complementary to our other makeup brands. BECCA's strengths is in foundation and complexion products, which are high loyalty areas. It has grown rapidly by offering a broad and balanced range of shades that appeal to multicultural consumers, along with a strong presence in fast-growing North American specialty-multi retailers.

It also is active on social media and attracts a diverse and loyal fan base. We also see great opportunity to strategically expand the brand internationally, as well as in travel retail and online, which are key growth areas for the Company.

Strong gains in fragrance this quarter were again led by our luxury brands, which are experiencing rapid global growth. Our newest fragrance brands are expertly crafted with authentic points of view, similar to our makeup artist brands, and are resonating strongly with the new consumers.

For example, we are continuing to build out our artisanal Le Labo brand to reach more of its target consumers by opening select high-growth department store doors and freestanding stores globally. At the same time, the brand has had strong like-door growth, leading to exceptional sales increases.

Jo Malone's superior growth was reinforced by its travel retail business, which benefits from increasing awareness of the brand in key local markets. Jo Malone is capitalizing on growth opportunities by opening new store formats in the travel retail channel.

After many quarters of strong growth, Jo Malone rose three places in the rankings to become the third largest women's prestige fragrance brand in the United States in the first quarter. This is especially noteworthy, given the brand's limited distribution in only 250 doors in the entire United States.

Jo Malone is the second-largest prestige fragrance brand in its home market, the UK, and growing double digits. Yet it has just 1/10 the number of points of sale compared to market leader.

We are anticipating on our high-end fragrances will perform well in the holiday season, with enticing gift offerings of new and classic scents. And we expect their momentum to carry into the second half of the fiscal year.

In skincare, natural products are growing in popularity, and we are well positioned with our of Aveda and Origins brands. Aveda's new Tulasara skincare line, which creates glowing skin inspired by the ancient healing art of India, led to the brand robust skincare sales growth worldwide, exceeding its expectations. Aveda plans to broaden the franchise in the next few months with masks for the face and eye, centered on the theme of weddings.

Origins strengthened its leading position in facial masks, and its skincare sales climbed double-digits in every region. This includes a new line of face and body masks infused with tea that provides immediate benefits, a feature desired by today's consumers.

Many of our brands are enhancing their distribution in the fastest-growing channels to reach target consumers where they're shopping today. Our brands continue to successfully penetrate the specialty-multi channel globally.

In the US, Clinique continued its rollout in ULTA. And in September, Estee Lauder introduced a curated selection of top-selling skincare and makeup products in 30 ULTA doors and on ulta.com. Clinique, Origins, and Bumble and bumble added location in Sephora stores inside JCPenney.

Our brands are also further penetrating the channel in foreign markets. For example, in Germany, GLAMGLOW successfully partnered with Douglas to target core consumers throughout all of its locations. Likewise, when Smashbox entered Finland this quarter, it reached its target consumers by launching in the specialty retailer KICKS.

Our travel retail business was vibrant in the quarter, as our net sales growth far outpaced passenger traffic growth, despite some difficult markets, including Hong Kong, Japan, and Latin America. Our smaller and midsized brands, as well as MAC, are in high demand in the channel. They all increased double digits at retail, with very solid like-door growth as we continued to accelerate their rollout.

Geographically, Asia-Pacific was the best performer in travel retail, and the makeup, fragrance, and hair care categories grew sharply. We expect to continue our strong sales increases in travel retail, fueled in part by passenger traffic growth, which is projected to rise during the next three quarters.

Our online sales this quarter were once again very strong. Mobile continues to be the fastest growing area in E&M commerce, a trend also reflected in our business. In the quarter, m-commerce represented 41% of our online global sales, up from 37% last year, and sales from mobile devices grew 23%.

In the recent period, we opened approximately 100 new sites, mostly with international retailers.

Looking at our heritage brands, Estee Lauder and Clinique have remained stable. Importantly, in the quarter, both brands grew in makeup globally. They have generated makeup growth for several quarters, and we expect each of them to accelerate their makeup business in the second half of the year.

Estee Lauder's international makeup sales were vibrant, with a particularly strong performance in the UK following the Brexit vote, when a drop in the pound increased in a wave of tourists. The brand sold its especially well in department stores favored by foreign visitors, such as Harrods, where Estee Lauder's retail sales rose 20%.

Estee Lauder Double Wear foundation was a strong seller worldwide, fueled by its innovative Cushion Stick applicator. In skincare Estee Lauder had global success with Advanced Night Repair, another powerful growth engine for the brand. Estee Lauder continued to see strategic opportunity to accelerate its business this year by fueling these two core pillars -- with new products and compelling digital assets, as it targets a wider consumer base and increased penetration in higher growth channels.

Clinique's business in North America increased in makeup and skin care, driven by higher sales in specialty-multi retailers, online, and in select department stores. Clinique also had solid growth in makeup internationally, with strong results from its new foundation called Superbalanced Silk Makeup.

It has started a redesign of some counters and stores in the United States and Hong Kong. And as a result, sales climbed in those locations. Clinique expects to broaden its reach in high-growth channels, particularly in North America, and at the same time work with department stores to increase traffic at counters and accelerate its growth.

Improving productivity is a focus for our entire organization. Through Leading Beauty Forward, our multiyear initiative, we aim to increase our efficiency and reduce costs to achieve both leverage and for reinvestment in growth drivers.

Additionally, we will improve our speed to market and agility. We are making good progress. Much of the organizational design work and several projects are underway.

In closing, we continue to deploy the strategies to drive our sustainable and profitable long-term growth. Our diversified business is fueled by multiple engines of growth, and our financial agility enables us to quickly move resources to take advantage of changing consumer demand and new opportunities. This year we will further accelerate our strongest growth engines, reinvigorate slower areas, and create more resources to invest in opportunities and capabilities as we adapt to the changing dynamics in prestige beauty.

As we discussed in our August call, our sales profile this year is weighted to the second half and is rolling out as we had anticipated. We expect that fiscal-year 2017 will be another successful year that will advance our financial performance and strengthen our leadership.

Now I will turn the call over to Tracey.

Tracey Travis - *The Estee Lauder Companies Inc. - EVP and CFO*

Thank you, Fabrizio, and good morning, everyone. First, I will review our fiscal 2017 first-quarter results, and then I will cover our expectations for the second quarter and the full year. As a reminder, my commentary excludes the impact of restructuring and other charges primarily related to our Leading Beauty Forward program.

Net sales for the first quarter were $2.87 billion, up 2% in constant currency compared to the prior-year period. Incremental sales from By Kilian contributed approximately 20 basis points of this growth.

From a geographic perspective, Europe, the Middle East, and Africa saw the fastest growth again this quarter. Net sales rose 7% in constant currency, with double-digit growth from the travel retail channel; developed markets, like Italy and Spain; as well as most of the region's emerging markets. Sales in Germany and the UK were also solid.

Last quarter, we called out two issues that we predicted would put some pressure on our first quarter sales in EMEA. As we anticipated, sales in France declined due to significant drop in tourism against a tough comparison, with an exceptionally strong first quarter of last year.

Net sales in the Middle East fell sharply as distributors in the area significantly rebalanced inventory levels to adjust to weaker retail traffic, due primarily to the impact of lower oil prices on the overall macro environment. We do see some traveling luxury consumers from the Middle East taking advantage of the weaker pound and buying more in UK. Excluding the Middle East, the EMEA region grew 10%.

Sales in the Asia-Pacific region grew 5% in constant currency. Growth was led by Korea, which grew low double digits, followed by strong growth in Australia, Taiwan, Thailand, and Japan. China grew in line with the overall region.

Sales in Hong Kong continued to decline. Excluding Hong Kong, the region grew 7%.

Net sales in the Americas declined 2% in constant currency. Latin America grew 15%, led by strong growth in Mexico, while Brazil remains challenged. Canada rose low single digits, and the US declined mid-single digits. Our sales through both online and specialty-multi channels again rose double digits. However, we saw continued declines in the brick-and-mortar business of midtier department stores, as well as tourist-driven freestanding stores. Additionally, the US had a tough comparison to the prior year, which included some major new product launches in department stores.

Net sales by product category were led by the 10% constant currency growth in fragrance for the quarter, reflecting the success of our strategy to focus on the higher-margin top-tier segment of the category. Jo Malone was once again the largest contributor to our overall fragrance growth.

The launch of Basil and Neroli, strong comp-door growth, and expanded consumer reach drove a strong double-digit increase in sales. By Kilian contributed incremental sales, adding about 1 point to the fragrance category growth, and Le Labo also grew rapidly.

Makeup sales rose 1% in constant currency. Tom Ford delivered exceptional growth, nearly doubling its makeup business this quarter. Smashbox rose double digits, and Estee Lauder and Clinique innovation in makeup also drove the category, as previously mentioned.

And as Fabrizio discussed earlier, MAC continued its strong double-digit trends in most international markets. However, the brand's US business continues to experience lower foot traffic and tourism in its core channels of distribution, constraining overall makeup growth in the quarter.

Hair care sales increased 1% in constant currency, primarily due to growth from Bumble and bumble. Skincare sales grew less than 1% in constant currency. Double-digit growth, supported by strong innovation from La Mer, Origins, and Aveda was mostly offset by lower sales from Estee Lauder, which had a major launch in the prior-year period; and from Clinique, reflecting continued softness in Asia and in EMEA.

Our gross margin declined 30 basis points from the prior year, due primarily to unfavorable currency and a slightly unfavorable product mix. Operating expenses as a percent of sales increased 10 basis points. Higher store operating costs and selling expenses associated with our retail store growth, along with the accounting for stock compensation expenses, were mostly offset by favorable currency transactions and a gain on the sale of a fixed asset, as well as more prudent expense management. As a result, operating income fell 1%, and operating margin decreased 30 basis points.

Net earnings increased 2% to $314 million, reflecting a lower effective tax rate. Diluted EPS rose 3% to $0.84 or 5% in constant currency. Earnings per share for the quarter included $0.02 of unfavorable currency translation. EPS was higher than anticipated, due primarily to more prudent expense management.

As you are aware, we have seasonally higher working capital requirements in our fiscal first quarter as we build inventory to support the holiday selling period. During the quarter we used $150 million in net cash flows from operating activities and we invested $85 million in capital projects.

We used $222 million to repurchase 2.4 million shares of our stock and paid $111 million in dividends. We also announced this morning that our Board approved a 13% increase in our quarterly dividend to $0.34 per share.

Now let's turn to our outlook for the next quarter and for the full year. As Fabrizio mentioned, we continue to expect sales to grow 6% to 7% in constant currency for the fiscal 2017 year. This range includes the expected contribution from BECCA, as we plan to close the transaction this quarter.

On a preliminary basis, we estimated that BECCA could add approximately 30 basis points to sales growth and dilute EPS by $0.02 in fiscal 2007 (sic - 2017), which won't affect the range of our forecast. Currency translation is expected to depress sales by less than 1%, reflecting weighted average rates of $1.10 for the euro; $1.22 for the pound; and $1.05 for the yen for the fiscal year.

Diluted EPS is expected to range between $3.38 and $3.44 before restructuring charges, including approximately $0.08 of dilution from currency translation. In constant currency we expect our EPS to rise by 8% to 10%.

For the fiscal 2017 second quarter, our sales are expected to rise by approximately 5% to 6% in constant currency, reflecting new product launches and holiday promotions as well as easier comparisons in the US and France. The Middle East and Hong Kong are expected to continue to weigh on sales growth until the second half.

Negative currency translation is estimated at approximately 2 percentage points. Our most recent acquisitions could add approximately 50 basis points to sales growth for the quarter. EPS is forecast between $1.10 and $1.15 before restructuring charges. This includes about $0.05 dilution from currency. The acceleration in EPS growth implied in the second half of the year is directly related to the sales growth trends.

We are pleased with the performance we made on our strategic initiatives in the first quarter, and we remain focused on delivering another successful year, despite the volatile political, economic, and currency environment.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Dara Mohsenian, Morgan Stanley.

Dara Mohsenian - *Morgan Stanley - Analyst*

The first question is more short-term. In your release, you changed the expected full-year top-line outperformance versus the category to more than 1% from 2% previously, along with the 4% to 5% beauty category growth. So given that commentary, and Q1 came in at the low end of the range -- Q2 is still expected to be below the full-year FX-neutral sales growth rate -- should we expect the sales growth to be more the low end of your 6% to 7% range now? Is that reasonable?

And then the second question, more longer-term, is: last quarter you announced you were expanding more of your business into ULTA and Sephora. As we look out over the next few years, I was hoping you could discuss conceptually how much further distribution expansion you'd expect to see in nontraditional retailers versus your historical footprint, and if bringing more brands into those retailers over time is part of your plans? Thanks.

Tracey Travis - *The Estee Lauder Companies Inc. - EVP and CFO*

So let me take the first half of that question in terms of the range. It's still pretty early in the year, which is the reason why we give a range for the full year. So at this point we're not prepared to say that we're going to be at the low end of the range.

And certainly, the second quarter is a big quarter for us. It's holiday. And obviously the second half of the year is big for us, for all the reasons that we spoke about in our prepared remarks. So at this time, it's still very much within the range.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Yes. And the answer to the fact that we will continue increasing our penetration and winning channels -- the answer is yes, that that's part of our program. There are several winning channels around the world in this moment in the area of luxury and prestige.

One is definitely specialty-multi. And we will continue to increase not only distribution, but success and continue to increase brands which are tailored to this channel in the future around the world.

We will also continue to increase our penetration of the online channels. And we will continue to increase also our penetration of travel retail and distribution in these areas, among others.

Operator

Olivia Tong, Bank of America Merrill Lynch.

Olivia Tong - *BofA Merrill Lynch - Analyst*

Thank you, just following up on Dara's question. If you're not taking the high end off the table, then what are you seeing to make you confident that the second half can accelerate to essentially a double-digit pace in the second half in order to get to the high end of your outlook?

But really, what I wanted to ask more about was MAC, because -- what are you doing to sort of remedy some of the things that are going on in the US? I get that part of this is an appeal to tourists, and less travel, and the impact of that; but how much of this is just how much more competitive the makeup category has become, particularly with younger consumers that MAC has captured for so long?

Tracey Travis - *The Estee Lauder Companies Inc. - EVP and CFO*

All right. So, Olivia, thanks for your questions. Let me start off with the expectations, again, for the second half.

We talked a bit about the innovation that we are expecting in the second half. We talked about pricing, and we also talked about the acceleration of consumer coverage for many of our smaller brands.

As you're aware, we most recently acquired a number of smaller brands that are in expansion mode. Brands like Jo Malone, and Tom Ford, and others have quite a bit of expansion opportunity as well ahead of them. And so they are -- certainly much of that distribution growth is planned for the second half of the year.

If you were to think about the second half in terms of the building blocks that we typically talk to you about for the full year, 2% is roughly -- you know, a little over 2% is roughly the pricing expectation that we expect to get in the second half of the year. New distribution would be about 3% to 4%, so a bit of a step up versus the first half of the year.

And then our existing and new business, including our newer acquisitions, are another 3% to 4%. So that's how we get to the numbers for the full year that we guided to in terms of 6% to 7%.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Yes. And as far as MAC is concerned, first of all, I said in my prepared remarks that MAC is still growing double-digit in many of the global markets, where there is equally new -- it's equally tough, the new competition that there is in the US. And MAC internationally has been growing in line with the very fast-growing market, continuing to well compete with mass and all the mass brands -- that despite some of them are now using prestige codes, they continue to grow on average less than the prestige brands.

So MAC continued to be one of our most successful brands and a fast-growing brand. And we will count on this for the future. In the US, there is the specific two issues in the short-term that we have already commented on, which is -- obviously, MAC is very concentrated and focused on high internal distribution and presence in high touristic areas and in mid-tier department stores. And the traffic in both of these areas has been lower, significantly lower than in the past. And so MAC will need to react to that.

The second is the programs. And you are right; there is new competition. There are some very successful brands. We have acquired one of them -- BECCA.

And there are many other successful brands particularly, specialty-multi, which are a new competition among the Millennial generation. And MAC is stepping up their activity, their innovation, their collection, their social media, and their penetration of this new target group with new activity.

That's why in our prepared remarks we brought up the example of the Selena and what's happening there, when MAC speaks to this target group more directly. And we plan to introduce much more also in the second semester of the fiscal year. So, net, we expect MAC to continue to be one of our strong growth brands in the long-term.

Operator

Steve Powers, UBS.

Steve Powers - *UBS - Analyst*

I actually want to take a step back and think about your long-term algorithm. Because within that algorithm, I know you've got objectives to grow the top line while also expanding operating margins and improving free cash flow. But it seems philosophically as though maintaining the top line at 6%-plus really dominates the other two. And arguably that's not wrong, assuming the 6%-plus growth is there.

But I guess as we hear questions today related to the top line, what would it take for you to see -- whether in your business or in your end markets -- where you'd say, you know what? We're going to throttle back just a bit on the top-line investment and seek to generate similar profits, maybe improve free cash flow, by going more after margin.

I guess my concern is that you've been growing 6%, 7%, 8% in a market growing 4% to 5% for a while. And clearly, that can't go on forever, at least not without significantly higher costs. I think the market's concern is that's what we're starting to see this quarter.

And to that point, if you do happen to trend short of 6% in fiscal 2017, I think the market's fear is that you'll continue to spend as if you were still growing at that level -- leading ultimately to deleverage and EPS reduction. So can you just help frame for us how you're monitoring top-line trends and give us confidence that, if the revenue does start to fall short, that the flexibility you have been speaking of the past few quarters can be applied to cost management to better protect bottom line, even in the face of top-line disappointment? Thanks.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

I would like also Tracey to add on this, but first of all, our -- in a market which is growing 4% to 5%, as I said, our long-term opportunity of growth remain between 6% and 8%. And again, it is between 6% and 8%. It could be 8% in some years or quarters; it could be 6% in others, depending on the external situation and of our internal innovation programs and priorities and spending, as you mentioned.

So I still believe the range for the long-term is the right range. And we are moving into that and continue to use this range as an opportunity. The key areas' opportunities -- we continue to have pricing power. So as we say in our -- for example, in our 6% to 7% this year, which is a representation of our long-term view, is 2 points are coming from pricing. And then 2.5 are coming from distribution and 2.5 from organic growth.

So our portfolio of brands, as Tracey explained before, still offer a lot opportunity of more distribution of at least half of our brands, which are high growth, high productivity, and not at all available to the global consumers in many areas. And this will be true for many years to come.

As an example, even our recent acquisition, BECCA, has enormous opportunities for going also international, online, in travel retail, in all of these areas which will build value and today are not leveraged by a brand which is doing very well among its target group. And we have plenty example of this in our portfolio.

The 2.5% organic growth in a market which is growing 4% to 5% in prestige, that continues to grow much faster than mass, is frankly achievable if we get our plans together. So we still believe that the 6% to 8% range is achievable, but also it's possible that in some years we'll be 6% and not 8%, as we had demonstrated in the past.

In terms of your second question, which is our flexibility is actually the key point -- our financial flexibility is there, and we are regularly adjusting resources to -- not only to the overall grow level, but also to the different priorities that we have around the world and to reallocating resources to the winning areas. That, I believe, is most important element of flexibility we have demonstrated to have.

Why it is important? Because in this moment, the markets around the world is very volatile, and there is a lot of change going on. So the ability to adapt and to reallocate resources in an agile way is one of the biggest trends that I think we can exercise to continue to succeed. And we are ready to do it; we are prepared to do this and our Leading Beauty Forward program, among other benefits, has also the benefit of making us stronger in our ability to do exactly that.

So to close on your question: yes, we are committed to adjust and adapt cost to the future sales growth opportunity that we will have. Tracey?

Tracey Travis - *The Estee Lauder Companies Inc. - EVP and CFO*

Yes, Stephen, the only thing I will add on to what Fabrizio has already said -- you know, some of the margin gains that we are achieving through our SMI program and other cost initiatives are, in fact, being offset by acquisition accounting and currency. So we are seeing almost an equal cost set in terms of some of the benefits that we are achieving from an organic growth standpoint with some of those factors.

As I had mentioned, I think, on our year-end call last year, that purchase accounting will bleed off over the next year or so, and you'll actually start to see some more of the margin flow through. One of the things that we also look at here, obviously, is EBITDA. Given the fact that we have done a number of acquisitions in the last few years, and certainly you see more progression in terms of our EBITDA margin.

Operator

Caroline Levy, CLSA.

Caroline Levy - *CLSA Limited - Analyst*

Again, my question is around margins, and just -- in your 2% or 2% to 2.5% organic long-term growth, are you factoring in the likelihood of a -- you know, some years where two or three of your biggest brands are down in your biggest market, which is what we're seeing right now? I think it would be helpful to understand why MAC in the US should get back to growth, separate from innovation. But just given where travelers are going, you're benefiting in the UK. Is it realistic that MAC gets back to growth, based on everything you are seeing right now?

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Yes, it is realistic that MAC get back to growth. But also the point that I keep making is diversification. MAC is a big global brand. US is less than 30% of MAC volume. The rest of MAC growth around the world can be double-digit -- has been high single digits in the quarter we just closed, and is projected to be double-digit.

So a brand that has double-digit power already demonstrated, and enormous amount of opportunity, including extra distribution opportunity internationally, is a brand that can definitely grow and go back to growth very fast. Now, in the US specifically, the growth -- to go back to growth, there will be certain actions that are required, including new successful innovation and some other activity in social media that -- I can understand you say they need to be proven successful before believing them, but we know what they are, and so we have trust in them.

But even in terms of mix, the power of the brands will allow a double-digit growth in the medium-/long-term. And then on the -- what was the first part?

Tracey Travis - *The Estee Lauder Companies Inc. - EVP and CFO*

It was really the big brands, and then Estee Lauder and Clinique, and them stabilizing, which is what we spoke about is happening. So that actually is progress.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Sorry, I didn't get the Lauder/Clinique part of the question. So then on Estee Lauder and Clinique, as we said, we have stabilized the brand. These brands have been declining in the past. We have stabilized them, and we have started growing consistently the makeup part.

As we said, we have said that our program was to start growing from makeup, and now the quarter we just closed is one more quarter where this seems to be now sticking. And we keep doing this work.

By the way, makeup is one of our priorities, and a lot of the growth in the second semester of this fiscal year, as we anticipate it, will come from makeup acceleration. And Estee Lauder and Clinique will be part of contributing to this makeup acceleration in the second part of the fiscal year.

Next, we need to address this skincare trend on these two brands. This has been slower than what we wanted, but in the situation with Hong Kong, not really been declining. And the traffic softness in US department store, which are two of the biggest skincare contributors to these brands, has been tough. But we have now plans to also add skincare acceleration to the already achieved makeup acceleration.

In our -- and the last thing I want to say: in our plan, we play the portfolio brands. And I said other times that we have one-third of our portfolio which is growing always double digits. One-third of our portfolio that could be just growing single, low single-digit, and one-third of our portfolio that is growing high single-digit. And in this way, we deliver the total.

And so, yes, we are not seeing that the big brands have the role to drive the 6% to 8% on the high side; the big brands have the role to drive growth, but there are the other brands in the portfolio we are driving double digit. And the portfolio mix is what's driving our long-term algorithm. Think of it like one-third pricing, one-third distribution, one-third organic growth; and one-third small brands -- the high-growth brands -- one-third medium-sized brands, and then the big brands.

And that's why this flexibility of managing through the different levers of growth and the different brands in the portfolio in the different countries make us a less volatile, more reliable, more sustainable company than any other company. Today, companies that just count on one or two brands, given the volatility of the world and only one or two markets, I believe are less reliable in the long-term than the model that we built.

Operator

Bill Schmitz, Deutsche Bank.

Bill Schmitz - *Deutsche Bank - Analyst*

Can you guys just bridge the gap for us between 7% to 8% makeup category growth and the 1% you reported? Because if I did the math -- and I think Fabrizio just said that only 30% of MAC sales are in the US. So if you assume that international business grew 7%, in line with the makeup category, does that mean the US was down 20%?

So I was just sort of trying to figure out, like, what is the source of the volume or share losses? And how do you fix it?

Tracey Travis - *The Estee Lauder Companies Inc. - EVP and CFO*

I'll start. I think we talked about three markets that were softer than last year, some due to macro factors. The US was obviously one of those.

France, which had a exceptionally strong first quarter last year, is softer for obvious reasons this year. And the Middle East. And those are big markets for MAC and for makeup in general, and certainly for MAC.

And we expect throughout the balance of the year, A, we won't be anniversarying -- we will be anniversarying some of the events, but in addition to that, we do expect a pickup in all of those markets throughout the course of the year.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Yes. I want to add that Hong Kong is also a decent makeup market. Brazil is a very big makeup market in general for us and has been declining.

And so it's been a -- but there are other markets, like China, where -- give you an example -- MAC has been growing at 20% more, and there are other markets we are aware that our makeup portfolio is growing 30%, 40%.

So it's not as simple as just one market explain everything, but the average of our international market has been growing doing very well. Middle East, Brazil, a low base in France, I also said Germany in my prepared remarks, and Hong Kong are other examples of market that are driving down.

But down significantly the growth -- Middle East -- they are at a very difficult moment. And so double-digit declines numbers that are impacting in quarter one, offset by other phenomena.

So it's not only the US. But in the US was specifically MAC. The rest of our portfolio in the US has been performing well, as we anticipated also in the prepared remarks. Lauder and Clinique makeup in the US has been growing on both brands, for example. So that's the situation.

How we fix it, I think I just said -- I just answered this question. We will improve the trend in MAC in the US, continue to accelerate our distribution in that of all our makeup brands that have distribution opportunities internationally, turn around our MAC organic growth in the US, and continue to accelerate our winning makeup brands around the world also in the organic growth with more programs, particularly expanding innovation and better social media plan. And we will activate the planned price increases in January that we plan to activate.

Operator

Wendy Nicholson, Citi Investment Research.

Wendy Nicholson - *Citigroup - Analyst*

Just housekeeping -- specifically, can you give us the like-door growth in China in the quarter and the actual number for MAC? How much was MAC down in the US, and what was MAC's growth globally just for the quarter?

And then my bigger, sort of conceptual question: I get and I understand the opportunity for distribution expansion for so many of the brands in so many new markets. And I see why that will drive a third of your growth, and that's great.

But my concern is that you are gaining more market share, it seems, through distribution expansion as opposed to with your own innovation. And I look at your two really big new products over the last year: New Dimensions and Estee Edit, which we heard about for several quarters before they were launched. They were supposed to be game-changers; New Dimensions was supposed to set off a whole new category. Estee Edit was supposed to revitalize the brand with Millennials.

And both of those brands have fallen well short of your expectations. And I know it may take time, and Estee Edit may be a slow build, and all that kind of stuff. But my bigger question, Fabrizio -- and you even mentioned it at Barclays, that the Company is changing its focus less from blockbuster home runs, successful new product innovations, and more smaller things. But I'm just wondering how big a change that is culturally? Does that change the cost to compete? Those kinds of things. Because that strikes me as a very, very different philosophy or approach to building your brands and launching new products than we've seen historically at the Company. Thank you.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Yes, you raise a lot of questions. So, China: this was again a quarter where China retail touched double digits. So we are very happy.

China retail grew overall 10%; MAC in China grew outstandingly, and our same-door in China grew 2%. So that's the situation.

So we have again good, interesting growth in China. By the way, this is also driven by our makeup brands -- in a big way by the makeup part of our heritage brands as well. And MAC is a really strong driver of this growth in China, among others.

Same thing in Korea. We are competing very well with Korea brands. We have another quarter in which in Korea we have been at very strong retail, and continue to grow market share in the country of Korean brands, which make us very competitive -- and again, this has been driven by a lot of our makeup brands as well, including MAC.

The second part of your question is the innovation plan. Definitely the New Dimension was below are expectation. And, in fact, by the way the launch of New Dimension last year was in the first quarter. And part of what we see in skincare this year in terms of pace is that we are anniversarying a base where there was the launch of New Dimension -- that, although below our expectation, was significant in terms of overall volumes of innovation.

And the future of our innovation is changing, as I explained in the Barclays conference and the rest, meaning there are some very exciting innovation and less blockbusters. We believe this is much more in line with current consumers' expectations, where a consumer wants to try new products and have a variety of them.

And the model is not -- the breakthrough model assumes a lot of advertising before the product is in store. So in reality, it's higher risk financially.

While the model where we use the growth -- the innovation to attract new consumers and to engage them; and then when we see success, we further accelerate and further leverage this innovation is a model that, particularly in our mid-sized and smaller brands, is much more manageable and allow faster and better financial results from these innovations than in the past.

So in the idea, we are going to have a mix. We still are going to add some breakthrough technology innovation and some more commercial innovations, including product, packaging, aesthetics, et cetera, innovation. The fact that a lot of the growth come from [micarte] is increasing the percentage of innovation, which is not about breakthrough technology, obviously. But this is still part of our portfolio.

But the way in which we will launch even this breakthrough technology will be with less risky upfront investment and more gradual evolution of the winners. And that is a change in our innovation program and is a change that will be -- is associated already with some great results where we have the right innovation, and will be associated, I believe, with a lot of good success in innovation.

As we said before, last year we went from 20% of our sales growth coming from innovation and fiscal-year 2015 to 24% coming in fiscal-year 2016 from innovation.

In terms of the cost of innovation, which was the last part of your question: frankly, I believe it's the opposite. This new improvement of our innovation program is decreasing the cost of innovation, because it's decreasing the risk of it. It's decreasing the amount of money that are put upfront on innovation and that don't work, and are allowing us a better agility in tailored resources where the consumers react positively to our innovation. So it's increasing the effectiveness and the rate of return on our innovation.

Operator

Nik Modi, RBC Capital Markets.

Nik Modi - *RBC Capital Markets - Analyst*

Thanks for the question. Fabrizio or Tracey, given the importance of the December quarter and the overall year, can you just maybe give us your overall macro undertones that you are kind of assuming in your forecast for the second quarter, just to kind of give us a feel on how much potential cushion or risk you are baking in, just given the environment right now?

Tracey Travis - *The Estee Lauder Companies Inc. - EVP and CFO*

So I'll start, Nik. It certainly is difficult to predict the environment, certainly most near-term here in the US. But at least the election uncertainty will be over next week, and we can move forward.

I think that we are very pleased with the programs that we have to take advantage of the holiday season. And MAC has an incredibly strong giftable program this year, and so we're very excited about that. Certainly we expect that that is going to drive a great amount of volume and sales for MAC.

In terms of Jo Malone, many of our brands are fragrance brands. Obviously, we are well positioned for holiday.

We are still mindful of the fact that there are many parts of the globe that are weak, and certainly Fabrizio talked about some of those. Hong Kong, the Middle East -- we are not expecting a big pickup in those markets in the second quarter, in the holiday season. We expect the UK to have a bit of a pickup, certainly, given the currency favorability there.

We do expect that that will be the case. And we were actually in the UK last week and certainly saw quite a bit of traffic in the UK in the shops.

So I would say it's a mixed bag. I think we're very in tune with what's happening around our globe, and certainly our regional presidents are, as we migrate into this holiday season. And I think we feel we have an incredibly strong lineup across all of our brands, including Estee Lauder and Clinique, for holiday.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Yes. The other thing I want to (technical difficulty) was about our assumptions. We do not assume Hong Kong to go back to growth this fiscal year. We do not assume Middle East to go back to growth this fiscal year.

We do not assume US, the mid-tier department store, big improvements in the course of the year. We assume they will not further deteriorate, but we do not assume big improvements. And the rest is we assume that we will be able to reallocate resources, depending on the volatility we see in the other element of economical and political volatility around the world.

Operator

Lauren Lieberman, Barclays Capital.

Lauren Lieberman - *Barclays Capital - Analyst*

I just wanted to clarify, Fabrizio, what you just said about Hong Kong, Middle East, and US department stores -- that was -- you are not expecting them to be positive for the fiscal year, or for the calendar year -- like, for the second quarter?

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Both.

Lauren Lieberman - *Barclays Capital - Analyst*

Both, okay. Hong Kong --.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

Both -- now, by positive, depending what you mean positive. I said I don't expect Hong Kong market to grow in the fiscal year, and definitely not in the next three months. We don't expect Middle East will be positive in the fiscal year, and definitely not in the next three months. And I said we don't expect US department store to further deteriorate in the level of traffic for the remaining of the fiscal year.

Operator

Mark Astrachan, Stifel Nicolas.

Mark Astrachan - *Stifel Nicolas - Analyst*

Wondering if you can comment on MAC growth, excluding new distribution outside of the US -- and how sustainable current double-digit growth is?

And sort of broadly, we've estimated MAC has driven somewhere around 20%, 25% of Company sales growth in recent years. So if it's slowing, and I get the comment about international being called 70% of brand volume, but how much can the Company make up with acquisitions or other, assuming that the rest of the portfolio doesn't accelerate? And why or why not is this a good way to think about that?

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

So the way -- as I said before, the way to think about that is one-third of our sales will be growing single digits; and one-third of our sales or our brands will be growing double digit; and then one-third will be in the middle, as I said before. And this -- you can make the same assumption by channel, by country.

We manage the portfolio at different grow levels. So specifically to MAC, MAC is internationally, so outside of the United States, MAC is relatively intact brand in terms of price and distribution in many countries. Take countries like China, where MAC has really, really untapped its enormous opportunities, only in a limited number of cities and a lot to go. And there are many examples like that.

And there are other places where MAC is well penetrated and well developed, like the US or the UK. So it depends by the mix.

Each one of these brands has a very different mix and portfolio. That's why I don't think we are going to deploy every single brand and every single opportunity in price and distribution and organic growth per brand. And that's why I summarized it with the one-third, one-third, one-third.

And then your second -- so this will continue. And the second part of the question is the role of acquisitions. Yes, we have -- in the fragrance business, the role of acquisition has been to create the engines of growth of this new, high-end, artisanal fragrance category, where we want to lead and to drive growth. And I think this quarter you see for the first time a very significant sign of that and the potential of it in the long-term.

We are doing in fragrances what we did in past history on makeup. And then we will continue to drive that.

In the other categories, acquisition will play a role, like they always played, and will continue to play a role to create the right portfolio brands and to create the right possibility of growing in areas where we have strategic opportunity or strategic gaps. And so you can expect us to continue leveraging acquisitions and continuing analyzing the opportunities on your acquisition in the future to manage the strategic gaps or opportunities.

And last, we have also some minority investments around the world that could be very interesting in the long-term. For example, Dr. Jart+ in Korea, which is one of the fastest-growing Korean brands, where we have a minority investment that could be an acquisition in the future, is an example of strategic opportunities that we continue to enrich our different engines of growth.

And, to close, we are building engines of growth. Differentiated, different in many, to diversify our opportunity for growth in the long-term. That's the key strategy. And frankly, we're making great progress on it quarter by quarter.

Tracey Travis - *The Estee Lauder Companies Inc. - EVP and CFO*

And the only thing I want to add to that is internationally, outside of the markets that we've spoken about, MAC growth from a comp-store standpoint is strong and is expected to be strong throughout the balance of the year. So the international MAC business is quite strong. The travel retail business is quite strong for MAC as well. So I just want to mention --.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

And the online is very, very strong.

Tracey Travis - *The Estee Lauder Companies Inc. - EVP and CFO*

And online as well.

Fabrizio Freda - *The Estee Lauder Companies Inc. - President and CEO*

One specific issue is US distribution platform on MAC and the competition in the US. That's the specific MAC issue that we have addressed and we will address in the next months.

Operator

That concludes today's question-and-answer session. If you were unable to join for the entire call, a playback will be available at 1 PM Eastern Time today through December 2. To hear a recording of the call, please dial 855-859-2056, passcode 4794540.

That concludes today's Estee Lauder conference call. I would like to thank you all for your participation and wish you all a good day.
