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EL - Q2 2013 The Estée Lauder Companies Inc. Earnings Conference Call

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OVERVIEW:

Co. reported 2Q13 net sales of \$2.93b, net earnings of \$457m and diluted EPS of \$1.16. Expects FY13 local currency sales growth to be 6-7% and non-GAAP EPS to be \$2.51-2.59. Expects 3Q13 sales local currency growth to be 3-4% and EPS to be \$0.28-0.32.



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PRESENTATION

Operator

Good day, everyone, and welcome to The Estee Lauder Companies' fiscal 2013 second-quarter conference call. Today's call is being recorded and webcast. For opening remarks and introductions, I would like to turn the call over to the Vice President of Investor Relations, Mr. Dennis D'Andrea. Please go ahead, sir.

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

Good morning, everyone. On today's call are Fabrizio Freda, President and Chief Executive Officer; Tracey Travis, Executive Vice President and Chief Financial Officer; and Fabrice Weber, President Asia-Pacific. Fabrice will give a strategic overview of this fast-growing region.

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. Except where noted, our discussion of our financial results and our expectations are before restructuring and other charges. You can find a reconciliation between GAAP and non-GAAP figures in our press release and on the Investor Relations section of our website.

And I'll turn the call over to Fabrizio.



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

Thank you, Dennis, and good morning, everyone. During the second quarter of fiscal 2013, we continue to confidently steer our strategy on a successful course through varying market conditions. This resulted in solid sales growth at the high-end of the range we provided. Sales grew 7% in local currency, while diluted earnings per share were better than we anticipated.

Around the world, Prestige Beauty continues to grow, but at a slower pace than a year ago. While this reflects the reality of the markets, our brands and high-quality products are winning with consumers, thanks to our diverse portfolio that gives us a presence in a full range of Prestige channels. With effective advertising that promotes our standing innovations, we pull consumers to our counters and then generate sales with High-Touch personal service.

In the recent quarter, all three of our geographic regions contributed to our higher sales, despite some soft markets and specific challenges. Sales in all of our major categories also rose. Continuing a recent pattern, the fastest brand growth came from the high end of our Prestige portfolio. The affluent consumer is spending freely for products she desires. As a result, our luxury brands, including Jo Malone, Tom Ford and La Mer, are thriving -- each up more than 20%.

We believe these brands have terrific growth potential, and we plan to continue to invest in them over the next several years, so they become more formidable players in the beauty landscape. Our emerging markets continued to deliver the most rapid growth. Sales rose 24% in the quarter and they accounted for 14% of our total business. In China, our largest emerging market, our retail sales climbed 28%, enabling us to gain market share. We continue to push into new cities and add counters for our brands, and also increase our advertising on TV in advance of the Chinese New Year.

We foresee further expansion opportunities into smaller cities in China for several years to come. Other emerging markets showing strong local currency sales growth included South Africa, Turkey, the Middle East and Brazil. And many of our brands in those countries gained share, thanks in part to their success in being locally relevant.

Our brands continuously seek to reach new consumers and one way is being expanding geographically. MAC, for instance, is deepening its presence in sub-Saharan Africa. It recently began selling in Zambia, Nigeria, and Botswana. In Russia, ongoing distribution challenges continue to impact our two largest brands; yet our luxury and makeup artist brands are growing very fast and resonating with consumers. To compensate for the overall soft results, we are working to accelerate our innovation, marketing and online opportunities.

Turning to our established markets. We enjoyed the solid sales increase in North America, as Prestige Beauty growth continued to outperform mass brands. In the past, our performance in our core market was largely dependent on our biggest brand. But this quarter, it was also due to healthy sales for several of our smaller and midsize brands, especially luxury and specialty ones. For example, gains in Bobbi Brown stemmed from successful products and special events.

From a distributional perspective, in North America, our fastest growing channels were e-commerce and special (technical difficulty). Sales of our products in Prestige department store outpaced mid-tier ones. Our North America results were positive, despite the impact of the Hurricane Sandy tragedy, which affected a large portion of the Eastern US.

Several challenging markets in Europe, particularly Spain, Italy and Greece, impacted our overall results in the region. Still, our sales rose high-single digits, as compelling advertising attracted consumers to our counters for the latest launches and out of the selling products. As a result, we gained share in several well-established countries. In France, our brands grew faster than competitors in the key skin care and makeup categories. In the UK, retail sales were healthy, led by e-commerce, Jo Malone and MAC.

We are proud that our Estée Lauder and La Mer brands won the prestigious Marie Clare Prix D'Excellence Award that honored the most innovative products of the year for their Revitalizing Supreme Anti-Aging Cream and their Moisturizing Soft Cream, respectively.

Our total business in Asia-Pacific expanded nicely, driven by double-digit gains in skin care. This region posted the best sales growth this quarter. However, Korea remained a difficult market where sales declined; but we are aggressively working to remedy the situation. Fabrice will elaborate on our Asian business in a few minutes.



During the quarter, employees across our regions prepared for the next wave of our Strategic Modernization Initiative in advance of the January 7 launch. The latest implementation occurred in China, Hong Kong and France, among others' markets. It also involved several business processes. I am very proud of the dedication of our SMI teams and the strength of our organization. The preparation went smoothly and the go-live was a success.

As more continual countries and functions start using SAP, the overall initiative should unleash further efficiencies, and thereby cost savings, in the coming years, particularly in cost of goods, indirect procurement, and advertising and promotional spending. Currently, approximately 75% of our Company sales are SMI-enabled, and we continue to gain better visibility into all facets of our business. Leveraging our SMI capabilities is a major priority to create further value and enhance our growth.

Looking at our categories, innovations continued to drive the growth of skin care. Globally, the Estee Lauder brand focus on skin care continues reaping benefits, with skin care sales up 14%, driven by new products, strong core businesses, and continued robust demand in China. La Mer global sales rose an outstanding 25%. In the United States, our skin care sales grew solidly, and we gained share after adjusting for facial cleansing devices.

Demonstrating our strengths in this category, our brands held 17 of the top 20 Prestige skin care SKUs in the quarter, as measured by NPD. Our makeup business grew on the strength of our makeup artist friends. MAC opened 42 new doors globally including a flagship on Fifth Avenue, which has surpassed its Time Square store for the highest average unit sales in New York City.

Bobbi Brown sales increased double-digits globally, and we expect Katie Holmes, its new celebrity spokesperson, will continue to increase brand awareness and sales. Smashbox also had strong double-digit gains, fueled by more than 200 new doors opening globally. We are aggressively expanding the brand's distribution, confident that he has strong global appeal and fantastic potential, particularly with young consumers.

Our luxury brands drove our fragrance business. Jo Malone and Tom Ford generated strong double-digit sales, due to organic growth, successful launches, and new distribution. Contributing incremental sales this quarter was the introduction of Coach Love, which initially rolled out in Coach boutiques.

In hair care, Aveda Invati line, which was launched about a year ago, remains a success. Aveda used TV for the first time beginning in September to promote the franchise, and the investment paid off. A three-product Invati set was popular for the holidays. Looking ahead, using our successful launch and leverage approach to major product introductions, we have additional Invati product planned, and Aveda intends to run TV commercials in the UK in the second half of fiscal 2013.

Our brands grew online, and our e-commerce business continues its double-digit advance against this quarter. Cyber Monday was our biggest day ever for online sales in the US, up 17% over previous year. Holiday sales from our brand size grew much faster than overall online sales in the US, and retailer site gains as well. We continue to develop our important mobile commerce business. And we were encouraged that, in our home market, our m-commerce sales more than doubled.

We were also extremely pleased that the Estee Lauder brand earned the top ranking in a recent Digital IQ Index for the China beauty market by L2, a leading research group that explores digital innovation. The study measures the digital competency of 20 global beauty brands based on websites, digital marketing, social medias, and mobile. It said the Estee Lauder brand has established itself as a digital leader in China.

Our retail sales in the travel channel continued to climb double-digits, driven by a surge in China. The destocking issue we had been experiencing, primarily in Asia-Pacific and Americas, slowed toward the end of the quarter. Our travel, retail and net sales rose high-single digits, exceeding the growth of air passenger traffic, which remained strong. Our sales were up sharply in Europe, the Middle East and Africa, driven by emerging-market travelers. Clinique, in particular, benefited from a new campaign, featuring products from its Even Better franchise.

To support innovation in key brands, we increased our advertising, merchandising and sampling by approximately 75 million, with a large portion spanning some of our biggest markets to capture the most promising opportunities. In China, advertising on TV is helping us to attract thousands of new middle-class Chinese consumers, who come to our counters when they start buying their first Prestige beauty products.

Clinique's TV campaign behind the launch of Even Better Clinical in China helped lift the brand sales there more than 30% at retail in the quarter. We have many exciting developments across our brands coming in the third quarter, including MAC's newest flagship that will open this month on the Champs-Élysées in Paris. The store, in high-traffic shopping destination popular with tourists, should fully express the brand and build further awareness.

In term of anticipated products and drawing on our strategy of being locally relevant, MAC is introducing a makeup collection to Chinese consumer called the Year of the Snake to coincide with the country's New Year's celebration. And two brands are extending best-selling franchises. Estée Lauder recently launched a new eye serum as part of its Advanced Night Repair line, and Origins in adding an anti-aging cream to its prescription collection. Both products should generate further interest in the brands.

Additionally, our Aramis and designer fragrance division has a busy season planned with the launch of Marni and Zegna Essenze collection, and the further allowed for Coach Love.

On January 1, we introduced an enhanced organization structure to recognize our top executives, expand senior leadership positions, and prepares for future growth by providing resources for growing brands. We believe these strategic changes will strengthen our Company, and provide additional development and career opportunities for current and future leaders. Our dynamic organization is constantly evolving; and to be competitive, we must be agile. Our people and our brands are our greatest assets.

By realigning responsibility, we believe we will continue to leverage the Company's amazing trends across our world-class brand and more of our most talented leaders. This organizational design should enable us to be more locally relevant, better focused on global opportunities, and strongly positioned for sustainable, profitable growth.

This year, we are rebalancing our marketing spending, and the second and third quarters will have the biggest increases. In the past few years, the highest amount of incremental investment occurred in the fourth quarter. The different cabins this year is still the launch dates of innovations, and determining the best times to invest in growing markets and support our business in soft markets. The combination of the advertising rebalancing, the SAP shifts, and the changing dynamic of global markets, makes it very difficult to read trends by quarter. More than ever, we encourage you to focus on our full-year performance.

For fiscal 2013, we expect the macroeconomic climates to be mixed, with continued growth in many countries, such as United States and China. But challenges will remain in several international markets, including Southern Europe and Korea. We expect recent trends in the demand for global Prestige Beauty to continue, and our Company growth to exceed the industry once again.

For this reason, we reaffirm our top line local currency growth of between 6% and 7% for the full fiscal years. And at the same time, we are raising our full-year earnings per share forecast to between \$2.51 and \$2.59.

Now I will turn the call over to Fabrice, who will discuss our Asian strategy.

Fabrice Weber - *The Estée Lauder Companies Inc. - President of Asia-Pacific*

Thank you, Fabrizio, and good morning, everyone. I have worked in the beauty business for over 25 years and joined the Estée Lauder Companies 12 years ago. For the last six years, I have led the Asia-Pacific region, and previously served as President of our Aramis and Designer Fragrances division, and oversaw our travel retail business.

Our Company began selling products in Asia-Pacific in the early '60s, and soon thereafter, we opened our first affiliates in Australia, Japan and Hong Kong. Today, we sell in 13 countries, and our brands have a presence in travel retail locations in 24 markets. The region is very wide geographically and extremely diverse in terms of cultures, ethnic groups, consumer expectations, skin types, and beauty regimes and routines.

Asia-Pacific closed fiscal '12 with net sales of \$2 billion and achieved compound annual growth of more than 15% over the last five years. In Asia-Pacific, we estimated we are the leading Prestige Beauty company in our distribution, and the Estée Lauder brand is number one brand in



each distribution after several years of significant growth. We currently sell 20 of our brands in the region, although not all are sold in every country, so we still have expansion opportunities.

Our travel retail business in Asia-Pacific has also grown significantly in recent years, and today, comprises over 50% of our global travel retail sales. Due to the high demand for skin care products in this part of the world, the category represents 62% of our region's total sales, twice that of makeup. Fragrance comprises 5% of sales and hair care, 2%.

Distribution formats vary across markets, but 86% of our sales are to department stores. We have been rapidly expanding into beauty specialty stores and freestanding store formats in most countries over the last few years. And e-commerce is the fastest growing distribution channel.

Let me now said a few words about three of our largest countries in the region, mainly Korea, Japan and China. Korea is the most Prestige-centric beauty market among the large countries of the world, with Prestige representing nearly half of total beauty. Prestige Beauty is nearly exclusively sold in department store, and historically, our Company has a leading position with 24% share in our distribution at the end of fiscal '12.

Korean Prestige Beauty has experienced a sharp reversal during the last year, as consumers have been cautious with their discretionary spending, due in part to excessive mortgage debt. This has had a significant impact on Prestige Beauty, with a noticeable trend of young consumers trading down. However, Korea remains a critical focus for us, as Koreans are passionate about high-performance beauty products, luxury brands, and the quest for flawless skin, making this market a driver of innovation and product competitiveness.

In this challenging climate, we're investing in innovation and focusing our in-store execution on High-Touch experience. We are cautiously optimistic that Korea will stabilize or rebound, as it has done before following periods of uncertainty.

In Japan, the beauty business remains challenging. And in fiscal 2012, Prestige Beauty is estimated to have grown only marginally in our distribution. Fiscal year-to-date, Prestige Beauty remains relatively soft, although we are encouraged by our recent performance, with growth across most of our brands and share gains in our distribution in the last few months.

Japan remains a strong strategic focus for our Company, because we believe that the country will remain the largest worldwide for Prestige skin care and makeup combined 10 years from now. It is also home to the most educated and discerning skin care consumers, leading to innovation in product performance, services and package design.

We have the largest share among foreign Prestige Beauty companies, although Japan remains dominated by local brands with significantly wider distribution. However, a credible network of Prestige Beauty specialty retailers is developing in high-traffic train station and malls, offering younger consumers open-sale shopping with assisted sales service. We are very encouraged by this recent development, as it will help strengthen our ability to recruit new consumers.

We created our own affiliate in China slightly over 10 years ago, although we have been present in the market since the mid-'90s with the Estee Lauder and Clinique brands. We now sell 14 brands in China and have over 3000 local employees. China today represents about 30% of the region's business, and has grown on average 33% annually over the past three years.

The Estee Lauder brand is the largest Prestige brand in China in its distribution. And our combined portfolio had a 26% share in fiscal 2012, an increase of 340 basis points from fiscal 2009, according to external sources. Beyond the expansion of our brand portfolio in China, we are increasingly capturing consumers' eagerness for Prestige Beauty brands and services across new distribution channels like Sephora, freestanding store, and e-and m-commerce. Online capability spans about 350 cities, and both this geographic reach and our online sales are expanding rapidly.

Since fiscal 2009, we have doubled the number of Chinese cities where we have a brick-and-mortar presence from 33 then to 66 cities today. This has come from department stores, the fast-expanding Sephora distribution, and increasingly, our own freestanding stores. In fiscal 2012, our growth in China was 8% inorganic, like door sales, [when] additional 16% was contributed by distribution expansion. Large numbers of emerging consumers are entering the Prestige category in secondary and tertiary cities, while consumers in Tier 1 and mature Tier 2 cities migrate increasingly towards buying online and when they travel.



Traveling Chinese consumers will remain a strong source of growth for our business across Asia in many of the other High Street destinations around Europe and North America, as well as throughout our global retail travel retail network. In the second quarter, our retail business in China remained healthy, with like door growth of 6% and total growth of 28%, including distribution expansion. This performance also reflects increased TV advertising behind key franchises for Estee Lauder and Clinique as part of the Company's commitment to continuously invest in important growing markets.

The Estee Lauder Company needs its focus on winning with consumers in the Asian markets. Skin care and face products command the lion's share of Prestige Beauty consumption, with an estimated 80% of the Prestige Beauty sales in the region. This is clearly a priority and one of our strengths. Our significant capabilities in product development and blue sky innovation, particularly at our R&D centers in Tokyo and Shanghai, are focusing on creating more products in these segments, with a strong emphasis on local consumer relevance backed by increasing investments in consumer insights.

Although we started long ago offering Asian consumers specific products that meet their unique beauty regime expectations, like brightening and spot correcting solutions, we have reinforced this commitment by significantly increasing the depth of our Asia-centric product assortment across all our brand. As an example, in fiscal 2012, 20% of the Estee Lauder brand's Asian sales came from franchises developed for the region, such as Nutritious and Cyberwhite. And more recently, we went a step further by creating a locally researched and produced premium skincare brand, Osiao, which was launched in Hong Kong this fall.

The preeminence of our demonstration led distribution model in the region offers us another strong opportunity, namely to leverage our expertise in High-Touch and in-store experience, especially against mass competitors. Asian consumers have taken the lead in adopting the digital space to actively engage in social media and beauty blogging, as well as buying online. We are currently the leading beauty company in terms of the number of marketing, e-commerce and mobile sites across Asia. Most of our brands are actively connecting with consumers via Facebook and Twitter, and also on local social media sites.

Over the last few years, we've greatly expanded our regional capabilities, and we believe our proficiency in R&D, product development, consumer insights, High-Touch service, and retail expertise, positions us well to capture a greater share of future growth. We're focused on our biggest opportunities with a clear priority on pursuing various Prestige channels of distribution, emerging middle-class consumers, geographic expansion to mid-tier cities, locally relevant innovation, and new ways of connecting with younger consumers.

We also remain focused on hiring and retaining regional and local talent, and we want to become the employer of choice in Asia-Pacific. We believe the focus on talent is critical to succeed in this highly promising part of the world, just as much as we have historically done in our home markets.

Our strategy in Asia-Pacific closely mirrors the Company's priorities. So by winning in critical high-growth areas, we will help the Company achieve its financial goals. Asia-Pacific's particular focus on skin care innovations, China, emerging-market consumers, travel retail, and fast-growing channels, will benefit some of the most critical global overarching strategic goals.

Over the long term, we believe we are optimally positioned and well-prepared to continue to fully capture the massive growth in demand forecasted in this part of the world for Prestige Beauty products. With rapidly growing emerging markets expected to drive extraordinary growth in Asia, coupled with our strong leadership team and strategic vision, we expect to win across consumer segments, geographies, brands and categories.

Thank you. And now I will turn the call over to Tracey.

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

Thank you, Fabrice, and good morning, everyone. As a quick reminder, a commentary on the quarter results and the outlook for the remainder of this fiscal year excludes restructuring and other charges. As Fabrizio mentioned, we delivered sales growth during the second quarter at the high end of our expectations. Reported net sales were \$2.93 billion, a 7% increase over the prior-year period.



The effect of foreign currency on total net sales versus the prior year was de minimis in the quarter. Net earnings increased 14% to \$457 million, compared with \$401.1 million in the prior-year quarter. And diluted EPS was \$1.16. Our EPS was higher than our previous expectations, primarily due to favorable foreign exchange impact on EPS, a higher than anticipated SAP order shift into the quarter, and a nonrecurring gain associated with the settlement of the remaining terms related to the 2007 sale of Rodan & Fields, one of our product brands at that time.

As we anticipated, some retailers accelerated their orders into our second quarter, that otherwise would have occurred in our third quarter, in advance of the January launch of our third wave of the rollout of SAP, which is part of our overall Strategic Modernization Initiative, as you're well aware. The impact of this shift in this year's second quarter was an additional \$94 million in sales, and \$78 million in operating income, equal to approximately \$0.13 per share.

The prior year's second quarter also included an SAP impact, and reflected a pull-forward of \$30 million in sales and \$23 million in operating income, with the same quarterly timing affect on the third quarter. Excluding the SAP-related order shifts in both this year and last year, local currency sales would have grown 5% in the second quarter, and the related EPS would have also grown 5%. Please refer to the schedule included in today's press release for more details of these shifts by both region and product category.

Sales of skincare products rose a robust 10% in local currency and we generated strong growth in every region. New product launches from Estée Lauder, Clinique, and La Mer, in addition to continued strength in our core franchise skincare products, supported this category growth. In makeup, local currency sales rose 7%, driven by solid growth from our makeup artist brands, as well as new and existing products at Clinique.

Our fragrance business rose 5% in local currency. Double-digit growth in the Europe, Middle East and Africa region drove the overall increase, with new product launches and expanded distribution of our higher-end fragrance brands.

In hair care, sales rose 9% in local currency, as Aveda benefited from the continued success of both the new products that Fabrizio mentioned earlier, as well as expanded distribution. Regarding our geographic performance in the quarter, sales in our Americas region increased 6% in local currency. And within the Americas, the United States rose 6%, while Canada and Latin America each grew double-digit.

From a channel perspective, our North American sales to department stores grew mid-single digits. Online sales and multi-brand specialty stores rose strong double digits. Salons and spas grew in line with the overall region, and our own stores grew low-single digits.

In the Europe, Middle East and Africa region, sales increased 7% in local currency. We achieve double-digit increases in France, Switzerland, the Nordic region, and several developing markets. This growth was partially offset by continued economic difficulties, primarily in Spain, Italy and Greece, as we've mentioned previously, as well as continued declines in Russia. Our travel retail net sales rose 9%, as trade destocking in the channel began to subside, and retail sales growth rose to solid double digits in the channel, driven in part by passenger traffic increasing within the quarter.

Our Asia-Pacific region sales rose 9% in local currency. Fabrice just shared with you some of the highlights of this region, but during the quarter, China grew sharply, driven by accelerating same-store sales growth and new distribution. During the quarter, our brands added 17 doors and entered two new cities in China. Our business rose double digits in Hong Kong, while Japan growth accelerated to mid-single digits.

We continue to experience weakness in Korea, as challenging economic conditions impacted sales across most of our brands. Our gross margin increased 80 basis points to 80.7%. The increase came primarily from 40 basis points related to favorable pricing, and 40 basis points related to manufacturing variances, favorable mix, and other items. The gross margin also reflects savings of \$10 million from our cost reduction programs.

Operating expenses were flat in the quarter as a percentage of sales, primarily as a planned increase in advertising, merchandising and sampling expense of 100 basis points was offset by a decrease in general and administrative costs, and the impact of an out-of-period adjustment of 70 basis points combined. Foreign currency transactions were 30 basis points favorable in the quarter. And our cost savings initiatives reduced expenses by \$16 million in the quarter.

Operating expenses rose 11% to \$667.7 million and operating margin rose 80 basis points to 22.8%. We realized total savings of \$26 million in the quarter from our cost savings programs, and still expect to save \$50 million to \$75 million for the full year. In December, we recognized \$21.3 million



in other income, which effectively represents the sale of our contingent interest from the 2007 disposition of the Rodan & Fields brand. This was not included in our original guidance for the quarter.

We recorded \$14.6 million or \$0.02 per share in restructuring and other charges during the quarter, as we identified and finalized new activity under the program. The restructuring program closed as of December 31, 2012. For the full fiscal year, we now expect to record charges of approximately \$25 million.

For the six months, net cash flows generated by operating activity (technical difficulty) increased 7% to [\$655 million] compared to \$610 million last year. We invested \$205 million in capital expenditures, \$327 million to repurchase approximately 6 million shares of our stock, and paid our shareholders \$280 million in dividends, which was \$76 million higher than the prior year. As we have previously mentioned, we transition to quarterly dividends beginning with the current third quarter.

Days sales outstanding increased to 47 days compared to 45 days at the end of the second quarter last year. Inventory days to sell rose to 163 days compared to 148 days last year. The planned increase reflects the inventory that was anticipated to maintain service levels in advance of the SMI go-live in January.

And that concludes my remarks regarding our second-quarter and year-to-date results.

As we turn to our outlook for the balance of the year, we do expect to experience continued market weakness in certain Western European countries and Korea. However, this should be more than compensated by the strong sales growth we are experiencing in other markets. For the year, we continue to forecast local currency sales growth of 6% to 7%. We now estimate a negative currency translation impact of about 1% on our full-year sales growth.

Our estimate assumes weighted average exchange rates for the full year of \$1.28 for the euro; \$1.59 for the pound; and \$0.84 for the yen. The benefits that we will continue to experience from pricing cost savings and operating leverage are expected to drive operating margin performance improvement of approximately 70 to 90 basis points for the year. Therefore, we are raising the full-year non-GAAP EPS forecast to reflect the nonrecurring gain related to the Rodan & Fields settlement.

We now expect EPS will come in between \$2.51 and \$2.59, equal to growth of 11% to 14% versus last year. Our EPS range excludes the charge of \$0.03 related to the repurchase of debt, as well as \$0.04 for restructuring charges. For the year, we continue to expect to generate \$1.2 billion of cash flow from operations. We still estimate our effective tax rate will be between 31% and 33%.

With the impact of our orders shipped, the third-quarter sales growth is forecasted at 3% to 4% in local currency. The foreign currency translation impact on this sales growth is expected to be minimal. We anticipate EPS for the third-quarter to be between \$0.28 and \$0.32.

As a reminder, this third-quarter sales growth comparison is affected by the SAP-related pull-forward of \$94 million in orders that we spoke about earlier into the second quarter this year, and of \$30 million in orders with the same timing last year. These shifts are expected to reduce normal third-quarter sales growth by approximately 3 percentage points. EPS for the current-year quarter will be impacted by \$0.13 due to this year's sales shift versus a \$0.04 impact in last year's third quarter.

We recognize that these shifts related to both EPS as well as the cadence -- of SAP as well as the cadence of our quarterly advertising spending this year, make year-over-year quarterly financial comparisons difficult. We believe our full-year outlook in terms of both sales and EPS growth is a better reflection of the overall trends of our business.

And that concludes my prepared remarks on the quarter and the guidance for the balance of the year. We'll be happy to take your questions at this time.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jason English, Goldman Sachs.

Jason English - Goldman Sachs - Analyst

Thanks for the questions. Two questions. First, travel retail destocking, I'm encouraged by what you guys said about it abating throughout the quarter. Do you think that's at an end?

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

Yes. We see basically on the quarter I think that soon retail sales and net sales will get aligned again. That's our expectation.

Operator

Lauren Lieberman, Barclays.

Lauren Lieberman - Barclays Capital - Analyst

Just one housekeeping was, I think Fabrice said that China was 30% of Asia. I was curious if that includes travel retailers that's -- you know, as reported in China number.

My real question was more about launch activity. And I know that the strongest growth was coming from the ultra-premium brands of the super-high luxury. But is innovating and spending more money on those brands versus on Estee and Clinique, is that less impactful overall? Because the halo effect of a hit product in Tom Ford is going to be smaller than the halo effect of having a big winner in Clinique or Estee brand. Thanks.

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

I'll first answer the second question and let Fabrice answer then the first question. Is -- no, we will continue to focus on Estee Lauder brand and Clinique as much as we can. We have a fantastic innovation program for both brands in the future three years, which is leveraging our compass analysis, meaning the areas of fastest growth in the world, and leveraging our best technologies.

So there is, in no way, our investment in building Tom Ford, Jo Malone, La Mer to the next level will dilute our focus on Estee Lauder and Clinique.

Fabrice?

Fabrice Weber - The Estee Lauder Companies Inc. - President of Asia-Pacific

Yes, Lauren. The 30% was actually excluding travel retail. We were talking China domestic sales only.

Operator

Dara Mohsenian, Morgan Stanley.



Dara Mohsenian - *Morgan Stanley - Analyst*

Fabrizio, I was hoping you could give us a review of your market share performance in the US during the holiday season. It looks like some of the share gains from the last couple of years dissipated a bit based on some of the market data. So wanted to get your thoughts around holiday performance, and also what you're expecting in the back-half of the year from a marketshare standpoint in the US?

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

Sure. So, now, first of all, our -- if you look at the calendar year '12, we continued to grow market share in skin care in a very solid way. And that's been our main focus. Obviously, you need to exclude devices from the way the market is reported by NPD, because it's like putting electronic brushes in the toothpaste market.

So, looking at skin care, we are growing skin care, and that will remain our focus. Looking at makeup, we are also growing in makeup very solidly. Because, again, in the market number you see did not included all our online business and all our freestanding stores. That represents a big and fast-growing part of our MAC, particularly, business.

So we are very satisfied with makeup. And we continue to grow skin care and makeup in the future, and to grow market share. The other positive aspect is that the Prestige in general is growing faster than mass, so we'll continue to grow market share versus mass, meaning marketshare of the total market.

On our fragrance business, we had a tougher year in terms of market share. This was in part designed, because we had focus on improving the model and profitability of the sector, and also reduce the promotional level in a very big way, in order to improve profitability. This is particular to us in the October/December quarter, because as you probably know, the October/December quarter is the quarter of the year in the US where fragrances are the biggest -- biggest -- part of the market. While in the other nine months of the year, skin care and makeup are a much bigger proportion of total cosmetics.

So, yes, growing marketshare without a strong fragrance innovation program and high promotion in October/December is tougher. We have experienced that. But in next fiscal year, we have an outstanding fragrance program. We plan to come back with a more important ability to grow fragrance as well on the new better profitable way.

Operator

Wendy Nicholson, Citi Research.

Wendy Nicholson - *Citi Research - Analyst*

The first question for Fabrice, can you give us a sense -- the 6% like-door growth you saw in China, is that the right run rate for the business, do you think? Because I know it's been a little bit weaker than that over the last couple of quarters, but maybe that's just China-specific and macro-related. So was 6% a good run rate for us to forecast?

And then, I guess, a question for Tracey. The guidance for the third quarter, I think everybody assumes, is pretty conservative. But if we take you at your guidance, that implies, I think, like 10% or 11% organic growth or like-door growth or whatever, local currency growth in the fourth quarter, which seems high, given the tough comp. So are there a particularly strong number of new products launching in the fourth quarter that's going to make that quarter so good? Thank you.



Fabrice Weber - *The Estee Lauder Companies Inc. - President of Asia-Pacific*

So, Wendy, let me first remind you that the 6% like-for-like growth in Q2 comes after 2% in Q1. We certainly expect to see, on average, the like-for-like sales remain in the single-digit range. And remember that the growth is clearly expected to come from new consumers in new cities across the country.

That's simply the reflection of the fact that the mature cities in China -- Tier 1, if you want -- actually are very close in terms of consumption per capita with what you see in neighboring countries like Korea, which are very developed in terms of beauty industry. So consumers are also in those markets starting to shift towards e-commerce and travel consumption, as we have noted before.

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

Yes, on the total business, I just want to say that we believe the number is absolutely our goal in the last quarter and is doable. First of all, in the last quarter, we have a easier base period last year, because our two biggest problems, which are Korea and Russia, we are [rating] the numbers at a point in time of the year.

Second, because we have a very strong initiative program and great new launches on our main brands -- Estee Lauder, Clinique in the period. And, third, again, the increased advertising spending that will also continue in the third quarter, we believe will impact strongly the last quarter of the year; where, in the past, we were increasing advertising also in the last quarter, there will be also, further impacting the first quarter of the year after.

Now, Tracey, you want to add --?

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

No, that's it. Your assumption is correct, Wendy.

Operator

Ali Dibadj, Bernstein.

Ali Dibadj - *Sanford C. Bernstein & Company, Inc. - Analyst*

I had a question related to the pull-forwards and a couple parts. First, just to get a sense of the level of confidence you have in investments for the pull-forwards, because it's often underestimated, it seems. And I'm trying to understand whether that's actually bad or could that actually be interpreted as good?

And, in fact, if your level of confidence is high -- but I do want to go back to the share question -- the 5% underlying top line growth, [eventually] to be at best maintaining share but likely losing share globally versus your peers? And I'm trying to get a sense of whether that's a shift in luxury competition or a shift between mass and Prestige growth rates?

And then the second related part to these pull-forwards is -- and Tracey you mentioned this -- there is the chart that is in the back, I think it's like the fifth from the back, a table, that talks about the Company's top line and EPS, excluding returns and charges, and as well SAP adjustments. It was in -- it's in this quarter; it wasn't in last quarter; it was in the quarter before. And this quarter it says, look, 5% EPS growth is what we believe the underlying growth is. A couple of quarters ago it was zero.



And absolutely get it that you're not a quarter-by-quarter Company. I totally get that. But I'm trying to understand when that actually normalizes. So when should we expect that to be at a normalized run rate going forward? So lots of stuff in there, but if you can help on any of those, that'd be helpful.

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

Okay. That was definitely more than one question, but let me take the pull-forward questions, because we certainly can appreciate, as we said earlier, that it can get a bit confusing, especially since this is the second year in this quarter that we've had this phenomena.

So as it relates to the pull-forward, and the pull-forward actually being more than what we had originally anticipated, so it was indeed above the high end of our range, that actually is a good thing, I think, especially since, as Fabrizio said, the SAP go-live thus far has gone quite smoothly. So the fact that our customers were willing to take advanced orders from us, and we were able to get those shipments out, I think is certainly a good thing.

It speaks to the relationship that we have with our customers, both -- and many of those orders actually were in Fabrice's region, in the Asia-Pacific region; some in Europe and then some here in the US. So, I think that it was a good thing. And the fact that the SAP go-live went well, we are now bringing down the inventory levels related to some of the extra inventory that didn't get shipped out in the quarter, that certainly will be shipped out over the next few months.

We do have another go-live next year. So, unfortunately, it won't be as big as this year's go-live in terms of advance shipments. But it is the last major way for us at SAP, what we call Release 4, so you will see this phenomena one more year.

The normalized, as we mentioned, is really the full year. So looking at the second and third quarter is very difficult, and again, we can appreciate that. The full year, I think, gives you a better indication of the normal growth rate of the Company. And the same will be true next year, as we have this phenomena again next year.

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

And I will just to add one point, as Tracey said, normal is the full year, which is 6% to 7%. And we estimate the global market to be, in this moment, about 3%, because there are many markets which are actually declining. To be very clear, France, Italy, Spain, Greece, Portugal and Germany, have been on the declining trend, and Korea as well, as we explained.

So, yes, we believe the global market in this moment is at 3%. We are growing at 6% to 7%. We have definitely continued to grow share.

Operator

Alice Longley, Buckingham Research.

Alice Longley - *Buckingham Research - Analyst*

My question is, can you update us on the outlook for your ad ratio for the whole year and your selling ratio? Will those ratios be up, flat, or, I assume, not down for the year?



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

We don't have that information handy, and we typically don't speak to that information. So if there's another question that we can answer for you as it relates to advertising, we're more than happy to. I'm not sure if the base of your question is related to the shift in the advertising spend that we've had, which follows a different cadence of innovation and promotions this year. But we typically don't talk (multiple speakers) --.

Alice Longley - *Buckingham Research - Analyst*

Well, I'm trying to smooth out that shift, and see if your advertising ratio is actually going to be up for the year overall? And if your -- maybe you could talk longer-term, if your idea is to generally increase your advertising ratio and more than offset that with your profitability improvements?

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

Okay. So our advertising spend will be up this year. And I think we had communicated that that was the intent at the beginning of the year. What has changed this year, slightly, is just the timing. The double-digit increase in the second and third quarter that we're having in advertising spend, which will not be -- which will be more normalized again, when you see our full year results in terms of advertising spending. But it will be up this year for sure.

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

And just to add that as we said several times, in the last years, we are doing a lot of work to eliminate cost. We do not add value in the Company. And to reinvest cash to this, improving our advertising and our ability to influence the consumer. And, on top, we are doing this year we are focusing these advertising spending on the biggest growth opportunity in the world. Namely some categories in the US, China, many growth emerging markets. And building share in some of the important soft markets around the world, like France, where the market is declining and we are growing 8%.

And so that's what we are doing. And so the answer is yes, we are going to keep investing in absolute more and advertising as we take other costs out of the Company.

Operator

John Faucher, JPMorgan.

John Faucher - *JPMorgan - Analyst*

Just following up on that last question there, so the investment levels are going up. Can you talk a little bit about what you're seeing from a competitive standpoint? So on an absolute basis, spending is higher. Do you think that you're increasing your share of voice in the category at the same rate maybe as you were before? Or are we seeing a bigger increase from your competitors?

And then one housekeeping adjustment. Tracey, I believe you mentioned something about an out-of-period adjustment in the SG&A for the quarter. Was that material? Or can you give us just a little bit of color on that? Thanks.

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

So, first of all, we believe we are increasing our global share of voice on average, in general, that's with the market. But there are some of our competitors which are also increasing their spending. And so the competition is pretty tough, particularly in the big, growing markets. So this increase of advertising spending is essential.



However, I want to clarify that independently, from share of voice, the really important thing that we see in the business is just the ability to spend. Because this is bringing new consumers and transferring people from mass to Prestige. And, in turn, is what is behind the growth of the entire Prestige sector in the main markets we operate in.

So, share of voice is not necessarily the key measure of the success of advertising that we are using in this period.

Tracey?

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

And the out-of-period adjustment -- we've had a few this quarter, obviously, Rodan & Fields; but the one that you're referring to was related to an accounting adjustment, and it was about \$0.02 in EPS.

Operator

Bill Schmitz, Deutsche Bank.

Bill Schmitz - *Deutsche Bank - Analyst*

I just want to try to squeeze in two questions here. I think you said you were going to spend \$80 million of incremental advertising in the quarter originally. And then I think in the prepared comments, you said that advertisement was up 100 basis points, so that's \$30 million. I just want to make sure that's correct. And maybe why you decided to push some of this forward, if my math is right?

And then just a housekeeping item, just the sales growth ex-SAP for Clinique and Estee Lauder brands in the quarter?

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

I'll take the first one. So the -- and no, we said we spent \$75 million advertising extra in the second quarter. So not \$80 million at the end, but \$75 million. So your math on \$30 million is wrong. I don't know where this came from, but happy to reconcile it later with Dennis.

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

And while we don't disclose specifically Clinique and Estee Lauder, in the press release, we do show adjusted growth numbers by category, i.e., skin care, makeup, et cetera, excluding the impact of SAP. We also show it by region. So I would refer you to that.

Operator

Connie Maneaty, BMO Capital Markets.

Connie Maneaty - *BMO Capital Markets - Analyst*

If I heard you correctly, you said that the restructuring program closed on December 31. So could you give us what the total cost in savings of the program were and how much they exceeded the going-in expectations? And, also, what the benefit of the savings you've gotten out of that program, how they will affect 2014? Thanks.



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

So, we will still incur some restructuring charges in the balance of the year. I called out in the guidance that -- what the third quarter impact would be and then the full year will be \$25 million. So we only incurred a portion of what we had identified in the second quarter in the financial results for the second quarter.

The total restructuring charges under the now closed program will end up somewhere between \$325 million and \$350 million. So that is consistent with what we have discussed previously. And our restructuring savings related to that program are still in the area of [\$760 million] to [\$785 million].

Operator

Chris Ferrara, Bank of America.

Chris Ferrara - *BofA Merrill Lynch - Analyst*

Just a clarification and then another question. So the clarification is, can you talk about what China's growth was? I think the numbers you cited, maybe you said retail; maybe I got that wrong. But what was China's growth ex the SAP adjustment? And I mean sell-in, not necessarily retail takeaway.

And then can you just talk about some of the Western European markets? Obviously, there have been pockets of weakness there. Can you talk about the cadence there? Are those pockets of weakness getting weaker, getting stronger? Have they stabilized? And then have the places that have been more resilient in Western Europe, have you seen any deterioration there at all? Or are they staying strong? Thank you.

Fabrice Weber - *The Estee Lauder Companies Inc. - President of Asia-Pacific*

I'll just take the China net sales growth. You're right. I was actually referring to retail sales. So taking at net, the actual growth is 23.6%. And this is adjusted excluding the SMI impact.

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

In terms of -- sorry, what was -- the second question was about European markets?

Chris Ferrara - *BofA Merrill Lynch - Analyst*

Talk about how they've progressed. Like if the weak markets, have they stabilized? And then the markets that have been more resilient on an ex-SAP basis, have they remained resilient? Or are you starting to see some of those markets get a little bit weaker as you move through?

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

Okay, so, in terms of the markets, the dance, I need to divide it into three blocks. So the Southern European market, the European market, the markets are definitely getting weaker. The markets in the October/December has been negative. Many markets -- France, Italy, Germany, Greece, et cetera. So, the markets.

We have been growing in most of these markets with the exception of Spain and Greece. And so we are gaining market share. Now the best example is France, which has been a market negative in total, where we've been growing 8%, basically based on Estee Lauder, Clinique, great successful trends and our smaller brands' successful trends.

So we are doing well. The key idea here is that we seem to be able to grow and progress also in soft market and not only in strong markets. Now the exception to this story is Russia, where the market is strong and we are not doing well because of distribution issues. And we are -- we believe we have a plan to come back and restart positive trends in the next fiscal year.

Operator

Caroline Levy, CLSA.

Caroline Levy - CLSA Limited - Analyst

Would love to just think about the dynamics going on in China with online, and the potential for that to be much, much bigger than it is in other parts of the world. I'm trying to understand the margin impact. Is it purely positive? Is there any expense in building that out that makes the margin anything less than stellar?

And, also, just to understand if same-door sales are negative in the first tiers in some second-tier cities, what the impact of -- on returns and margins is from that? And, finally, do you have any sense of how many consumers you're reaching in China?

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

These are a lot of questions. I will give you, first of all, the start with online and let Fabrice answer the rest of the questions. So our online sales in our own sites in China is growing, and is an important asset to penetrate more than 300 cities, as Fabrice explained in his prepared remarks. And we believe this has a strong future. We continue to grow.

But, to be clear, we are strong, growing fast, but it is the beginning of the journey. It is still a relatively small part of our sales in China at this point.

Fabrice?

Fabrice Weber - The Estee Lauder Companies Inc. - President of Asia-Pacific

Yes, I'd just like to add that we are already six brands that, in China, are active with our own e-commerce sites. This is E without M; we are actually working on launching M as well. But the point that Fabrizio made is correct. We have seen a very, very active expansion of the demand through the channel.

Regarding your point about the Tier 1 negative retail growth, we actually have a fair amount of brands with positive retail trends in Tier 1 cities. So I don't think we should go that far in terms of categorizing Tier 1 as a declining market. It's just not growing as fast as the rest of the country. Because basically, as I said before, it has reached levels of maturity, which are very close to neighboring countries. So that's expected.

In terms of the audience we reach, I can maybe share with you the fact that through our CRM activities and our willingness to create loyalty, and work hard at retaining consumers in a market where they are still educating themselves very, very rapidly, but still educating themselves in the industry, we think that annually, we're looking at 7 million to 8 million women and a few men, we hope are buying our products across the country in the domestic context. Remember, as we sell probably twice as much to Chinese people outside China in terms of value, certainly.

Operator

We have time for one more question. Your last question comes from Mark Astrachan with Stifel Nicolaus.



Mark Astrachan - *Stifel Nicolaus - Analyst*

I'm still trying to reconcile the fourth-quarter guidance. What gives you confidence that increased ad spend can drive that kind of acceleration on the top line? And then maybe sort of related to that, what are your expectations for category growth? Is there something underlying that in terms of an anticipated acceleration? Or do you anticipate still at the low end of that [3 to 4] for the year?

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

As I said is, yes, is the increased advertising spending in the third quarter that should help the fourth-quarter, but it's also the fact that we have a very strong initiative program in the fourth-quarter on our core brands and on all our brands. And because the quarter, some of our softer markets started being soft, actually, that quarter a year ago, and so we have an easier base on this one to beat.

And, finally, we are -- there are some markets which have started recovering, and we see in accelerated growth that we are also planning to exploit at best.

Tracey, you want to -- have answers?

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

No, other than category, without giving specific information, I mean, the -- what is driving the bulk of that growth from a category standpoint and giving us confidence to Fabrizio's point is skin care, and actually fragrance. We talked about some of the strength of our fragrance launch performance, as well as some of the newer products that are continuing to expand and grow with Jo Malone and Tom Ford. So those two from a growth standpoint are driving a good chunk of the growth in the fourth quarter.

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 p.m. Eastern Time today through February 19. To hear a recording of the call, please dial 855-859-2056 and enter pass code 86189449. Again, the number is 855-859-2056 and enter pass code 86189449.

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.

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