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EL - Q3 2013 The Estée Lauder Companies Inc. Earnings Conference Call

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OVERVIEW:

EL reported 3Q13 reported net sales of \$2.29b, net earnings before restructuring and other charges of \$177.8m and diluted EPS of \$0.45. Expects full-year 2013 local currency sales growth to be approx. 6% and EPS (excluding certain items) to be \$2.56-2.61.



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PRESENTATION

Operator

Good day, everyone, and welcome to The Estee Lauder Companies fiscal 2013 third-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 Estée Lauder Companies Inc. - VP-IR*

Thank you. 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 Ivan Fernandez, President - Europe, Middle East and Africa. Ivan will give a strategic overview of this 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. Our discussion of our financial results and our expectations are before restructuring and other charges.

Tracey's discussion will also exclude the impact of sales shift related to our SMI implementation.

You can find a reconciliation between GAAP and non-GAAP figures in our press release and on the Investor Relations section of our website.



Now I will 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 third quarter of fiscal 2013, consumer demand for our Prestige brands and [innovative] products remain solid around the world. Our sales grew 3% in local currency, more than 5% excluding the advanced shipments related to our Strategic Modernization Initiative discussed with you previously and reflected in this morning's press release. And we gained share in strong markets like China as well as in soft ones such as Spain and Italy.

The key forces driving our sales were emerging markets, e-commerce, travel retail, and certain of our luxury brands. We made focused choices as we increased our immediate spending on our most promising opportunity, yet we also deferred some planned investment to the fourth quarter. Combined with strong improvement in cost of sales and our ongoing cost savings, we delivered 20% EPS growth before charges which exceeded our expectations.

With most of fiscal 2013 now behind us, we are confident we can achieve double-digit earnings per share growth for the fourth year in a row. In fact this morning, we announced we are raising our fiscal 2013 EPS guidance to a range of \$2.56 to \$2.61. Our sales growth in the quarter was tempered by continued weak economies in Southern Europe and Korea.

Additionally, in the latest rollout of SMI some short-term customer service challenges emerged which negatively impacted our ability to ship all of our orders in the quarter. We expect to have the issues resolved by the end of our fiscal year. Tracey will provide more details later in the call.

Despite these difficulties, we achieve higher sales in all three of our regions. In the Americas across our diverse portfolio, the strongest advances came from our top tier luxury brand as affluent consumers continued to demonstrate their purchasing power. Additionally, the Estée Lauder brand benefited from several recent skin care launches and our makeup artist brands enjoyed healthy retail sales.

Aveda Hair Care business rose nicely, due largely to the successful advertising behind Invati, its hero product which helps to build awareness for the entire brand.

And in Latin America, Venezuela and Brazil led our double-digit growth. In the US, our Company and the Prestige Beauty industry continued to outperform mass in the recent quarter, thanks to many of our brands' terrific product and service innovation. As a Company we grew broadly in line with the Prestige Beauty and a number of our brands gained share led by MAC and La Mer.

Our sales grew in Europe, the Middle East and Africa even though consumer spending remained sluggish across Southern Europe. Many of our brands outperformed Prestige Beauty on the strengths of their appealing products, targeted marketing and the High-Touch services they provide to consumers in all our channels.

Our business was robust in the region's emerging markets including the Middle East and South Africa. Ivan will go into more detail about the region. In travel retail our net sales have improved as the year has progressed. Our double-digit net sales this quarter were closer to retail trends and nearly twice the growth of passenger traffic. Our sales of retail grew fastest in Asia Pacific and rose sharply in China during the Chinese New Year. Other countries also benefited and saw stronger sales as Chinese consumer traveled during the holiday. Our UK business had a healthy retail performance with positive results across most brands.

For instance, Bobbi Brown enjoyed excellent sales at retail after launching a new campaign featuring the actress Katie Holmes, a trend we expect to continue. Asia-Pacific remained very positive and continues to hold terrific opportunity. Our growth at retail was robust in Greater China as we gained new consumers and broadened our presence. In China our sales at retail climbed 25%. We recently opened a new flagship store in Shanghai, its largest in the country, which features a collection of our brands. Japan continued to grow faster than Prestige Beauty although modestly, and we expect sales growth there to be positive for the full year.



Several of our brands took additional steps to elevate their profile in the challenging Korean market. Clinique, for example, created a an innovative pop-up store in Seoul, featuring its Chubby Stick products to reach new and younger consumers. The popular concept received widespread media coverage raising Clinique's profile in the country. Aveda launched e-commerce, La Mer reached out to fans on Facebook and their fans expanded into 16 more doors.

Turning now to our product categories. In skin care we continue to launch well-received innovative products. skin care remains an important strategic priority, but the category had a tough comparison to the double-digit growth over the past two years when we had several major launches.

The makeup category was driven by strong global sales at MAC reflecting outstanding product innovation and broad international expansion. Archie's Girls, its Limited Edition makeup Collection, was a huge success, selling out worldwide. The brand also opened its third global flagship store on the Champs Elysees in Paris which was backed by an extensive media and relations campaign. Consumers are responding enthusiastically to our growing network of freestanding stores and the creative service they provide.

Our improved fragrance sales were largely due to our luxury brands namely Jo Malone and Tom Ford. The recent launch of our Marni brand was well-received in Europe, meeting our expectations.

In hair care, Aveda had healthy growth reflecting strong product launches, particularly in North America and Asia-Pacific including Korea where it opened in eight department store doors.

Our online business continued its robust growth posting strong double-digit sales increases across all our categories and regions. Globally, we had terrific sales from our brand sites as well as retailer sites. We launched five e-commerce sites including our first ones in Thailand and Turkey, which are for Clinique.

As we are wrapping our fiscal year '13, we see a continuation of the macro trends that have framed our direction this year. China and other emerging markets are expected to remain vibrant. The US should see continued solid growth and Southern Europe and Korea will likely stay at current levels and provide ongoing challenges. Our investments will continue to support the most compelling areas driving our strategy, such as developing striking innovations and blockbuster launches and channel diversification through a combination of online and mobile e-commerce sites, freestanding stores and a greater presence in specialty multi-tier retail.

We also will continue to focus on the important emerging market consumer wherever she lives and along travel corridors. Reflecting these priorities, here is a sampling of upcoming initiatives. Clinique and Smashbox are introducing CC Creams with innovative technology. CC Creams, which stands for color correcting, are among the most popular new products on the worldwide beauty scene.

Zegna Uomo Scent for Men is beginning a global rollout in our fiscal fourth quarter and expect it to be a boost to our fragrance category. Our brands continue to expand their retail presence, focusing on the best opportunities. MAC expects to open nine freestanding stores, mostly in international markets, and La Mer plans to expand in Sephora's flagship locations in China and France.

Looking ahead, we expect our sales will accelerate in the fourth quarter despite some economic headwinds. For the full year, we again expect to post record sales and outpace global Prestige Beauty. With a winning team, strong innovation, substantial media investment, world-class brands and a sound long-term strategy, we plan to continue our journey of sustained sales growth and improved profitability.

Now I will turn the call over to Ivan who will discuss our business in Europe, the Middle East and Africa.

Ivan Fernandez - *The Estée Lauder Companies Inc. - President-EMEA*

Thank you, Fabrizio. I am happy to be here. I have been with The Estee Lauder Companies for 23 years. I have led the part of the EMEA that covers Continental Europe, the Middle East, India and Africa for the past five years.

My area of responsibility does not include the UK or travel retail, which are managed separately.



This part of EMEA is a diverse region of 60 countries, managed through 17 affiliates. It represents approximately 30% of the Global Prestige Beauty and Personal Care category. Within our region, fragrance represents over 50% of the Prestige category mix, followed by skin care, makeup and Hair Care.

Distribution formats vary at gross markets but perfumeries are the most important channel for us, with over 50% of our net sales mix, followed by department stores, freestanding stores, online and other channels.

We closed fiscal 2012 in EMEA with net sales of \$1.8 billion and achieved compound annual growth of nearly 7% over the last three fiscal years versus Prestige Beauty growing at 2%.

In the region overall, we gained 2 points of share in Prestige Beauty in the past three years ending calendar '12 with an estimated 13.6% share. In Western Europe, which is the largest market for Prestige Beauty, we have added substantial share. By creating a successful strategy and investing during a downturn, our sales have grown by nearly 6%, way ahead of Prestige, which has been flat. In the emerging markets our sales growth of 14% during the last three years was far above the 8% for Prestige.

In fiscal '13, we estimate our growth in the EMEA region to be a solid 5%, eight times faster than the Prestige cosmetics industry which has us slowed even further to essentially flat, allowing us to aggressively gain share in this important market at this critical time.

As you are aware and Fabrizio discussed, Southern European countries have been impacted by tough economies and weak consumer spending. Despite the difficult economic environment in Southern Europe, we continue to outperform Prestige Beauty by adhering to our strategy which I will describe later on. As an example, we are growing 7% in Italy as compared to the 4% decline in Prestige in calendar '12, and in Spain and Greece we are substantially outperforming Prestige as well.

You are aware of our challenges in Russia but our outlook for the business remains positive. We see our growth coming from developing the Ukraine and CIS and regions outside Moscow and St. Petersburg; Accelerating the growth of our brands with lower penetration, particularly with freestanding stores, and Developing e-commerce.

In EMEA we have an estimated share of over 25% in Prestige skin care and makeup combined. And we are already number one in Prestige's skin care and makeup combined, in more than half of our affiliates representing two thirds of our sales. The success we have experienced in the past few years has been a result of a change in our strategy.

This new direction started with establishment of regional office in Paris with the vision to unlock Europe's potential, drive scale and efficiency and ensure local relevance, develop new capabilities and offer best-in-class support to local affiliates.

Our successful business transformation has been based on five key strategic pillars.

One, strengthening of pull advertising especially TV and media [ads]. Two, providing High-Touch experiences and service through new navigation and point-of-sale systems. Three, focusing on key categories and developing fewer but stronger locally relevant programs. Four, acceleration of distribution expansion for our developing brands, and five, acceleration of growth in emerging markets.

I will say a few words on each one of these five strategic pillars.

The first one has been the strengthening of pull advertising, especially TV and digital. This is a critical business driver in a market dominated by generic or self-assisted service. In the past three years, we have increased our advertising by over 50% including a 7 fold rise in TV advertising, an increase of 2.5 times in digital.

Additionally, we have focused our investments behind a select number of franchises in skin care and makeup creating break-through-the-clutter programs that stand out against the competition. As a result, for the first time, The Estée Lauder Companies reached the number one share of voice ranking in prestige skin care and makeup combined in EMEA with Clinique and Estee Lauder ranking number one and number two.

We currently are one of the leading prestige skin care and makeup companies online in terms of marketing, e-commerce and mobile commerce and we continuously leverage our social media expertise to connect with our diverse consumer base. Our brands have more than 100 Facebook pages throughout the region and continue to launch e-commerce where they see opportunity. For instance, in the recent quarter, Smashbox began selling through its own e-commerce sites in Germany and Italy.

Our second strategic pillar has been to provide a High-Touch experience and service through new navigational systems. We have worked together with our key retailers to reinvent the consumer shopping experience. As a result, during the past few years we have introduced new skin care and makeup navigation units and have the strengthened service through more robust education programs and adequate monitoring via mystery shopper protocols.

Our third strategic pillar has been to focus our resources and efforts behind key categories and develop fewer but stronger locally relevant products. Some examples of this focus effort have been Estee Lauder Revitalizing Supreme, developed specifically for European woman which today is the number one Prestige moisturizer in 12 EMEA markets. And Advanced Night Repair, the iconic serum product which is the number one anti-aging serum across Europe.

Clinique gained substantial share in Prestige Anti-aging with the launch of Even Better, which currently is the leading Prestige hyperpigmentation franchise in EMEA. And Clinique's Chubby Stick franchise has made a significant impact, leading to a greater share in the lips category and makeup overall.

Other examples of local relevance have been pioneering the introduction of oud fragrance for the Middle East, with Cologne Intense from Jo Malone, Wood Mystique from Estee Lauder and Calligraphy from ADF, all important successes, and most recently Sahara Noir from Tom Ford.

We have also developed relevant shade assortments in makeup for diverse geographies and ethnicities and promoted them through local campaigns such as Shades of Africa and Shades of Arabia from Clinique.

Our fourth strategic pillar has been the acceleration of distribution expansion of MAC, Bobbi Brown, Tom Ford and Jo Malone in markets with low penetration. MAC has increased its EMEA distribution by over 50% in three years to 445 doors in fiscal '12. Today, MAC is the number one Prestige makeup brand in over one third of our markets. The distribution expansion of these brands has been done in great part through freestanding stores. EMEA currently has the largest number of freestanding stores in the Corporation outside of North America.

Last month, for example, we opened a MAC flagship store on the busy Champs Elysees in Paris which is expected to become one of the brand's largest stores in the world in terms of sales volume.

The fifth strategic pillar has been an acceleration of growth in the emerging markets. These markets, which represent about one third of our business and nearly half of the growth in our region, are at varying stages of demographic and distribution development. Our share of Prestige in the emerging markets is 17% higher than the overall region due to channel mix, lower service costs and young population. We continue to see a lot of white space and a great potential coming from these countries especially the Middle East, North Africa, sub-Saharan Africa and the CIS markets where the Prestige segment is still very small. There is a growing middle-class consumer, a young population and we have the opportunity to recruit from mass.

The transformation of our strategy required a reallocation of resources and a major focus on driving out nonvalue added costs. We have been proactive in finding savings through various initiatives, such as indirect procurement, productivity improvements and distribution center optimization. These initiatives have delivered substantial savings contributing to the outstanding margin improvement in the past three years. Our well-executed strategy has enabled us to outperform Prestige Beauty and gain share in both Western Europe and emerging markets.

Looking forward, we remain cautiously optimistic for Prestige Beauty in the EMEA. In Western Europe, we still see relatively sluggish market for the remainder of calendar '13 and we expect that the emerging markets will maintain their high single-digit growth.



Looking at the Prestige Beauty landscape, we forecast a strengthening of the leading brands as well as a proliferation of new brands entering the market especially in makeup. We believe that the aging of the population will drive growth in the skin care category where we have a leading position. We project makeup to grow at a faster rate than overall beauty with continued innovation and new brand entries. These trends will benefit our makeup artist brands and our newest makeup brand, Smashbox.

Within fragrance, we expect an acceleration of ultra Prestige brands where we have a stronger position. This subcategory represents approximately 11% of the Prestige fragrance mix in Europe at already 18% in France and is growing at double digits. And we see high end hair care developing nicely, particularly in retail, albeit from a small base.

We will continue to improve on our strategy. Our primary focus will remain on skin care and expanding our makeup business while strengthening our local relevance, initiatives and innovation. We also plan to accelerate the rollout of our brands with low penetration.

We will take a more active role in fragrance where we plan to increase our growth rate through an acceleration of our ultra Prestige portfolio of brands such as Tom Ford, Jo Malone, Marni, and Essenze di Zegna collection.

In the mainstream selective fragrance area we are evolving our strategy with the ambition of achieving a top 10 Prestige ranking in selected programs in key markets in both sales and investments. The first example of such an approach is the current launch of Zegna Uomo.

We believe we are very well-positioned to capture a greater share of future growth. We are focused on our biggest opportunities with clear priorities and have the most talented and passionate teams in the industry. We are confident that our strategy will allow us to be a winning company in all categories to continue growing at a faster pace than Prestige Beauty and deliver sustainable profitable long-term growth.

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

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

Thank you, Ivan, and good morning everyone. Reported net sales in the third quarter were \$2.29 billion, a 2% increase over the prior year period. Excluding the impact of currency translation, our net sales rose 3%. Net earnings before restructuring and other charges increased 19% to \$177.8 million compared with \$149.2 million in the prior year quarter, and diluted EPS was \$0.45.

EPS was higher than our previous guidance range, primarily due to the timing of some marketing and other activities as well as a lower tax rate in the quarter. As you are aware, our third-quarter sales growth was affected by the pull forward of orders into the second quarter in advance of the January roll out of the third wave of our Strategic Modernization Initiative. This acceleration reduced our third-quarter results by \$94 million in sales and \$78 million in operating income, equal to approximately \$0.13 per share.

The prior year's third quarter also included a shift from our second wave of SMI of \$30 million in sales and \$23 million in operating income equal to \$0.04 per share. Excluding the shifts in both years, local currency sales would have grown by more than 5% for this year's third quarter.

Please refer to the tables and text included in today's press release for more details of these shifts by both region and product category.

As Fabrizio mentioned, some challenges emerged later in the quarter with the latest wave of SMI. We rolled out to seven additional countries in January and that went well. Global supply planning also went live, integrating our overall supply planning processes with locations where we have implemented SMI. We experienced some difficulties with the additional complexity contained in this launch, and in the short term, it has led to some customer service delays and certain products being briefly out of stock. We rapidly began fixing the situation when it emerged and have made good progress thus far.

In fact, the initial issues are addressed and we expect full resolution of them by the end of the fiscal year.

These challenges contributed to the third-quarter sales growth coming in at the low end of our guidance range. To ensure the best possible outcome of the next wave four, which had been scheduled to occur in January of 2014, we have decided to defer the next rollout by six months.

Separately, in last year's third quarter we established a \$16 million provision for returns related to changes in US sunscreen regulations. This charge aided sales growth this quarter by less than 1 percentage point. The provision was reversed in our fourth quarter last year when the regulations were deferred.

To get a true picture of our underlying business performance, all of my commentary on the third-quarter financial results excludes the impact of the SMI shifts I just reviewed as well as restructuring and other charges.

Geographically in the quarter, sales in our Americas region increased 4% in local currency. Latin America saw strong double-digit growth and North America rose approximately 4%. The prior year sunscreen returns provision that I just mentioned added more than 1 percentage point to the Americas growth in the quarter. From a channel perspective, our North America sales at retail were strong, led by multibrand specialty stores, online, department stores and our own freestanding stores.

In the Europe, Middle East and Africa region, sales increased 5% in local currency. We achieved double-digit increases in the Middle East and South Africa. Our travel retail sales rose 11%, slightly below the retail sales and driven by both increased passenger traffic and increased conversion. This growth was partially offset by continued economic difficulties primarily in Spain and Greece. Of the other major markets in the region, France and Switzerland declined slightly while Italy grew approximately 2%. In the UK, net sales growth was flat to last year, but grew 10% at retail as certain UK retailers reduced their trade stock levels, given the continued uncertain economic environment.

Sales in the Asia-Pacific region rose 8% in local currency. China and Hong Kong each grew approximately 27%. Thailand and Taiwan rose high single digits while Japan was up 1 percentage point.

As mentioned previously, Korea has been challenged as continued soft economic conditions combined with additional competitive pressures have impacted sales across many of our brands. Our gross margin increased a healthy 170 basis points to 80.8%. The increase came primarily from 70 basis points related to favorable cost of goods, 50 basis points from improved obsolescence expense and 30 basis points related to positive pricing and mix.

Operating expenses as a percent of sales improved 20 basis points to 67.3%, primarily reflecting favorable selling cost of 50 basis points and advertising merchandising and sampling of 20 basis points. These favorable variances were partially offset by a combination of higher stock-based compensation and general and administrative costs of 50 basis points.

Operating income rose 22% to \$321.5 million and operating margin increased 190 basis points to 13.5%. We realized total savings of \$29 million in the quarter from our cost savings programs and expect to save approximately \$75 million to \$80 million for the full year.

Our effective tax rate fell to 25.2% this quarter, primarily due to some discreet tax benefits in the quarter. We recorded favorable adjustments of \$1.7 million to our restructuring charges in the third quarter. For the full fiscal year we still expect to record charges of approximately \$25 million.

Year-to-date, net cash flows generated by operating activities increased 7% to \$934 million compared to \$870 million last year. We have invested \$306 million in capital expenditures, \$363 million to repurchase approximately 6.3 million shares of our stock and paid our stockholders \$349 million in dividends, which reflects the increase announced last fall and the transition to quarterly dividend payments beginning this past quarter.

Days sales outstanding increased by 1 day to 53 days. Inventory days to sell rose to 165 days compared with 150 days last year, primarily due to the SMI inventory build.

Let me now talk about our outlook for the balance of this year excluding restructuring. Our forecast reflects broad-based growth from product launches, marketing and service activities and retail expansion. However, we do expect continued softness in Southern European countries and in Korea.



For the year, we are now forecasting local currency sales growth of approximately 6%. We estimate a negative currency translation impact of approximately 1% on our full-year sales growth. Our estimate assumes weighted average exchange rates for the full year of \$1.28 for the euro, \$1.56 for the pound and \$0.86 for the yen.

The combined benefits of pricing, cost savings and operating leverage are expected to drive operating margin improvement of approximately 70 to 90 basis points for the full year. As Fabrizio noted, we are raising our full year EPS forecast to a range of \$2.56 to \$2.61, which is equal to solid growth of 13% to 15% versus last year.

Our EPS range excludes a charge of \$0.03 related to the repurchase of debt earlier in the fiscal year as well as \$0.04 for restructuring charges.

For the full year, we continue to expect to generate approximately \$1.2 billion of cash flow from operations and expect to invest approximately \$500 million in capital expenditures. We now estimate our effective tax rate will be between 30% and 32%.

With three quarters behind us, our full-year guidance does imply an acceleration in our fourth-quarter sales growth from our fiscal year-to-date growth of 5%. There are a number of factors giving us confidence in this result.

Greater benefits from our innovation pipeline including strong shipments of fourth-quarter launches such as Zegna's Uomo and Clinique CC Cream as well as incremental sales of products launched in the past nine months such as Estee Lauder's Advanced Night Repair Eye Serum, sequential improvement in travel retail and or comparable year-over-year results in Korea.

In the fourth quarter, we expect our advertising spending will now be consistent with the prior year's quarters as we properly support our innovation and business trends to drive higher sales.

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). Tim Conder, Wells Fargo Securities.

Tim Conder - Wells Fargo Securities, LLC - Analyst

Tracey, could you give us a little more color on the impact of the quarter from the supply-chain disruptions, whether that be total topline if you can quantify that and then any EBIT impact?

Tracey Travis - The Estée Lauder Companies Inc. - EVP and CFO

Sure. So it is a bit difficult to quantify because we certainly had product substitution that happened in the trade and, certainly, with consumers. But we believe it was worth a couple of basis points from a sales standpoint.

Operator

Javier Escalante, Consumer Edge Research.



Javier Escalante - *Consumer Edge Research - Analyst*

Good morning, everyone. I just would like to understand how you see fiscal '14 shaping in terms of your operating margin expansion target of 70 basis points to 90 basis points as you have less savings going forward and there has been a modest lift from the [A&P] spending as I understand it? So what gives you confidence that this new earnings growth target that you floated back in [August] are achievable given the difficulties that you have had in fiscal '13 to deliver your numbers? Thank you.

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

First of all, we didn't get any difficulty in fiscal '13 in delivering our margin growth numbers. Actually we are over-delivering our margin growth results. And in the last three years, we have been growing margin in a very strong way. So we plan to continue our margin growth as announced. Our target is 15.5% to 16%.

Actually we are, the way we are trending we are more likely to hit the top of our guidelines. Because as we said we have the capability to grow about 0.5 a margin point per year driven by a mix of cost savings, mix of product geography and categories and the initial impact of our SMI value creation model.

Operator

Linda Bolton-Weiser, B. Riley.

Linda Bolton-Weiser - *B. Riley & Co. - Analyst*

I was wondering if you could explain why you think that travel retail growth for you will accelerate in the fourth fiscal quarter? Is that a function of things you see in the marketplace or is that specific initiatives that you have planned for the fourth quarter?

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

It is a combination of factors. The most important factor is that in travel retail after initial destocking during the beginning of our fiscal year, the retail sales and the net sales are now aligned. Our retail sales in travel retail has been strong in double-digit all along and now that net sales are aligned to retail sales, this implies an acceleration of our travel retail sales. On top of that, travel retail has continued to be very successful with expanded distribution. We are up a bit and also travel retail sales are also depending from the quality initiatives we have in the various countries. And as we discussed, the quality of our innovation is going to accelerate and in this way is going to drive also our travel retail sales.

Operator

David Wu, Telsey Advisory Group.

David Wu - *Telsey Advisory Group (TAG) - Analyst*

Good morning, everyone. Can you update us on your distribution opportunities, including how the testing of Lauder at Sephora and Aveda at Nordstrom are performing, if you are planning to expand into more doors this year? And you also mentioned introducing La Mer at select Sephora flagships in France and China. But what other brands could you introduce into new channels? And then secondly you mentioned that travel retail sell-ins and sellthroughs are both up double digits. But could you perhaps quantify the increase there and update us on your distribution strategy and long-term door potential especially given that we are seeing more retailers open up stores in this channel? Thank you.



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

So our distribution strategy includes a continuous increase in distribution of our key brands in [Specialty mostly] around the world referring to your specific question on Sephora, US for its diluted -- the test has basically started only few, six months ago. So the test will continue and where we will [read the test], we will decide the opportunity for [expansion]. And the same for Aveda in Nordstrom. We started there recently so we are still in the middle of the test. But there are other activities going on many of our brands project we our new brands.

Ivan commented in his prepared remarks that a big part of the strategy of expanding our brands internationally and gaining new distribution is a big part also of the forecast in Western Europe.

We also are improving distribution via freestanding stores around the world. Another big driver of distribution is China where we are increasing distribution in tier 2 and 3 cities and this increased distribution in tier 2 and 3 cities is actually now getting applied to more and more emerging markets in general. For example, in Brazil, with the brand MAC.

And we are opening new geographies. We recently opened some new geographies in Africa, particularly with the MAC brand, and we are continuing expanding distribution in the geographies that we open up more recently like Vietnam and others. So -- but I want also to clarify that the majority of our growth is still coming from same doors and we are growing very well same doors so distribution is really at net extra versus the main strategy the remaining same-door strategy in general as a total company.

Your travel retail question, yes there are newer reports and particularly the travel corridors, meaning where a consumer travels and which nationality travel where has been studied in that. And so we are adjusting in our distribution to be completely relevant to the traveling corridors, to which consumer travels where and which are the [airports] which are getting the maximum success in these years.

Operator

Wendy Nicholson, Citi Research.

Wendy Nicholson - *Citigroup - Analyst*

My question has to do with the full-year sales growth outlook. I know at the beginning of the year you offered 6% to 8% in local currency terms and that is kind of your long-term target. And now it is looking like it is going to be closer to 6%, and I assume that your initial guidance was actually pretty conservative because that is the way it usually is. So I am trying to understand what the change is. How much of that is a reduction in category growth? How much of it is maybe less market share expansion than you had expected? And as you look towards 2014, do you think you need to step up again your investment in advertising in proportion to re-accelerate from that 6% level or how do you think about that? Thanks.

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

Wendy, first of all, as we explained already in the first six months, the big driver of our -- at the end forecast in this fiscal year at the bottom of our initial range, so 6 to 8, you're right, we are projecting 6. It is mainly a change in the market assumption. The 6% to 8% was accompanied by an estimate for the market around 5%. And today we believe that the market is trending more 3%. So there is first of all a difference in the market.

And then we -- so what we see, how we see the future is that we are point to accelerate our topline already in the fourth quarter. And the main driver of this is the acceleration of our quality of innovation pipeline as explained by Tracey in her remarks.

Also for us is very important, the alignment of retail sales and net sales for travel retail, and is also clear that some of our difficult markets like Korea, Russia, or Southern Europe will start hitting in our numbers probably -- we at least count on having hit the bottom or close to the bottom which means that in terms of comparable sales this will be helping that growth in the next quarter and in the future in general.



So that is the way we see it. So we are pretty comfortable with our 6% to 8% long-term range to continue to be our focus.

Operator

Bill Schmitz, Deutsche Bank.

Bill Schmitz - *Deutsche Bank - Analyst*

Good morning. Can you talk about the difference between what looks like sell-in or shipments and consumption and how long you think it is going to last? Because it seems like in pretty much every region and every bend there's a big disconnect between actual retail sales and what you were shipping in. So maybe how long you think the retail destocking lasts.

And the second part of the question is the margins in Europe or EMEA were great this quarter and I am curious if you think that level of new margin is sustainable? Is there something one-off in the quarter that drove that? Thanks very much.

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

In terms of retail and sell-in in retail, frankly this is a function of many things. It is a function of the innovation pipeline build, it is a function of the -- obviously our going to SMI that when we announced that we go to [SAP] trade react, as you know, stocking gap and then during the SAP like this time where we had some problem this was a good year because the problem has been contained also because we had some stocks. So these all manage that very carefully, and has a certain influence on the relation between the retail and not.

But the biggest influence, frankly, is the expectation on the market. There are some markets where the retailers are concerned with the trend of consumption and they become more prudent with stock and then when the concern goes away, they stock back again. And this is very different in different parts of the world. We have seen this happening in the beginning of the fiscal year in travel retail, then happening in the Southern European markets in Europe in general during this period, and so that's the way it goes. But we managed the global portfolio in a way that we try to be as aligned as possible over the long term.

Now as far as Europe is concerned, I would like Ivan to answer this question.

Ivan Fernandez - *The Estée Lauder Companies Inc. - President-EMEA*

Well, first of all today we are running our sell-out 2 points ahead of our sell-in. So they decided on this stocking that Fabrizio has mentioned. But our stocks are extremely healthy across Europe. So we don't expect -- we expect that they would [polarize] in the coming months.

Also I think it is important to mention a little bit on outlook. On Europe where we definitively don't see a lot of change in current trends so we still see some markets in Western Europe and positive development on emerging ones. However, we believe that we will continue outpacing the market substantially both in South -- Western Europe and in emerging markets. And we will do that by continued focusing and strengthening our winning strategy in the skin care and makeup by accelerating -- as Fabrizio mentioned, development of brands with still relatively low penetration in our portfolio.

And in addition we will play fragrance with great ambition and therefore we believe we will continue delivering growth in Europe in all categories.

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

Bill, it's Tracey. Lastly, I will mention regarding your commentary on specifically the third quarter and EMEA performances. As Ivan mentioned, he does not have the responsibility for travel retail or the UK. Travel retail was a big driver in the profit growth in the third quarter, given their sales

performance. I also mentioned that we had shifted some advertising that had previously been focused on the third quarter into the fourth quarter and that did impact travel retail as well. So not only did they have a great sales quarter, they had terrific cost performance that was driven by cost savings initiatives, but also we did shift some timing of advertising spending.

Operator

Alice Longley, Buckingham Research.

Alice Longley - *Buckingham Research Group - Analyst*

Good morning. My housekeeping question is will the delay in shipments take a couple of points off of sales in the fourth quarter as well? And then my more substantive question is about the nature of your innovation. You have got these color correcting creams that you are highlighting as your major new invention in Clinique and I guess to a lesser extent Smashbox. So a lot of brands have CC creams and you are not the first with one. Can you tell us why yours, particularly the Clinique one will stand out and continues your images of hero developer?

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

I will take the first part of that question. As it relates to the SMI shifts, and I know we have a lot of different shifts to talk about with respect to our performance, but as it relates specifically to the SMI shifts, there is no impact in the fourth quarter. So that shift was between the second and the third quarter.

As it relates to some of the challenges that we had with our latest SMI implementation, I mentioned that we think that that was worth a couple of basis points in the third quarter, possibly a couple of basis points in the fourth quarter. We largely have those issues behind us. We had planned for the third quarter to be our hyper care quarter to really resolve any issues related to the start-up. We have extended that a bit into the fourth quarter, but certainly are well on our way to resolving those issues and being able to move forward with our next release of SMI.

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

Yes, in terms of the innovation, Clinique CC for example is a great formula which also is having important advantages. The concept is very attractive. Clinique is the biggest brand in the US in Prestige and in total. And so when a new innovation is brought with great product, new concept by the biggest brands it has a big impact on the market and that is what we are counting on.

And by the way we have seen and also have seen our tests.

And then, there are many other innovations. For example, Estee Lauder Advanced Night Repair Eye Serum is not the first eye product on the market, but is a roaring success and it will definitely continue into the fourth quarter. And Zegna Uomo launch is a new fragrance is the first Estee Lauder big launch of a Zegna fragrance. And the initial results are exciting.

And we have innovation, obviously, of every other brand, and particularly of MAC, that are very exciting. There are also some innovations that we cannot yet discuss for competitive reasons that we are very excited for, that will impact the near future. So we are really proud of our innovation pipeline as we discussed in category.

Operator

Mark Astrachan, Stifel Nicolaus.



Mark Astrachan - *Stifel Nicolaus - Analyst*

Good morning, everybody. Tracey, one qualification. So you are talking about a couple of basis points for the supply chain. You are talking, I assume, couple of percentage points, 200 basis points of the impact in the quarter?

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

No, more like 20 to 30 basis points.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Got it. And if you could maybe give us some sort of updates on monthly sales trends. It looked like the data got a little bit better in the US, in the most recent month, you are talking about this acceleration in the June quarter. So maybe if you could talk about how the last quarter played out, what you see maybe April to date. And if you could just specifically quantify the growth rates for travel retail, China and Brazil, in the March quarter, that would be helpful.

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

So, we cannot speak about April, but what we see as we said, yes, you are right in the US in March there was an acceleration and it was a good one. And as I said we are very comfortable and confident of continuous acceleration of base innovation programs and our strong advertising investment in the fourth quarter. And not only in the United States.

In terms of the travel retail question, we are looking for --

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

The travel retail growth in the third quarter was 11%. I think you asked about China as well and shift-adjusted for SMI was about 27%.

Operator

Chris Ferrara, Bank of America Merrill Lynch.

Chris Ferrara - *BofA Merrill Lynch - Analyst*

I think it sounds like you said that advertising, merchandising, sampling were up about 20 basis points in Q3 and there was some shift to Q4. And I think you also said Q4 is more of a normalized quarter. So I guess the question is where is advertising going to come in, relative to what you thought three or six months ago? And for Q4, when you say normalize, it is because you had a heavy up investment in Q4 a year ago and we are just going to be kind of in line with that as a percentage of sales?

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

So, in -- no, we didn't say a couple of basis points. Advertising was up roughly 4% in the third quarter. And what Fabrizio said is we expect that it will be flat to last year in terms of the fourth quarter relatively flat to last year in terms of the fourth quarter.

So, overall, we expect that our advertising spend will be up mid-single digits for a full year. And that is comparable to what we had expected coming into the year.



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

And also would like to clarify one thing on advertising spending. The absolute amount of total advertising [as I mentioned via] sampling is also what has an important impact. And the absolute amount, the biggest absolute amount is in the fourth quarter. So the third quarter increased 4% in a 5% adjusted sales environment.

So to be clear, as a percentage of sales, this was down not up. And in the fourth quarter we are going to be about flat in terms of total advertising, but with the biggest amount in any quarter to support our innovation. Which means again, in terms of percentage for sales is going to be largely down.

So we are -- we have a very solid advertising [team]. And then I want to clarify on advertising the concept that our advertising mix in the quarter is influenced enormously by which brand has innovation in that quarter, which category and which region, because our advertising spending level is very different by brand, by category, by region.

Example -- if the new innovation is on MAC, there will be less advertising and more in-store investment than if the initiative is on Clinique, which would be more advertised investment and less in-store. If the launch is in China or is in, I don't know, in the European market, it will be a different level. Understand if China is more advertising intensive than some European markets and the same by category, fragrances or skin care, tend to be more advertising [investment] than make up. So it is very difficult for us to read the year by quarter by quarter progress of advertising just as -- with a normal consumer company. We depend a lot by mix of innovation and our focus is to be really delivering the maximum effectiveness in the secrecy of our innovation launches and that's the way we made a decision advertising, not absolutely by quarter.

Operator

Caroline Levy, CLSA.

Caroline Levy - *CLSA Limited - Analyst*

Good morning. Not to beat a dead horse, but in terms of looking at the acceleration of sales, according to my numbers for year ago your comps are actually tougher in travel retail and in China than they were this quarter. So I just want to be clear that you really expect those key markets will be strong despite that. And, then again, on the 15 days of inventory that's ahead of where you were a year ago, doesn't that make your challenge even greater to grow that topline the required 7% to 8% in the fourth quarter to make the full year?

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

Yes, I will take the first part of your question. Yes, we had a great last quarter also last year. And as I said we are very comfortable with our innovation program and our plans.

However, within last year, the base of last year of the countries where we had office challenges this year, meaning Korea and Russia, were lower in the last quarter. So in this sense we have an easier comp where we had challenges and we have a challenging comp where our business is anyway very strong and will be accelerated by innovation. Tracey?

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

And the extra 15 days of inventory assuming that it is the right inventory actually helps us from a sales standpoint. As we see an acceleration of sales, we expect to draw down on that inventory.



Operator

Ali Dibadj, Sanford C. Bernstein.

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

So, it seems like you have been very careful about the language which you are using around market share whether it be in the prepared remarks or on the press release. And given that skin care grew about 3% adjusted given that the Americas is only about 4%, can you give us a sense of a few things? One is what was your market share globally so what was the change in and two, to come back to this question of are you spending enough? You [choose your word] distribute so you over-delivered on margins, I think you'll probably continue to do that. But I think at least to some expectations, topline was a little bit tougher. So can you just give us a little bit more confidence about that?

And the last thing is, I think, part of your answer will probably be about the category growth rate slowing. Do you have any insight on what was driving that growth between price and volume and mix? Because when you look at your peers, you don't see as much of a slowdown.

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

So, internal growth, again we have a plan over the long term of 6% to 8% growth every year. And as I said, there could be years where we are at 6 or 7 and years where it will be 8. 6 to 8 is our ability to grow. We have a strong innovation program for the future we believe will be in this 6% to 8% growth.

The big change was the market estimate this year. This market was supposed to grow about 5%. We estimate the market will be growing at about 3% and that is why in this fiscal year we forecasted to end that at the lower part of our range. We believe that this quarter the quarter four will accelerate this and we are confident in this acceleration.

Sorry, the second part of your question?

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

Can you repeat the second question?

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

(multiple speakers) second part advertising spending which I --

Operator

(Operator Instructions).

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

Yes, the second part was around the over-delivering that you are clearly doing and will probably continue to do on margins. But a little bit less than expected on topline. Particularly versus your peers. So, again are you spending enough question. And to your point about the category growth being what is slowing a little bit if you could give us more insight on whether that is pricing or volume or mix that would be helpful.



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

Yes. In terms of pricing our -- there is about 2 points of pricing in our sales. And that's been also consistent in the last years. And we do not expect this to change in a very significant way.

In terms of growth versus competition, we are growing at 2 points at least above market. So we are growing global market share. We are growing global market share in some markets more than others. In the US, we have -- for example, we are stable in market share this year, in makeup, skin care and we are losing market share in fragrances and in fact we are going to have to, now, an acceleration innovation in skin care, makeup to [axillary] growth and we are going to be more active in fragrance, to start growing also in the fragrance category.

I would also want to point out, for example, in the US, that the overall market grew 12% versus mark -- mass growing at 1%. So we have about 40% market share in the US. So the double-digit growth of the Prestige market in the US that we are generating with our activity is benefiting first of all us. So even in the context of a stable market share for some months, this is still very beneficial and is still the right strategy to continue to source and from nothing grow the category as a whole where we have a big market share.

In markets where we have smaller market share like Europe you just heard Ivan comment where market share gains has been spectacular in markets like Italy, where the market is minus 5%, we have been growing 7%. Again this is by choice. Because since the euro we have at 13.7 market share we are aiming at growing market share, taking advantage of the recession here, so to enjoy bigger market share later. And then in emerging market we are growing market share very aggressively everywhere. In China in the last quarter we counted we have grown 1 full market share point as an example.

So we keep growing market share overall and in the selected market with very specific strategy by markets which depends by the level of market share in that market, and that is what drives our strategy.

In terms of advertising, are we investing enough? I think we have basically doubled the level of media investment over three years. I believe that's been one of the major elements of our restructuring. We have taken as you all know a lot of costs out of the system and we have reinvested part of this in creating the right level of media investment for the Company. The Company needs to expand globally. I think I feel very comfortable with the level of advertising power that we have reached at this point in time, and from now on, we believe we can continue driving media updates on sales growth while internal percentage of sales, we are in the range of our ultimate goals.

Operator

Lauren Lieberman, Barclays.

Lauren Lieberman - *Barclays Capital - Analyst*

So, I wanted to clarify, particularly I apologize because I am not that bent out of shape about market share, but I think you just said that US procedure was growing 12% and I noticed this quarter, North America was up [4]% so that doesn't suggest shares are stable. I don't know if a lot of that is from fragrance or what the dynamic is, but that is just a clarification point.

My real question was more forward-looking just about innovation. So I'm hopeful this isn't the one you didn't want to talk about, but the relaunch of dramatically different moisturizer because I have read about it in the media and I thought that it was slated for June and it looks like it is now coming in August. So is that correct and kind of the thing that gets pushed into next year? Was it potential meaningful launch activity? Then also on La Mer, the sun care launch, I think that is really interesting and you didn't mention it. Is that sort of a softer initiative and build through the summer or is it a lay the groundwork now? It is more of a push for next year's sun season.

And then finally on the CC Cream for Clinique. I have seen a lot of advertising so I just didn't know if it had the real push started and it has really been late March into April so that is why it impacts Q4 more than Q3. Thanks.



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

On the US NPD, sales 12% in the last March and so is -- I would just indicate in these as how much mass Prestige is growing more than mass. And we have been growing also at retail very, very well in the March month as you probably know from NPD data.

In terms of our big initiative on Clinique that you mentioned, yes. This is a big initiative and we are doing it in the moment we believe is the right moment from a competitive standpoint in every market. So if we are continually adjusting launch dates and activities, it is based on our decision by markets and our competitive decisions more than anything else. Yes, this is going to be a very important initiative for us and we believe it will be a successful one.

And then in terms of La Mer, yes. This has been recently launched and obviously this is an important initiative for La Mer summer. And for the La Mer brand this is going to be an important initiative. The specific SKUs are not going to be significant in the context of the total Company, but very important for the La Mer brand.

Operator

That concludes today's question and answer session. If you were unable to join the entire call, the playback will be available at 1 p.m. Eastern time today through May 16. To hear a recording of the call, please dial 855-859-2056, passcode 520-45-999.

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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