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EL - Q4 2013 The Estée Lauder Companies Inc. Earnings Conference Call

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## OVERVIEW:

Co. reported 4Q13 net sales of \$2.41b, net earnings of \$96.8m and diluted EPS of \$0.24. Expects FY14 constant-currency sales to grow 6-8% and EPS to be \$2.74-2.87. Expects 1Q14 local-currency sales to grow 5-7% and EPS to be \$0.67-0.71.



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## PRESENTATION

### Operator

Good day, everyone, and welcome to the Estee Lauder Companies fiscal 2013 fourth-quarter and year-end 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.

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**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 Daniel Rachmanis, President of Latin America. Daniel 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 will 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. You can find a reconciliation between GAAP and non-GAAP figures in our press releases and on the investor relations section of our website.

I will turn the call over to Fabrizio now.

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

Thank you, Dennis, and good morning, everyone. I'm pleased to say that for the fourth consecutive year our winning strategies steered our Company to new highs of success. We delivered strong results in fiscal 2013 with solid sales gains and double-digit EPS growth and our improvement was broad-based. Every product category grew in every region. This performance enabled us to gain share in global prestige beauty and strength in our industry leadership.

We delivered these results despite challenges in several important international markets and slower growth in the US. Yet overall our brands thrived thanks to well-received product innovations, personalized high-touch service, and compelling advertising.

Our sales rose 6% in local currency, 2 percentage points more than prestige beauty did worldwide and EPS increased 16% to a record \$2.64. Most of our brands contributed, fueled by targeted investment behind products in fast-growing channels and countries.

We improved our leverage of consumer insights and our digital reach, which helped us connect with consumers of widely differing backgrounds in more than 150 markets including many who were new to our brands. We appealed to global consumer to local lengths with products and communications tailored to their desires and customs.

By focusing our resources on our biggest and fastest-growing opportunities across consumer segments, categories, channels, and countries we achieved record financial results and hit some major milestones.

In fiscal 2013, our sales topped \$10 billion for the first time in our history. Globally we gained 30 basis points of share with gains in skincare and makeup and in Asia Pacific, Western Europe, and Latin America. By maintaining our financial discipline, we leveraged the higher sales and grew operating margin to an all-time high of 15.2%. Net earnings passed the \$1 billion mark for the first time. Our total stockholder return was 23.7%, which was better than the S&P 500.

From a brand perspective, the standouts during the year were our luxury brands, La Mer, Jo Malone, Tom Ford, which together grew about 20%. La Mer new moisturizing soft cream helped drive the brand total sales and attracted new consumers. We believe that more than 50% of people who bought the soft cream were new to the brand and the product lifted sales of the brand's moisturizer category 30%.

Combined, our three largest brands grew 5%. Estée Lauder and Clinique gained share globally in both skincare and makeup while MAC enhanced its position in makeup. The Estée Lauder brand generated double-digit growth in travel retail and Asia. Clinique's fastest growth was in North America and MAC business grew sharply in every single region.

In Latin America, MAC's makeup collections have been gaining in popularity and across the region, it is our number one brand.

All of our categories advanced but skincare was the fastest growing and most profitable. Our overall growth continues to be supported by innovation. 16% of the Company's sales came from innovations and new products. We believe our newest products have great potential and expect more of sales this year to come from fiscal year 2014 launches.

Prestige beauty gained over mass in several countries including the United States and China. Several of our brands gained share in North America and our brands had the top nine SKUs in skincare and the top five in makeup according to NPD.

We gained share in China, where our 14 brands collectively grew 23% as well as in Asia overall. Estée Lauder, the prestige beauty leader in China, gained share and Clinique made terrific progress, also increasing share in its distribution. We had an encouraging year in Japan where our business



continued to recover and we gained share in our distribution. As we have discussed throughout the year, Korea was challenging and our domestic sales there fell sharply.

Our region covering Europe, the Middle East, and Africa grew overall with emerging markets such as the Middle East expanding double digits. We again demonstrated our ability to achieve growth in strong markets as well as soft ones. In the UK, prestige beauty outpaced mass and we experienced healthy sales growth and share gains. And in Italy, where prestige beauty declined, we had robust sales due to strong innovation and new door openings.

Through a wide range of prestige distribution channels worldwide, our brands are able to reach consumers in the most engaging and appropriate ways by region and country. One of our big wins was e-commerce, where we again had significant growth and crossed a milestone. Sales surpassed \$0.5 billion. Sales rose in both our own brand sites and retailers' sites.

Travel retail started out more slowly than we had anticipated as sales growth accelerated throughout the fiscal year. Our retail sales outpaced total beauty sales in the channel and we have tripled the pace of passenger traffic.

Having now completed four successful years of our long-term strategy, let me give you a sense of our progress. Sales have climbed 40% and our operating margin more than doubled. We completed a four-year restructuring program saving \$781 million, which was more than 50% greater than the original forecast. Some of that savings along with better managing the growth in expenses freed up substantial resources to invest in advertising and marketing.

Since 2009, we have increased advertising, merchandising, and sampling by almost \$900 million, which went to developing creative print, TV, digital advertising, and exciting in-store displays. This model has created greater awareness for our brands and helped lift sales significantly. We are confident that the next phase of our strategy will allow us to continue growing sales and profits, enabling us to set a new long-range operating margin target of 16.5% in fiscal 2016.

As we start this new fiscal year, we will stay the course. We are guided by our strategy, which remains solid, and we are making some refinements based on changing market conditions and new insights. We foresee stable global prestige beauty growth, increasing approximately 3% to 4%. We believe Southern European markets will remain soft and Korea will continue to decline but not to the same extent as last year.

Starting in our recent fourth quarter, we have seen slower prestige beauty growth in the US. Despite this challenging condition, we still expect to grow at double the rate of global prestige beauty. We are positioned to maximize the potential of the power of our brands and estimate constant currency sales gains of 6% to 8% this year.

To fuel that growth, we will exploit our best opportunity for our brands. They are to win in large markets and in core department store channel, further penetrate smaller cities in emerging markets, create exciting innovations, be locally relevant, re-energize the fragrance business, advance our retailing concept, and gain in high-growth channels.

To expand our leadership in our heritage markets, we plan to look for granular opportunities to target multiethnic consumers more effectively because they are expected to drive the majority of prestige beauty growth through 2020. In the US and the UK, we will continue to work with our important department store customers to refine our assortment to reflect regional differences in trend, consumer ethnicities and distribution.

China is expected to remain one of our fastest-growing markets as we continue to expand distribution to smaller cities. We have made progress with our skincare business in China and we raised awareness and educated consumers about our makeup and fragrance offering. Skincare will remain our biggest opportunity since it is used by 94% of Chinese women. Long-term, we see good potential to build up makeup which is only used by 16% of Chinese women regularly today. And also fragrance, which 47% of Chinese women use only occasionally.

As part of that effort, we recently brought Zegna into China and Jo Malone will launch this fiscal year.



We also plan to broaden our presence in smaller cities in other emerging markets, including the Middle East and Russia, as we diversify our distribution and introduce more locally relevant products. This promises to be a major year for attention-getting innovations and our two biggest brands already have launched blockbuster products.

Clinique Dramatically Different moisturizing lotion commonly known as DDML is the best-selling prestige moisturizer in America. Now Clinique has created the first reformulation since the original product was introduced 45 years ago. The new product called DDML+ features new technology and much enhanced moisturizing benefits but has the same look and texture.

Estee Lauder's major global launch is a new version of its iconic Advanced Night Repair that combines the latest technologies to create its most advanced serum. The new ANR will continue building this important franchise. In conjunction with the launch, the Estee Lauder brand commissioned a clinical sleep study that showed poor sleep quality negatively affects skin function and appearance and can weaken the skin's natural repair capabilities. ANR helps maximize skin's natural nightly repair processes and helps women wake up to younger looking skin.

Both of these new products are being heavily supported with major advertising investment including TV in many markets, which should help with sales momentum in coming quarters. These blockbusters illustrate our intent to create fewer but bigger launches mapped to the largest market and consumer opportunities.

We have many other innovations that will debut these coming months some based on new technologies, other on local insights, and they span regions, categories, and brands. Some of these new products will be fragrances, which we are giving increased attention and intend to grow more rapidly this year. Fragrance represents about one-third of the worldwide prestige beauty sales and is expected to be the strongest area of industry growth after skin care.

We believe it can be a larger and more profitable opportunity for our brand as well, particularly in emerging markets such as Latin America and the Middle East. In the past few years we focused on improving fragrance profitability. Today we are well-positioned to resume faster growth, leveraging the new cost structure we have implemented.

We have many activities underway to expand our share in the fastest growing and profitable ultra-prestige segment. Tom Ford is expanding distribution particularly in the European region and will introduce a collection of four private blend scents designed for the brand entry into Asia.

Also in the luxury area, we expect Jo Malone global popularity to continue sending its sales up sharply. The Aerin brand will launch its first scents in November in a five piece upscale collection to be sold in select specialty stores in the US, Canada, and the UK.

Marni and Zegna, recent additions to our portfolio, will expand their geographic presence and another newcomer to our fragrance portfolio, Tory Burch, will launch next month.

We expect our Aramis and designer fragrance division to grow double digits and to strengthen its designer brands including Donna Karan, Coach, and Tommy Hilfiger. With Michael Kors' success in apparel and accessories along with our new launch activity, we believe our sales of the brand fragrances will also strongly accelerate. We will build scale and profitability in ADF by optimizing its portfolio by region and business model.

In our third fragrance pillar, those that are part of our beauty brands, Estee Lauder will begin rolling out Modern Muse in September to the US, UK, and certain other markets. This marks its first major fragrance launch in a decade. Timed to take advantage of the important holiday season, Estee Lauder will generate buzz with an extensive TV, print, and digital marketing campaign.

On the retail front, we intend to leverage MAC's expertise with freestanding stores, develop new concepts, and strengthen our high-touch services as we open more stores globally for many of our brands. Freestanding stores selectively complement our wholesale business and in some regions of the world, we are building equity for our brands that traditional retailers can then build upon.



We are trying to create a more cohesive experience for consumers with engaging merchandising across retail and wholesale locations. Our brands are approaching freestanding stores in various ways. MAC for instance has created several different store formats that vary by size, location, and target consumers that allow it to maximize its penetration. For example, Aveda will expand its presence in Japan and Korea with its own stores.

We are the leader in prestige beauty in e and mobile commerce with sites across 20 countries. In fiscal 2013, we had triple digit growth in mobile sales and site visits. This year we will launch E&M commerce operation in new markets including Poland, Israel, Malaysia, and Taiwan and several brands will expand their digital sales to much more countries.

Travel retail business is expected to increase double digits as we capitalize on the growth in skincare in Asia, focus on opportunities in makeup and accelerate our widening fragrance portfolio with key franchises in trial corridors.

We are well situated. Prestige skincare and Asian consumers are the fastest-growing segment in the travel retail channel and they are our areas of strength.

We continue to improve our social media skills and find exciting ways to engage consumers. A dramatic example of this was in May, when MAC created an online-only event to sell a coveted Rihanna lipstick. The brand sold out the collection online in North America in less than three hours and the only way consumers heard about the sales was through email, social media, and MAC's E & M commerce sites, not a penny was spent on traditional advertising. We are looking forward to two more MAC Rihanna collections that will launch this fall. They will have an online component and be available in stores.

We have always been a growth company but over the past four years, our mission was to make that growth more profitable and sustainable and we clearly accomplished that goal. Having established a firm foundation, we are in an even better position today to focus on our topline growth with the added advantage of having greater advertising firepower to ignite our brands and promote their latest innovations.

With our creativity and innovation, a wide geographic reach and the ability to react swiftly to the best opportunities worldwide, we believe we can continue growing faster than prestige beauty. At the same time, we continue to improve our operational capabilities so that we can further enhance our service to our retail customers as well as our consumers.

I am extremely proud that our Company has achieved such important historic milestones and we couldn't have done it without the constant hard work and dedicated efforts of all our employees. I want to thank them for believing in our vision, executing our strategy so well, and making the Estee Lauder Companies what it is today.

Now I will turn the call over to Daniel.

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**Daniel Rachmanis** - *The Estee Lauder Companies Inc. - President, Latin America*

Thank you, Fabrizio, and good morning, everyone. I joined the Company in 2007 after 20 years in the industry. I was chosen to lead our newly established Latin American region in 2009 in order to build on our Company's 50-year history there and capitalize on the promising opportunities we see now and in the future.

Our first priorities were to strengthen the teams in our five affiliates and develop best in class regional capabilities in finance, supply chain, human resources, consumer insights, digital, and store design. We have made good progress in all these areas.

Today the Latin America region includes 17 countries from Mexico down to Argentina. Since this regional structure was created, we have doubled our net sales to approximately \$260 million totaling approximately 3% of the Company's sales and we have enjoyed a compound annual growth rate of 22%.



In fiscal year 2013, our sales growth was 11%, twice the rate of prestige beauty in the region, driven primarily by Brazil and Peru. We view Latin America's role in the geographic portfolio of the Company as a profitable engine of growth. We have grown sales and will continue growing twice as fast as the average of the Company while at the same time being accretive to the Company's profitability.

Also the investments we make in Latin America drive awareness for our brands among the millions of regional consumers who then buy our products in profitable channels such as travel retail and in destination cities across the United States and Europe. We estimate that for every dollar we sell in Brazil, for example, we sell another \$1.50 in travel retail and North America. With the strong results we have generated, we now have a solid platform for additional growth in the coming years.

To give you a sense of the possibilities that lie ahead, today we sell only 10 of our brands in the region and not all are sold in every country. In fact in Brazil, one of the fastest-growing beauty markets in the world, we sell only Clinique, MAC, Tommy Hilfiger, Donna Karan, and Michael Kors. We see terrific opportunity for additional brand expansion.

Latin America is a \$24 billion beauty market and the fastest growing among all global regions with a 10% CAGR in the past four years. However, 89% of the market is mass. That said, the prestige category has been growing faster than mass as millions of people have joined the middle class. In fact, Latin America's middle class has increased by 50% in the last five years to 165 million people. We believe we can convert many people in the new middle class to our aspirational prestige beauty products.

Within prestige beauty, fragrance and makeup are growing the fastest in the region since they represent an entry into the luxury market for the aspirational mass consumer. The growth of prestige beauty is also being driven by new distribution channels such as specialty multi and e-commerce.

From a category standpoint, fragrance accounts for nearly half of the beauty mix followed by makeup and skincare. Over the past couple of years we have become the number one player in the still small prestige makeup and skincare segment with a combined share of 54.2% for the 12 months ended March, up 230 basis points from the year earlier. This strong performance provides us a solid base to continue recruiting emerging prestige consumers from mass.

On the contrary, we are still very underpenetrated in the larger prestige fragrance categories so we see a strong opportunity for growth in that area as we roll out new franchises and increase our advertising. In coming months, we will launch Uomo by Zegna in Columbia and Brazil, the new Michael Kors collection in Brazil, and Tory Burch in Mexico.

Brazil is the number one fragrance market in the world yet we also see promising opportunities in other categories. For example, Brazil is the second largest global market for hair care products and we believe one or more of our hair care brands could do well there, so we are exploring our options.

Naturally-based products are also extremely relevant to Latin consumers. We just opened our first Origins counter with our partner, Liverpool Department Stores in Mexico City. Given the excellent initial results, we plan to expand to 50 doors in the country over the next five years.

In terms of distribution, across Latin America the largest channel is door-to-door at 50%, followed by supermarkets, perfumeries, department stores, and pharmacies. But the channel mix is different from country to country. Department stores are the strongest players in prestige distribution in the region and they represent 53% of our business. Perfumeries represent 10%.

Freestanding stores are a fast-growing channel for us and MAC's retail stores account for 20% of our total distribution mix, mostly in Brazil.

With our leadership structure firmly in place and a clear view of our growth potentials, we have developed a robust strategy with several strategic pillars to accelerate our business. Since we already lead in the prestige segment, our largest growth opportunity will continue to come from sourcing new consumers from mass. We will accelerate several proven and successful initiatives to increase trial and loyalty among emerging prestige consumers including greater accessibility of our products, better pricing awareness, flexible payment options, smaller sizes, and value of reframing.

Similar to many other countries, we know that many aspirational consumers live in high-growth secondary cities, particularly in Mexico and Brazil. We intend to increase our investment in those areas through more profitable and cost-efficient formats including freestanding stores.





In Brazil, MAC's 30 freestanding stores provide a profitable base for growth. That's why we plan to expand MAC's geographic presence in Brazil to 50 stores in 30 cities by fiscal 2016. We are also opening the brand in three new countries this year, Ecuador, Uruguay and Paraguay.

The second pillar of our growth strategy is developing the right distribution channels by country. While we expect to continue winning with our traditional department store partners, we also plan to lead in fast-growing emerging channels, namely e-commerce and specialty multi. We launched our first brand e-commerce site two years ago for Clinique in Brazil and sales have steadily grown. Later this year, we plan to unveil our second e-commerce site in the country, this time for MAC.

Looking further out, we expect to launch e-commerce in Mexico and Chile in fiscal 2015. We also have 10 marketing sites for our brands throughout the region and they have a local presence on Facebook, Instagram, and Twitter in many markets.

The specialty multichannel is changing the retail environment and creating new distribution opportunities for our brands. For example, Sephora is rolling out more stores in Mexico and Brazil and Smashbox, Clinique, Bobbi Brown, Estee Lauder, and our fragrance brands are leveraging this new distribution.

Another critical component to our continued success will be the further development of the freestanding store channel. Our retail stores allow us to build brand awareness fully express brand equity, and provide high-touch services to our consumers. They also serve to recruit and educate the new consumers we want to capture in advance of the arrival of traditional retailers.

We currently operate 37 of our own stores and another 43 are run by our partners. In the next three years, we expect to double the total number including stores for new brands such as Aveda and Jo Malone.

The third pillar of our growth strategy is our portfolio management by country. We are tailoring our go to market model according to the potential we see in each specific country. In Mexico, a well-established core market, we are the number one player in prestige beauty. The key to our success has been our ability to develop relevant concepts and products such as specific foundation shades for Latina consumers and special skin care products for oily skin. MAC's waterproof mascara and color collections have resonated strongly in Mexico.

We are also exploring opportunities to optimize the travel corridor linking Mexico to the southwestern United States where 13 million Mexican tourists visit every year. During the next three years we plan to grow our retail store presence in Mexico, invest in secondary cities, and launch e-commerce. We believe we can continue our current double-digit sales growth in the country.

The countries that we consider our strong growth engines are Brazil, Peru, and Columbia. With an average 35% growth a year over the past four years, Brazil is one of the Company's fastest-growing major emerging markets and our share has increased dramatically over the past two years. Brazil is the third-largest beauty market in the world after the United States and Japan, but is growing much faster.

However, we are still playing in a tiny segment. Since mass represents 98% of the total \$12 billion Brazilian beauty market. The country is dominated by very strong local players that offer masstige products and have strong business models. Despite this well-regarded competition, we were encouraged that MAC was recently voted the most loved cosmetics company in Brazil and the second most admired brand in all categories by a respected Brazilian trade and retail magazine. And we are seeing an important trend of consumers trading up to more aspirational foreign brands.

Although we have had strong growth, distribution in Brazil remains challenging. Department stores are nonexistent. Perfumeries are fragmented and losing share and the new prestige distribution is still emerging. Going forward, our distribution strategy in Brazil will focus on freestanding stores, specialty multi, and our e-commerce business.

In Peru, we are growing 40% a year as our Chilean retailers expand in the country by opening malls and department stores. In Colombia, Clinique is the market leader in prestige beauty and MAC is expanding into prosperous secondary cities like Cali and Medellin.





Lastly over the past four years we have successfully reduced the relative weight of the more economically volatile countries on our portfolio including Venezuela and Argentina. They are expected to represent only 11% of the region's sales this fiscal year. We will continue to manage these countries cautiously and direct our efforts and investments toward more stable countries.

As you see, we are still at the beginning of our journey with a vast majority of the Latin American beauty market left to pursue. In that context, I believe the Estee Lauder Companies brands are uniquely positioned to consolidate and accelerate their leadership in Latin America.

I would like to close by recognizing and thanking our 2400 employees across the region for their passion and dedication to our plans. Thank you and now I will turn the call over to Tracey.

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

Thank you, Daniel. Good morning, everyone. I'll briefly review the highlights of our fiscal 2013 fourth-quarter and full-year financial performance and then frame for you our expectations for the year ahead. As usual, my commentary on the financial results excludes the impact of restructuring and other charges.

For the fourth quarter, net sales rose 7% to \$2.41 billion. Excluding the impact of currency translations, sales grew 8%, net earnings increased 40% to \$96.8 million compared with \$69.2 million in the prior year quarter and diluted EPS was \$0.24 above the top end of our expectations. The challenges that emerged in our third quarter with the latest wave of SMI have been resolved and we have begun work on the last major wave of SMI implementation, which is scheduled to launch in July of 2014.

Regarding sales, every region contributed to sales growth in the quarter. Sales in our Americas region increased 5% in local currency with mid single digit growth in North America and high single digit growth in Latin America. From a channel perspective, our North American sales at retail were mixed with the strongest growth realized through multibrand specialty stores, luxury department stores, online, and our own freestanding stores. Mid-tier prestige department stores and salons were softer this quarter.

The prior year included a reversal of a provision for sunscreen returns, which lowered growth in the Americas by approximately 2 percentage points in the quarter.

In the Europe, Middle East, and Africa regions, sales increased 13% in local currency. We achieved double-digit sales gains in the developing markets of Turkey, the Middle East, and South Africa, but also in many established markets in Western Europe, including Italy, Germany, and the UK. Our sales in the travel retail channel rose 15%, slightly ahead of sellthrough. The region's growth was partially offset by declines in Switzerland and in Russia.

Sales in the Asia-Pacific region rose 5% in local currency. Double-digit gains were achieved in Australia, New Zealand, Hong Kong, Thailand, and Vietnam. China grew sales 7% as retailers sold through the inventory build from the SMI rollout earlier in the year. Growth at retail remains strong at early 20%.

Japan increased sales by 5%. Korea continues to be weak. However, declines are more modest now that we have anniversaried the initial downturn in the market.

Our gross margin decreased 20 basis points to 80.3%, primarily related to obsolescence. Operating expenses as a percent of sales improved 220 basis points to 74%. Selling costs decreased 80 basis points and advertising, merchandising, and sampling fell 120 basis points, reflecting the planned cadence of marketing increases to earlier in the year as we have discussed with you previously.

Operating income rose 54% to \$150.3 million and operating margin increased 200 basis points to 6.3%. Our effective tax rate for the quarter was 28.1% compared with 15.8% in the prior year. For the full fiscal year, net sales rose 5% to \$10.2 billion. Excluding the effects of currency translations, sales grew 6%. Net earnings gained 16% to \$1.04 billion and diluted EPS increased 16% to \$2.64. Every region and major product category contributed to our sales growth again this year.



Gross margin increased 70 basis points to 80.2%. The increase came primarily from 40 basis points related to positive pricing and mix and 20 points from favorable cost of goods.

Operating expenses as a percent of sales improved 30 basis points to 65%. We increased advertising, merchandising, and sampling 10 basis points, reflecting our continued commitment to support our brands' new launches. Collectively, all other costs fell 40 basis points as the benefit of cost savings and productivity improvements more than offset other investments.

Since fiscal 2009, our operating expenses have improved 250 basis points while at the same time we invested an incremental 230 basis points in advertising, merchandising, and sampling. This means that all other expenses have declined by 480 basis points, a significant achievement.

Operating income rose 12% to \$1.54 billion and operating margin increased 100 basis points to 15.2%, another record achievement. Our savings initiatives contributed \$73 million in fiscal 2013 and totaled \$781 million over the four-year span of the program.

Net interest expense declined 10% to \$54.8 million, primarily due to lower rates and our effective tax rate for the year was 30.7%.

We recorded \$17.8 million in returns and charges associated with restructuring activities in fiscal 2013 and believe that charges related to this program are substantially complete.

Net cash flows generated by operating activities increased 9% to \$1.23 billion compared to \$1.13 billion last year primarily reflecting higher earnings. We invested \$461 million in capital projects mainly for counters, retail stores, and systems. We returned 100% of our free cash flow to stockholders in fiscal 2013, which went to repurchase approximately 6.7 million shares of our stock for \$388 million and payout \$419 million in dividends which reflected a 37% increase in the dividend rate as well as the incremental outlay from a transition to quarterly payments.

Days sales outstanding increased by 2 to 44 days. Inventory days to sell rose to 183 compared with 164 days last year primarily to support both the SMI transition and planned future growth.

Fiscal 2013 marks the end of a four-year period where the Company focused on restructuring, resizing, and realigning the business model. Going forward we expect to build on our success and leverage the investments we've made in R&D, consumer insights, geographic expansion, SMI, and productivity to continue our growth trajectory.

We expect global prestige beauty to grow at 3% to 4% in fiscal 2014 and 4% to 5% annually thereafter. We continue to believe we can exceed this growth by at least 1 percentage point. More of our growth is expected to come from innovation, reflecting the emphasis on bigger, more impactful launches as well as locally relevant developments.

Our small and medium-sized brands are continuing their momentum and are likely to make a greater contribution to growth as they expand into more countries and more doors. Developing markets should provide a greater share of incremental sales as they grow in size and their populations continue to achieve greater wealth and we have continued to see accelerated growth in many of these markets in fiscal 2013.

Skincare and makeup will remain our largest categories but fragrance should continue to grow and contribute more as we renew our commitment to the category and launch new brands and products.

These drivers of strong topline growth combined with increasing productivity and prudent reinvestment should allow us to deliver operating margin expansion to 16.5% in fiscal 2016 and double-digit annual EPS growth for the next three years.

Let me now talk about our outlook for fiscal 2014. Sales are expected to grow 6% to 8% in constant currency. Currency translation is expected to negatively impact our full-year sales growth by approximately 2%. Our estimate assumes weighted average exchange rates for the full year of \$1.24 for the euro, \$1.50 for the pound, and 100 for the Yen. Our estimate also includes approximately 2 percentage points of growth from pricing.



The combined benefits of pricing and operating leverage are expected to drive operating margin expansion by 40 to 50 basis points for the full year. Continued cost discipline allows us to invest for sustained growth and efficiency. This year we plan to further strengthen our capabilities in consumer and shopper insights, research and development, retail stores, supply chain, human resources, and information systems.

We expect advertising, merchandising, and sampling to remain fairly consistent as a percent of sales annually with a different cadence of investment by quarter this year. We do have the flexibility to invest incrementally behind activities that demonstrate good momentum during the year.

Our fiscal 2014 tax rate is planned at 30% to 32%. We are forecasting full-year EPS in a range of \$2.74 to \$2.87. Depending on the magnitude of exchange rate movements, the approximately 2% negative currency impact on our topline equates to about \$0.10 of EPS. Excluding this foreign exchange impact, our EPS is expected to rise by 8% to 13%.

As a reminder, in fiscal 2013, we had some one-time benefits that will negatively affect the comparison to fiscal 2014 including \$23 million of other income related to the 2007 sale of Rodan & Fields, which was equal to about \$0.04 of EPS.

In fiscal 2014, we plan to generate approximately \$1.4 billion of cash flow from operations. Our capital plan of \$525 million will largely support consumer-facing investments in counters, retail stores, and e-commerce, as well as back-office support for systems and supply chain.

In our first quarter, we expect sales to grow 5% to 7% in local currency. Translation could hinder growth by approximately 1%. Major product launches including the new Advanced Night Repair, Modern Muse and DDML+ should help drive growth. We also expect our marketing investments to be substantial given the innovation activity in the quarter that we are supporting, which should aid to our sales -- should aid our sales momentum throughout the year. Therefore, we anticipate that EPS will come in between \$0.67 and \$0.71 in the quarter.

As we said earlier, wave four of our SMI rollout is scheduled for July of 2014, which is the first quarter of our next fiscal year. This group includes our North America order to cash business, our travel retail division, Japan, and the Middle East, and represents approximately 18% of our sales. As we've seen previously, we expect retailers to increase their orders in advance of the go-live to mitigate any potential disruptions from the transition. The impact of this potential shift in orders will be to increase sales in our fiscal 2014 fourth quarter and full year.

As we have done in the past, we will provide an estimate of the shift when we get closer to the date and have a better indication from the retailers of what this shift will be. The guidance however that we have given today does not include these incremental sales and profits.

That concludes our prepared remarks. We will be happy to take your questions now.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Olivia Tong, Bank of America.

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### Olivia Tong - BofA Merrill Lynch - Analyst

Good morning, thank you. I just want to talk about the growth rate that you are expecting for this year. So relative to the 3% to 4%, you're saying 2x plus 6 to 8. You mentioned a big incremental increase in advertising in Q1 but can you provide some color on the cadence for the remainder of the year?

And then also can you provide some perspective on where you expect your share gains to come from? Is it stronger in one region versus another or product category? And do you expect to source most of your share gains from bigger players or from smaller brands? Thanks a bunch.



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

For the full year, our advertising, marketing, and promotion as a percent of sales will remain flat, so we do see a shift as I had mentioned before in the quarterly spend and again as we have mentioned before, supporting our lunch activity, which is substantial obviously in the first quarter. Fabrizio mentioned DDML and Advanced Night Repair, which launched in July. We also have Modern Muse, which is the first relaunch in some time of a fragrance by the Estee Lauder brand, in September.

So the combination of those three as well as some of the other licensed brand fragrance activity that we have is increasing the spend in the first quarter. It should normalize over the balance of the year to create a flat percent of sales for advertising promotion and marketing.

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

In terms of share gains, we assume to continue growing share in Western Europe, Asia, Latin America, and we believe we will stabilize our share situation also in the US thanks to the innovation programs of the next 12 months.

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**Operator**

Jason English, Goldman Sachs.

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**Jason English** - *Goldman Sachs - Analyst*

Good morning, folks. Thanks a lot for the question. I wanted to zoom in a little bit more on the US. Fabrizio and team, can you guys give us your perspective on what has caused the deceleration of the prestige category? And then within that, maybe touch on channel mix. I know last year I think you said that your US business around 9% of those sales were coming from online. Where do we stand with that today? Thank you.

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

First of all, the deceleration of the US business that we have seen started in May. The US business has been growing in prestige as per NPD at about 6.9% in the first part of last fiscal year and then in quarter four, is 2.5% and then June was minus 1%. So there's been clearly a softening in that period.

Now we believe there's just been a reduced traffic for several macroeconomic reasons and we already see some improvements and we believe the back to school and then later the holiday season should bring the US markets back to solid growth, although we believe will be a growth below what we have seen in fiscal year 2012 and the beginning of fiscal year 2013.

In terms of channel mix, we are continuing expanding very strongly in e-commerce and e-commerce is growing 20% plus. We believe this will continue. We are also growing in our freestanding stores at double digits and we are continuing expanding in specialty multi successfully. However, independently from the soft last couple of months of the fiscal year, we grew about 6% in the US in fiscal year 2013. So a pretty solid growth and we believe that probably this growth will be reduced but will remain solid over the fiscal year 2014.

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

Just to add on to what Fabrizio said, as we have communicated all year, our online business has grown 2.5 to 3 times what our regular business has grown, so in the US, it's approximately 10% now versus the 9% last year.

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**Operator**

Dara Mohsenian, Morgan Stanley.

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**Dara Mohsenian** - *Morgan Stanley - Analyst*

Good morning. So from a margin standpoint your fiscal 2014 EPS guidance implies only about 40 basis points of margin expansion even at the high end. Given you have favorable pricing, channel mix, operating leverage, the drag from SMI, I would assume is improving, why can't you do better than that? What are the negative offsets to those positives I mentioned from a margin standpoint?

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

So you may recall that we made the decision a quarter or so ago to extend SMI, so we do have an extra quarter of SMI this year that we did not expect to have previously. So that is creating some incremental expense. Largely we have offset that incremental expense. We also have planned advertising increase obviously for the year and as I mentioned right now, planned flat for the balance of the year.

But we have other investments that we are making as well. We're making an investment in our HR systems. We're making investment in some of our marketing areas as well to support the growth in fiscal 2014 and beyond, making some investment in our innovation areas as well. So that's the reason why the margin expansion is 40 basis points, 40 to 50 basis points, and we expect that that will continue over the next three years.

Once we have fully implemented SMI and start to really leverage it and we expect to do some of that this year, so one of the benefits that the delay has given us is the opportunity to focus on the first three waves as a roll out and really optimize some of the tools and the deployment of SMI and SAP. That is expected to yield a benefit as well this year and certainly beyond.

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**Operator**

Ali Dibadj, Bernstein.

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**Ali Dibadj** - *Sanford C. Bernstein - Analyst*

I wanted to ask a little bit more about your thought process on just the incremental spend in 2014. You are clearly increasing spend but the topline isn't growing much faster than you have been without the spend. So I'm trying to get a better sense I guess of is it because it's just more difficult out there so competition is greater, consumers are tougher, or indeed your spending more for the future, whether it be innovation or distribution gains? I'm trying to get an understanding of the mix between those two.

And I ask that particularly in the context you had in your prepared remarks for the past four years being very strong from restructuring and spend back perspective, but now as we look forward, you are I think having to expect a little bit more of a leverage on your current expenses. So I'm trying to tie those two together in terms of your spending more this year, growing the same this year and then going forward, we are expecting more leverage I guess on your current expenses. So I'm hoping to I guess get some help tying those together.

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

Let me explain what is the idea behind that. We definitely are preparing for an acceleration of topline growth and this year was 6% and we planned 6% to 8% next year. Now the acceleration should also be read in the context of the overall market, meaning we are very confident that the sum of our activities will provide the acceleration. I will give you some details in a second.



But the market behind it is still some sign of softness. Southern Europe we believe will continue to be soft. Korea will continue to be soft and frankly for the moment we suspend our judgment on the US temporary softness that we've seen in May and July, and we assumed that this will not recover all the way to the levels of the US there was last year.

So with these assumptions, that's why we say the market in our opinion, if this assumption holds, the market will grow 3%, 4%, and we are saying 6% to 8%. So we are saying we will grow double to the market one more year in -- and to go double in the market frankly we need the innovation and all the other things, and investment in the advertising that we have created. Without that it will be very difficult to build a market in that way.

Now obviously if the market will go better, it will be stronger over time, then we can see even better leverage from our investment in advertising and innovation in our topline. We will see and we will do obviously the best we can.

The details I wanted to give is that obviously Korea, the current US trend, Southern Europe are somehow concerning but on the other side, we expect strong growth in developing areas like China, Middle East, Turkey, Latin America, as you heard. We expect double-digit growth in travel retail again in the year and the continuation of 20-plus% growth in online. We are looking to our luxury group of brands like La Mer and Tom Ford to continue grow 20% more and our innovation as I explained, should be a strong driver.

So we have in my opinion again not only improving our productivity and ability to leverage with growth our cost but also we are in a position to exploit our growth portfolio because even in a moment where we had a quarter of softening in US, we had strong growth in China offsetting it. And Korea is down. Japan is back up. So the strength of our portfolio to cover different regions, different categories, different channels is really one of the things that make us comfortable with a strong growth over the years. But obviously reflecting the reality of the market in every given moment.

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

The only thing I would add to that is, Ali, and you mentioned this, we are feeding distribution for those mid-tier brands to continue to achieve the kind of growth that we have experienced this year both from a comp standpoint they are doing terrific but also from a distribution opportunity standpoint now that Jo Malone and La Mer continues to have momentum and Tom Ford and some of the other brands that we have at that next tier -- Aveda for instance that Daniel mentioned in terms of perhaps an opportunity for Latin America.

So we are investing more in distribution both for our newer brands as well as in emerging markets.

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**Operator**

Mark Astrachan, Stifel.

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**Mark Astrachan** - *Stifel Nicolaus - Analyst*

Thanks, good morning, everybody. I wanted to ask quickly some gross margins in the quarter in terms of sort of puts and takes there and why it was not up as strongly as it has been. It was actually down a little bit.

Then just back on ad spend, is it going to be in different regions and channels in fiscal 2014? How do you measure returns and efficiencies on the spend considering the decision to maintain or to increase as you go forward?

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

Okay, so on the gross profit margin, there were a couple of different impacts. The mix favorability wasn't as great this quarter as it has been in previous quarters, but there was a favorability. So in addition to that as we have pulled out our inventory is at higher levels than certainly we had



anticipated this year with some of the delay in the SMI conversion. We ended the year with higher inventories, so we did make sure that we were properly provided from an obsolescence standpoint for that.

The last area is we did have a slight unfavorability in manufacturing variances for the quarter, but again for the year as you saw, we showed tremendous margin, gross profit margin expansion. So it's more of a quarterly phenomenon than certainly an annual.

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

In terms of our advertising and promotional spending, we are very deliberate and strategic about the resource allocation. We have a very thorough internal process to measure the return of this investment and they vary a lot depending on for example which area of the world we launch. If we do a big launch in China, this is normally more advertising intense than the Middle East as an example.

Or which brands. If we had a launch in MAC, it's obviously less advertising intense than Estee Lauder rate or the importance of our innovation. If we launch a big like Advanced Night Repair launch, that's much more advertised than the next variant of BB cream.

So it's very, very deliberate and it depends from market, from kind of category, and from the kind of innovation and we are getting better and better in measuring the return on investment of what we do.

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**Operator**

Alice Longley, Buckingham Research.

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**Alice Longley** - *Buckingham Research Group - Analyst*

Good morning. My major question is about the first half overall for fiscal 2014. Can you tell us if we put the second quarter together with the first quarter if the earnings for the first half of the year will grow roughly in line with your guidance for the year?

And I am just assuming that there is a shift in timing of marketing away from the second quarter back to the first quarter. Maybe if we look at the two together, they will be in line with the year. And then also China, you under shipped in the first quarter relative to sellthrough at retail. Will you be back in the second quarter to shipping in line with sellthrough at retail in China so we will get an acceleration in sales there?

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

Alice, I will start off and then let Fabrizio chime in. We are currently not giving second-quarter guidance. I would though remind you that we had an SMI shift last year where we actually pre-shipped product in the second quarter for the third quarter go live of SMI release 3. So just keep that in mind when you are looking at your model and modeling out the quarters. Certainly from a mix standpoint, the first quarter from an advertising marketing and promotion standpoint will be the highest as a percent of mix relative to the other three quarters. But that -- we will certainly be prepared to update second quarter when we have our next call.

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

In terms of China, it is difficult frankly to provide reconciliations by quarter of a single country in this way. But we are pretty happy of our trends in China and pretty satisfied. For the fiscal year, we are closing -- meaning fiscal year 2013 -- we grew 20plus% in China again at retail and our same-door grew 5% at retail, so China is doing pretty well and our strategy there is about reaching new consumers, the new growing middle class via the ability to penetrate new cities and the continued increased distribution and also reaching the many traveling Chinese consumers that want to travel outside of China, which we often speak about, which has been \$40 million in the closing year.





But also they want to travel within China, which we should not forget that \$350 million every year. And before they were used to all buying in Beijing but now they find the product in their own e-commerce site or in their own city and obviously it is so that by less in Beijing and more in their hometown and we are favoring this process. That's why we should look at China as a whole and over time and not divided quarter by quarter, piece by piece. It is a lot of depending of this incredible phenomenon of distribution expansion in the cities.

Just to give you a dot on this one, we have expanded in 2013 fiscal year 11 new cities in China and we plan in fiscal year 2014 to expand another 14 new cities in China.

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**Operator**

Bill Schmitz, Deutsche Bank.

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**Bill Schmitz** - *Deutsche Bank - Analyst*

Good morning. Can you talk about the trends on the Asian margin front because obviously I think this quarter was an anomaly. But can you just sort of explain what happened in the quarter and kind of how you kind of look at the margin profitability in Asia going forward?

And then just a housekeeping item. Is there any share repurchase included in your guidance for 2014?

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

So certainly on a reported basis obviously we have the impact of exchange on the margin in Asia in the quarter. In addition to that obviously we spoke about the fact that the shipments in China were a bit less in the quarter because of the amount of inventory that the trade was still working through, so the retails continue to be strong but our shipments were less, given the shipments that were made in Q2 to support the rollout of Q3 in China.

So the foreign exchange, Korea, obviously being down significantly as we've talked about, all impacted the margins in Asia Pacific. It is a tremendous high growth region for us, as you know, and it's a profitable region for us. So we certainly expect that to continue into fiscal 2014.

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**Operator**

Caroline Levy, CLSA.

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**Caroline Levy** - *CLSA Limited - Analyst*

Good morning, thank you. A couple of things. On the big push behind fragrance over the next year plus, what impact do you expect that to have on your margins? My understanding historically is that there's a lot of A&M that goes with it. But if you restructured in that business, is it possible for that to meet or beat your current average margins?

And then the second question is on Europe excluding travel retail, you must have seen enormous share gains and I was wondering what particular product might have driven that and if some of what you are seeing in Europe is on Middle East shoppers and things like that? So just a little understanding of what happened in Europe that was so strong.



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

Sure, let me first answer the fragrance question. Our fragrance portfolio is better in margin overall but the different components have different margins levels, so the high-end like Jo Malone or certain brands like Clinique, definitely the opportunity to be accretive in terms of margin as they grow. Other brands, more the designer fragrance portfolio as you know as an example are in a position where they are not accretive but they are in much better margin position.

So the impact also of the accelerated of fragrances will be to enable our acceleration of growth because this is an important category, which embraced 30% of the global market and we need to be able to grow in this market. This growth will allow us to leverage our cost base in a better way across the Company.

So it's not necessarily being accretive as a category but it definitely is going to be important in certain parts of it -- as I said would be also accretive but it's going to be important to accelerated growth and leverage our cost base over time.

In terms of what happened in Europe, we are doing very well. As I said I gave in my prepared remarks the example of Italy but we are doing very well in many developed markets, even the ones which are very soft. So what's happened is that we are winning there. We are winning there with our innovation because we are investing in this difficult moment and so in this way we are building market share.

This for us is a big strategic decision because never, never miss to exploit a crisis is our way of thinking, in the sense that our market share in Europe is not very high in all of these markets. So that's the moment where we have the opportunity to establish us as a bigger player in Western Europe and then benefit of it for the many years to come when we are starting from a higher market share when those markets will recover as we believe will happen in a certain moment in time.

The other thing which is happening in this area is huge success in emerging markets. The Middle East is doing very, very well for us it's 20 plus growth. Turkey is doing very, very well. South Africa is doing very, very well. So -- and the Russia situation has stabilized. So in this situation, we see EMEA as we call this region, doing pretty well despite the softness in Southern Europe.

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**Operator**

Neely Tamminga, Piper Jaffray.

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**Neely Tamminga** - *Piper Jaffray & Co. - Analyst*

Great, good morning. Fabrizio, you guys have been so innovative on the product side and I just want to talk a little bit more on the marketing side as well. Could you give us a sense of how you are thinking about your digital ad spend overall, how that's trended from last year to this year and maybe ultimately where you think your digital ad spend can go? And maybe some of the innovation behind that to drive these excellent e-commerce sales. Thank you.

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

So in the advertising, the digital part. So our digital budget in advertising is increasing significantly. It's tripled in the last years, so we are expanding much more in digital and we will continue to increase our digital spending. Obviously there are some of our brands which use digital online communication, digital advertising, and old e-commerce activities as their main communication activity example.

This is very important area for MAC, while there are other brands which are using more TV or more print, so this is again not -- I cannot speak about the Company -- the Company average in other words doesn't give you a real sense of the reality. It's by brand our decision-making, and our return on investment is calculated by brand.



So, on average, we are definitely increasing our investment in digital in a very significant way.

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**Operator**

Connie Maneaty, BMO Capital Markets.

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**Connie Maneaty - BMO Capital Markets - Analyst**

Good morning. Could you talk a little bit about the 2% in sales from pricing? Does this mean you're raising the price with the innovation that's coming on DDML and Advanced Night Repair? And are these actual price increases or would the introduction of new fragrance, is there also a positive mix shift because the fragrances are more expensive?

Then just a follow-on, could you give us an update on Ojon?

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

Yes. On pricing, the 2% is more or less in line with the cost inflation overall. How the 2% is driven is a mix of some regular price increases in certain countries where the inflation and the reality of the market allow us to do that. And some of innovation comes to higher prices. And then finally, there are also some price decreases, meaning 2% is the average.

But to be very clear, we have decrease in price, including of some of these new innovations in certain markets, particularly in Asia, where it was appropriate to decrease the prices. We are increasing the prices in other markets where it was the right decision, and then the innovation mix is positive. Some innovation is higher-priced. Some is lower-priced, so price is a pretty sophisticated exercise.

The result of it is an average of 2% to cover our cost inflation, and that's obviously our minimum objective to go forward. That is not an average number that we use. We use a very specific number by brand and by activity.

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**Operator**

David Wu, Telsey Advisors.

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**David Wu - Telsey Advisory Group - Analyst**

Good morning, everyone. Can you perhaps talk about your R&D spending goals in FY 2014, and any new hires or changes that you plan to make in the department, and which sort of product attributes you plan to focus the innovation on?

Just secondly, can you update us on new distribution, especially in the specialty beauty retailers and how the testing of Estee Lauder at Sephora North America is progressing and also your plans to increase distribution there and also similarly with La Mer and Sephora China and France? Thank you.

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

In terms -- can you repeat the first part of your question? (technical difficulty) It was on the R&D and our R&D spend, so we are slightly increasing as a percent of mix, our R&D spend this year and again, our R&D spend is certainly disclosed in our financial statements so that you know what we are investing. And a good portion of that as Fabrizio said, is we have looked at our strategy over the next three years, new products and innovation



have always been a critical element of the Company and we have a tremendous amount of leverage and momentum to increase that now and it's been a stated focus of the organization for the last few years. We've achieved good results in that area.

So we are seeing a slight increase in the percentage spend of R&D this year versus last year. Certainly a portion of that as you mentioned will be incremental headcount. And we are -- the R&D team is certainly executing against that.

In terms of Estee Lauder in Sephora in North America --.

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

Yes, in terms of our distribution, so the test on Sephora Estee Lauder is continuing and was planned for 18 months and so we probably make a final decision in the next six months. In terms of our distribution plan overall, we are increasing distribution next year and we have done it in fiscal year 2013 and we will continue to do next year in a very significant way in some emerging markets.

As I said, in secondary cities and in smaller cities around the world and in the new growth channel, expanding e-commerce, expanding travel retail, expanding specialty multi including our path in Sephora in many parts of the world. All this is up and just to give you maybe the sense of our 6% to 8% growth, 2% come from pricing as we just discussed and 1.5% to 2% will come from distribution expansion. The rest will be organic growth.

And so distribution is increased -- is a very important piece in our model. And I want to take the opportunity because I forgot to answer Ojon before and so for fairness I want to say that we continue our test of Ojon. We are encouraged by the results but we are still in a testing mood on this brand.

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**Operator**

Lauren Lieberman, Barclays.

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**Lauren Lieberman** - *Barclays Capital - Analyst*

Thanks, good morning. I just wanted to follow-up on your comment that there was going to be -- Tracey, you said there's more growth coming from some of the small and midsize brands and I didn't know if that specifically referred to fiscal 2014 as that starts to accelerator or was it longer-term comment?

Because it was particularly interesting in the context of this enormous launch activity in both Estee Lauder and Clinique just even in this first quarter. Thanks.

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

So it is a longer-term comment, Lauren, and the kind of growth as we had shared with you that those brands had in fiscal 2013, we certainly expect that they will have continued momentum both based on their innovation programs for fiscal 2014 and beyond as well as the distribution opportunities for those brands. They are obviously not as widely distributed.

And Jo Malone in the UK is doing tremendously well. Tom Ford has had some terrific success. Aveda has been a call out for us all year with some of the new products that they have launched. And there's still a tremendous amount of international opportunity for the Aveda brand. So we are very excited about not only our heritage brands and all of the wonderful innovation that we have this year planned for them and certainly that should make for an exciting year for Estee Lauder, Clinique, and MAC.

But also for that next year and so we have -- we are continuing to diversify our portfolio. Over the next three years we actually expect the mix of those brands to be a higher percent penetration.



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

I just want to add on this point that this is a deliberate strategy. We have three very big and successful brands -- Estée Lauder, Clinique, and MAC. We need to continue building the rest of the portfolio to critical mass and critical size. We are very successful.

The moment we do that, brands like Bobbi Brown, La Mer, Jo Malone, the moment they reach this critical mass level, they contribute enormously more in absolute terms obviously to the growth of the Company and this is happening and this is making us again stronger in terms of ability to grow and ability to penetrate different categories spanning from skincare to makeup to hair care to fragrances in the correct way.

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**Operator**

Joe Lachky, Wells Fargo Securities.

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**Joe Lachky** - *Wells Fargo Securities - Analyst*

Thanks, I wanted to take advantage of Daniel and ask about Brazil. Historically it's a direct selling and mass market but how do you see the market evolving over time? And specifically do you see door-to-door share of the market deteriorating over time?

And then also can you gain material share with your own stores or will you require additional department store build out before it really becomes a material part of the Company's business overall?

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**Daniel Rachmanis** - *The Estée Lauder Companies Inc. - President, Latin America*

You are absolutely right. Door-to-door is the main distribution channel for beauty in Brazil and if you look at the results of some of the door-to-door players this last year indeed we have seen some slow down in their sales growth. On the other side, the prestige market is growing much, much faster than mass in Brazil, almost 4 point faster, and that's the area where we are focusing on.

We see emerging distribution, such as specialty multi and e-commerce developing in Brazil. We see the middle class demanding better products, better services, and I believe our brands are perfectly positioned to offer those better products and better brands going forward as prestige distribution in the country increases.

So very clearly we are in Brazil for the long term. It's one of the key markets, it's one of the largest consumer markets in the world, so I think we are just touching the surface of our opportunities as we launch new brands and develop distribution in the country.

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

I would just would like to add one concept that was in the prepared remarks of Daniel that Latin America for us is small but provides great opportunity for growth in the future and our strategy like in many emerging markets is to grow profitably from day one. So we are maybe taking less advantage of the speed of addressing the market because we are growing more gradually but we are growing profitably so that the growth of this market will be accretive to the Company average and we have chosen this strategy for the several reasons that Daniel has explained in the prepared remarks.

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**Operator**

Wendy Nicholson, Citi Research.



**Wendy Nicholson** - Citigroup - Analyst

Two things, first on travel retail, Tracey, I think you said that the 15% was ahead of sellthrough and is that just intentional because of the timing of SMI or maybe if you can explain that gap?

And then second thing, someone asked about share buybacks and I don't think you answered the question whether the earnings -- the EPS guidance for 2014 includes buybacks or not. Thanks.

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

In terms of travel retail, there are slight differences in timing between sell in and sell through. They are never quite exactly matched from quarter to quarter. So no, it had nothing to do with SMI as it relates to fiscal, the end of fiscal 2013 and fiscal 2014 since the next wave is obviously beginning in July of 2015, Wendy.

But we certainly expect continued strong double-digit growth from travel retail in fiscal 2014 and believe that it's an exciting channel for us.

In terms of our share repurchase and the guidance that we've given, yes, some of it there is a slight amount of share repurchase primarily to offset dilution from our equity program.

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**Operator**

Joe Altobello, Oppenheimer.

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**Joe Altobello** - Oppenheimer & Co. - Analyst

Good morning, just wanted to stay on the inventory question here in terms of sell in versus sellthrough. I think in the past you've talked about sell in trailing sellthrough by about 2 points. That was most acute I think in travel retail. That has been I guess solved this quarter and I think also in Europe. So could you give us a sense of what sellthrough looks like in Europe at this point versus sell in?

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

At this point our sell in and sellthrough have aligned. Even in travel retail, what you keep mentioning is the beginning of last fiscal year where there was a destocking, then the stock normalized over the year, travel retail finished in a balanced way. And the same thing we see in Europe. In this moment I think our stock situation is pretty balanced versus what it has been in the last few years.

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**Operator**

Alec Patterson, AGI RCM.

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**Alec Patterson** - ATI RCM - Analyst

Good morning. First of all, thanks for keeping the call going this long. I was just curious about your strategy in Korea. It seems like a market which has got maybe more structural issues in terms of the prestige category. And so how are you thinking about handling that and to what degree does that impact the travel retail segment of Korea?

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

That's a great question. I completely agree. Korea is -- there is a structural think. The structural think is that during this recession or at least this very difficult economic situation that the country went through, consumers started to trade down. And so some local brands did a good job to attract particularly young consumers. So we are working on a rethinking on the way to manage our brands in the future, go back to advertise them in the correct way, analyze the right distribution opportunities, and particularly manage innovation in a much more locally relevant way able to attract all the young emerging consumer segments and their way of thinking.

So that's why we are guiding Korea as continuing to be soft next year, because we absolutely need time to fix this market for the long-term. However, we will fix this market. This is a very important market for us and for the long-term and we will have influence on total Asia over time, so we are working very diligently to adapt to the new reality and continue growth in Korea in the future.

On the other retail side on the contrary, there are good news. Our Korea travel retail as we explained last time is 13% of the global travel retail and it is growing again because the travel retail is recovering faster with also the currency situation is improving that so on the travel retail side, we are doing better and we are growing again, so is at nearly a recovery.

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**Operator**

Javier Escalante, Consumer Edge Research.

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**Javier Escalante** - *Consumer Edge Research - Analyst*

I have still a question with regards to -- and it had been alluded to at times during the call, which is the difference between shipments and like for like sales, if you will. I still fully do understand essentially if you can help us understand division by division the following and I'm going to give you a list because I have been kind of not fully tracking what the crumbles of information that you had given.

What was your shipment to department stores in the US, given that retail sales were flat? What was your shipment to Western Europe given that the industry is flat? And what is your shipment in travel retail given that it's growing only at 10%?

And in the case of Asia, why is that -- I understand that you mentioned about the destocking in China because you over shipped at the beginning of the year, but you mentioned that your retail sales in Asia were up 20% and that is an acceleration from what you saw in the first two quarters as you said that same-store sales were growing 2% to 6%. So I'm confused with regards to what is same-store sales, what is shipments?

So if you can clarify it in a more systematic way as I said, department stores in the US if you please, Western Europe, travel retail, and China that will be very, very helpful. Thank you.

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

Javier, I'm not sure we can clarify all of those individual areas. There are certainly differences in timing. As you know, shipments precede sellthrough and shipments are for comp doors as well as new doors, so to the extent that we along with our retail partners project sales to occur and therefore we ship them product, if the environment changes suddenly, there is a difference between retail sellthrough and our shipments that ends up curing itself when we ship less product in a subsequent quarter.

So certainly there are different dynamics that have occurred over the last year, year and a half if you will between the different channels and the different environments in North America, in travel retail, and in other parts of the world. But it all normalizes out over the course of a year or so. So I think that as you look at our patterns of shipments year-over-year, other than the major call outs as it relates to destocking that occurred last year and created some challenges for us earlier in the year, very specific to travel retail.





By and large, our are shipments year-over-year and the retail sales pattern year-over-year is the same with the exception of when we have promotions and launches and that will obviously affect some of the year-over-year piece. So again I would remind you that shipments also include new distributions, not just same-store sales.

It may be a bit confusing and perhaps we will certainly look at clarifying when we are talking about retail sales, we are talking about the sellthrough, if you will, versus the shipments. And so certainly we can spend some more time with you later on in the day and walk you through that in more detail if we can provide greater clarity. We would be happy to do that.

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#### Operator

That concludes today's question-and-answer session. If you were unable to join for the entire call, a playback will be available at 1 PM Eastern time today through August 29. To hear a recording of the call, please dial 855-859-2056 and enter passcode 17155041. (Operator Instructions).

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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