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The Estée Lauder Companies, Inc. (EL)

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CORPORATE PARTICIPANTS

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

OTHER PARTICIPANTS

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

MANAGEMENT DISCUSSION SECTION

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

And we're going to get started. Thank you, everybody. We have obviously CEO of Estée Lauder, Fabrizio Freda with us today. Fabrizio, thank you so much for coming up. It's great to have you back at the conference. It's been a few years.

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

[indiscernible] (00:00:12)

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

So you're coming off your last fiscal year that didn't go exactly as planned. So first, I just want to get your take as you look back on kind of what could have been done differently and maybe from here, what is the plan to drive stronger sales growth [indiscernible] (00:00:32) algorithm? So basically, everything.

[indiscernible] (00:00:38).

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

And – okay, so. [indiscernible] (00:00:46) fiscal year 2023, you know by now [indiscernible] (00:00:48) very well. But [indiscernible] (00:00:51) is that we – the volatility of the COVID in the East, in China, in Korea and the [indiscernible] (00:01:00) has been extraordinary. And we with our retailers in China and Korea, particularly in travel retail. We have been betting on a faster recovery of China if the COVID was under control. This faster recovery didn't happen. And actually, the recovery was – continue to be super volatile, the up and downs have been extreme and there are many reasons that maybe, if you want I can summarize where this recovery had been much slower.

Now having prepared for this recovery meant, so on a long supply chain, meant to build inventories for being able to serve the business in case the recovery was strong. Build inventory meant preparing this inventory and use our factory capabilities very, very well. But then the recovery didn't react, were two issues that impacted [indiscernible] (00:02:02) the first is the inventories in the travel retailers that we are still moving down as we go, as you know from what we spoke in the last quarter. And second on inventory in our [indiscernible] (00:02:15) and importantly the fact that now, for example, we need to produce much less than normal in our manufacturing because we have inventory to shrink at this stage.

This had a big impact on gross margin. And so the combination of lower net sales, I remind you that our retail sales in the difficult fiscal year 2023 globally were plus 5%, 6%. So they were strong, but the net sales was the big issue.

So in that situation, we are left with a pretty lower gross margin than usual. Also, we built some extraordinary important capabilities for the long term, which I'm going to summarize in a moment during the fiscal year 2023, but with the rebuild expecting stronger overall net sales in the company.

So today, they are too high versus the sales in the short term. So as a percent of the business in overheads as temporary also increased. So you have lower net sales and you have a gross margin and overheads impact in the short term, that's the summary of the big impact in fiscal year 2023.

Now I want also to underline this issue has been overwhelmingly important. And so obviously took a lot of our attention, your attention and the market attention. But I want to summarize that in fiscal 2023, we had done many, many important things for the long term. My thesis is that our fundamentals for the long term are intact and in 2023, our strong brands, for example, [indiscernible] (00:04:01) if you exclude travel retail, [indiscernible] (00:04:07) super strong double digits. Our skincare business that has been under pressure, if you exclude travel retail in Asia and Korea and China, it's [indiscernible] (00:04:16) plus 19%. By the way our total business in the last quarter, as I communicated several times, is growing plus 17% excluding the travel retail in China and Korea.

So a very solid performance everywhere else with the exception of North America that we're going to talk in a second, but we have been growing market share in China mainland very well. But if you compare our market share versus last, it's been up in the last quarter 2 full points. We almost completely recovered the market share that we lost in the [indiscernible] (00:04:57) moment of the closure of Shanghai. By the way this moment was the beginning of the problematic – of volatility for us more than the average of the market because we were concentrated in Shanghai and we have recovered all the market share. But so if I compare the market share not versus last year, but versus two years ago, it's still growing market share and very strongly. So we are growing also versus two years ago and versus 2019. So we are winning market share in China.

Not many companies are winning market share in China and also when I know that maybe we speak later about the local competitors, there are one or two local competitors which by the way, not in luxury, which are doing pretty well. But there is not many, not, different is the question is, will they be there in the future, [ph] in few years so we can talk (00:05:49) this later. But this fiscal we've done tremendously well in China.

Second, we have been growing market share in Europe, sometimes I get the question [indiscernible] (00:06:00) market share also in situation where there are strong local competitors and we are growing market share in France, so with local competitors in France. And so we can – we are growing market share in Italy. We're growing market share in Spain, in Germany. So it's been a very good momentum in [indiscernible] (00:06:17). Regular market share in our emerging markets. Our India business has been growing 50%, five-zero percent. And so our total emerging market in the last quarter ex-China is being growing at 38%. APAC, I mean, Asia in total, including

China, has been growing 36%. But if you do the comparison versus two years before 2021 [indiscernible] (00:06:39) people are growing a strong double-digit. And so all these is very – I can speak about UK, Latin America, all growing very well.

What I'm trying to say is that our fundamentals are really in the right direction. Our innovation has been very strong in the year. We had always [indiscernible] (00:07:03) 25% of total even in [indiscernible] (00:07:05) 2023 despite the pressure in Travel Retail Asia. If you look at our innovation is now less spread across our categories, skincare, we are aware we need to do more in one area, which we have invested a lot in 2023, which is all these [indiscernible] (00:07:24) derma performance oriented skin care wound that the consumers are driving around the world. Now this obviously is happening also in mass or in mass [indiscernible] (00:07:34), but frankly can be attacked also from the luxury point of view. We had prepared in fiscal year 2023 to do a lot of this. We increased by 85% the amount of [indiscernible] (00:07:52), dermatologists, the work in our brands with our brands that we casted engaging or in the case of some brands like reengaging in a very big way.

So we [indiscernible] (00:08:01), sometimes I get the question, which is the part of your portfolio that can better go in that election? First of all, within this period, we have increased the clinical [indiscernible] (00:08:13) capabilities enormously. We are running many more clinical [indiscernible] (00:08:17) now also in China on Asian skins because of the new R&D center in Shanghai. We, as I said, increased the amount of scientific support. We had increased the ability to deliver claims thanks to the clinical studies, et cetera. Importantly, the repeat [indiscernible] (00:08:32) the loyalty to our formulation. So the true appreciation of the consumer [indiscernible] (00:08:39) is still among the biggest in the world, has been increasing over the last years.

So we have all the fundamentals to win in high performance skincare. We need to address in the communication to the consumers and to make sure that we better connect with the expectation the consumers [indiscernible] (00:08:56) communicate to them. We are in the process of doing it. The brands, the Clinique is obvious derma brands [indiscernible] (00:09:06) you will see in the second semester, already you see signs. If you [indiscernible] (00:09:11), you see signs, going in that direction, for example, in this moment, we had our leading dermatologist, which is supporting the [indiscernible] (00:09:20) Clinique on Instagram or you can follow in TikTok and the success is extraordinary. So the consumer is responding to that [indiscernible] (00:09:27) communication.

As I said, [indiscernible] (00:09:30) product performance, innovation, clinical studies that we are [indiscernible] (00:09:32). We're getting better every day. The communication is the piece with interesting change, so not too complicated, has to be done. In the second semester of this fiscal year, you will see, for example, an important relaunch of Clinique in that area. [indiscernible] (00:09:49) opportunity area with the consumers globally. Then The Ordinary who is absolutely there in the most scientific oriented, [indiscernible] (00:09:59) oriented and in affordable, its quality and affordable price [indiscernible] (00:10:05) is doing extraordinary well. I don't know if you follow, The Ordinary is the leading brand in volume in number of pieces sold already in skin care in the United States. It's very, very, very successful in every place where we launch it. Particularly, The Ordinary is adding to our portfolio the right brand to win in emerging markets. Interesting, our brand to win in China has been Lauder, has been La Mer, has been the luxury products, they continue to be. Our brand to win in emerging market historically has been MAC because emerging market we are entering with the entry price of [indiscernible] (00:10:43).

The Ordinary is now the – together with Clinique the real right brand [indiscernible] (00:10:49) resulting in this of The Ordinary has been very, very strong, The Ordinary in India has been launched with becoming number one in few weeks of the [indiscernible] (00:10:58) in which they were sold. So very strong success [indiscernible] (00:11:03). The other brand is [indiscernible] (00:11:05). This brand is a young brand, Korean derma brand, but it's been badly affected by the travel retail [indiscernible] (00:11:12) it was a brand in Asia [indiscernible]

(00:11:15) in travel retail, but it's doing super well in places like UK, North America, US and [indiscernible] (00:11:21) in the US is a very strong growing brand. So this brand is smaller in the longer term, but will have a big impact in this derma plays. And then, we are relaunching our origin brands in this active natural space which is going to be created. So we have invested during fiscal year 2023 in what will be a acceleration of skincare beyond solving the issue in Travel Retail Asia.

Obviously the biggest benefit of skincare that we need to get is getting our mix right again between China Travel Retail and the rest of the portfolio because these will, as you know, China Travel Retail is a lot about skincare in proportions. So this will bring skincare back. Then – we have done two – one important acquisition, TOM FORD, that want to remind, is very strategic. TOM FORD is operating into the high end of couture business, where we have a space to do much better and almost [indiscernible] (00:12:27) competing with the Chanel, with the Dior, with the Armani, with [indiscernible] (00:12:30) of this world. TOM FORD is our brand best positioned, is doing great, but always been, last quarter has been growing outstandingly, continue to grow very well in fragrances and in makeup in Asia where this is a very important area for makeup acceleration.

[indiscernible] (00:12:47) was mentioning before has reached $0.5 billion more sales. We have $0.5 billion, the definition of now is a mid-sized brand and so from there, as the scale to accelerate in a very big way, anyway, it's much bigger than $0.5 billion. We don't communicate numbers by brand, but it's now become – we did our next $1 billion brand. I communicate also there were four $1 billion brands, will become six this year TOM FORD and Jo Malone would join this category. And I also say that in few years, The Ordinary will join these categories. So we are going to have seven $1 billion plus brands. That is a big improvement to our fundamentals. Historically we had two and now we are prepared to have a very big scalable [indiscernible] (00:13:35).

The other important thing has been the profit recovery plan that we have put together at this point. I want you to be obviously totally convinced to hear me say we are determinant to bring our profitability back in the best possible way. We have created a plan which is called the Profit Recovery Plan, where the prioritization has been focused [indiscernible] (00:14:02) in our business [indiscernible] (00:14:04) would have been already two times in China in the last 12 months for more than 10 days each. There is a full discussion on the various profit drivers. As I said, there are two things that we need to recover fast. One is the gross margin and the other one is the overhead as percentage of total in general.

And the third important one is the mix of our sales that impact also the taxation. So those are the three areas of focus. On the mix is the matter, as I just anticipated, to push Asia – [indiscernible] (00:14:41) Asia back to the right level and to get skincare going. The rest of the portfolio is going in the right direction. Makeup is recovering everywhere in the world where COVID has been – basically the volatility of COVID has gone down. Fragrances become very good and profitable business for us. I changed the strategy of fragrances several years ago to go more in the high-end luxury fragrance is much more profitable. And for example, we closed our [indiscernible] (00:15:17) business, designer business just last year for the same reason. We wanted to make fragrances more of an investment grade category for us for the long term. I think we did it the last two years. The fragrance profitability is getting better and better and now we have the opportunity to go for it for skin. So that will improve also, once skincare will be fixed, fragrance would be [indiscernible] (00:15:38), even if makeup had to be slightly less than what was historically in total, we will have the same potential and the same power because of the fragrance, that change that we never had in the past.

Then we – the mix is also about pricing, it's about less discounting a lot of the business in TR, particularly the [indiscernible] (00:16:02) business was associated with more discounting, the average, this would be normalized. And then the creation of value [indiscernible] (00:16:11) the mix and then the tax positive impact over the better mix. Then, gross margin, there are two issues. One is obsolete and excess, obsolete and excess, we had dramatically improved our forecasting. Particularly AI, artificial intelligence, is supporting our forecasting capability in a very positive way already and most will be discovered. And so we [indiscernible] (00:16:35). We make some decision to stop producing and not pushing the production and inventories, but wait that demand and retail net will align better and then restart production. So excess is a big, big improvement of profitability. Then better capacity utilization, as soon as we will go back producing normally, it would be with some rightsizing between categories that we still need to finalize. This will be another important improvement in profitability and then on the cost structure that we are readjusting to the reality of this transition and [indiscernible] (00:17:16) growth.

So there is a profit trend and you will hear more quarter by quarter how this will be put in place. And we are determined to recover our profitability in the best possible way. As Tracey said during the last quarter call, we believe that the long term profitability power or EPS power of the company is intact. It's just that we need to go this transition and rebuild it and to get there and will need the patience to do these because as I'm explaining, if there is no magic bullet or silver bullet is a process that we need to do. And then and as we communicated these first six months of this fiscal year are still affected by the negatives and not fully affected by the positives. But in the second semester of this fiscal year, we should have more of the engines going in the right direction as our guidance describes pretty, pretty clearly.

So that's the situation. Next, my thesis that the fundamental are intact, sorry, I forgot to say that our brands are really doing well in growing market share, also brand by brand [indiscernible] (00:18:27) all the most important brands at the right innovation in every aspect. So our fundamentals are intact. Our strategy, the majority of our strategy is still the right one. I mean, if you ask me, do you continue to see online, Travel Retail, to be the great channels and more profitable to continue to drive these industry, I think so absolutely, this has not changed. And as there are new things that are happening, that we control maybe later, there are – but we are on top of them. And we are as usual addressing our strategy [indiscernible] (00:19:00). So fundamental are intact, long-term is very promising. We need to get this turnaround or this acceleration, this recovery executed with excellence and the team is really there with it, completely focused on it. And I have an extraordinary team that even in a very difficult year is coming up with the right passion, with the right solution and with the right dedication. So I have great trust in the long-term.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.
Q

Okay. Let me talk for a moment about Travel Retail specifically. So as we kind of get through the disruptions and the volatility in the channel right now, how do you think this part of the business emerges? Kind of what are the long-term opportunities there? And within that, I'd love you to touch on how you think about the features that grew in the channel. It's not just the question of [indiscernible] (00:19:50), but also clear historically, predominantly [indiscernible] (00:19:55) market or channel level. So would love some perspective on how you think about the evolution of Travel Retail [indiscernible] (00:20:01) through the kind of...?

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

I think as I briefly anticipated, I believe Travel Retail will remain one of the most important channels. To be clear, Travel Retail was among the top markets of luxury beauty already in 2019, 2018. So it is not only the result of the distortion of regulation and activities in defense of COVID that happened in 2020, 2021 and 2022. The three years of COVID has created this by good distortion, but the Travel Retail is being one of the best markets for beauty for a long time, even when [indiscernible] (00:20:45) business was more about individuals trying to focus more in [indiscernible] (00:20:48). So I believe TR will continue to be extraordinary. First of all, it is the right place for consumer to try new products and a lot of trial happen in Travel Retail. So you can also see [indiscernible] (00:21:02) not only as a profitable channel, but also a trial channel very efficient cost. And so Travel Retail will continue to be that. We'll continue to be an equity builder in the airports, [indiscernible] (00:21:19) in the beautiful places of the world where there is a [indiscernible] (00:21:23) position that it services, so that are beautiful counters and all the rest. So we'll continue to be a equity building channel in the long term. Then it's driven my traffic and my duty-free elements and this will continue to happen. There continue to be duty-free opportunity.

There continue to be traffic and the traffic is coming back. As you know, the traffic today is still below 2019 because the entire Asia traffic is still missing in part and [indiscernible] (00:21:54) consumer don't want to try, but [Technical Difficulty] (00:21:56-00:22:00). So there is the infrastructure which is getting gradually rebuilt – will be rebuilt and traffic will get back to 2019 and beyond levels over the long term and this will feed the regular travel – travel return.

And so my view of the future is that all this positive will continue and that the regular travel rebuilt in absence of COVID will substitute the [indiscernible] (00:22:26) business that was [indiscernible] (00:22:29) during COVID and the balance between the two would be a long-term, efficient, effective and growing Travel Retail business.

The further would be much less [indiscernible] (00:22:41) and much more traveler would be very positive, also for the impact of Travel Retail on the other channels in the various markets of the world. So I see a positive outcome.

Hainan will remain one of the most important Travel Retail, if not, the most important Travel Retail location in the world. If you go there, I've been there recently [indiscernible] (00:23:03) remember that Hainan serves the Chinese that didn't have a passport, which are 85% of the population. So even when international travel will restart, China will have extraordinary traffic. We'll have a lot of people, it is a beautiful vacation place, there are great beaches, there are great theater exposition, [indiscernible] (00:23:27) is part of the entertainment. So it's almost back to the vacation. So Hainan is there to stay and also Hainan will be more and more regular travel and less, less [indiscernible] (00:23:38) that will be a good business and then in [indiscernible] (00:23:43), we'll become duty-free and we love retailers and companies like us. Opportunities also to have, for example, freestanding stores, that go directly to the consumers in a duty-free way. So there would be more opportunities that will be open and finally the Chinese government had made an important bet on Hainan and I believe that we'll continue to support it and did it over the years in a constructive way. So Travel Retail in total is going to be exact.

Now, the [indiscernible] (00:24:15) of that now, as we speak, are just in the UK last week, UK is also [indiscernible] (00:24:22) of our EMEA travel retail business is flying. Travel Retail in Europe, in the Middle East, in Turkey, is doing really, really well in this moment. So whenever regular traffic is back, we are investing in people in store, by the way taking time because it's difficult to find again on the people for these new increased traffic, but all these gradual improvements is frankly ahead of our expectations. Now the issue is that Travel Retail in the rest of the world is more than in Travel Retail in Asia, so we are waiting for Travel Retail in Asia to go in the same trend, but we have [indiscernible] (00:24:58) in America in this moment is Travel Retail is coming back where traffic is coming back.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Okay. Great. I know you discussed the health of your brand equities and the particular market share gains within China, but – mainland China. But one question we regularly get is whether or not the consumer in China in particular has been [indiscernible] (00:25:20) by water brands on discount and that's going to be the case even more so over the next couple of months as we look through the inventory and channel and kind of get back to baseline.

So I know it's a tough thing to gauge, but how do you think about that? I know in the past two conference calls, lower promotionality has actually been mentioned in the call. But I was curious if that was specifically Asia or it was also a global comment.

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

A

This was a global comment, [indiscernible] (00:25:49) but definitely also important for Asia. So it's true that they are doing more promotionality during COVID, frankly, not only in China. We look at COVID like a moment where governments have faced industry with retailers' people [indiscernible] (00:26:07) were risking to go bankrupt.

Different governments have reacted in different ways. Governments in the US have given to people money to pass through the very difficult moment to COVID, [indiscernible] (00:26:18) mix of support in money and presumably the jobs, et cetera, things like that. In Asia, they got the support of unique regulations that will allow them to stay in business during this very difficult moment. So the discounts are also the results of policies to protect this business, giving them the transition to sell more into [indiscernible] (00:26:46) in the case of Korea or give them the authorization to sell more online and joining the market to make them survive you despite the [indiscernible] (00:26:54) disclosed.

So there's been a lot of distraction dictated by, thankfully not by the companies, but dictated by the [indiscernible] (00:27:04) to pass through the COVID period. When these will go away and is already going away as you want, be part of the issue we are living through now is that this transition back to normal is painful...

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Yeah.

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

A

Because it is a transition back to normal, where the new normal meaning regular travel, good economy is not yet back and the transition or regulation is trying to change the past. But we are sitting in the mid of this with high inventories, so that's the real [indiscernible] (00:27:35) picture of what's happening. But it's a transition and the transition back to normal will include less promotionality and is exactly is already happening. And by the way, [Technical Difficulty] (00:27:49) Hainan intentionally and the fact that the [Technical Difficulty] (00:27:53) regulation will be more imposed in [Technical Difficulty] (00:27:57) speaks about, is decreasing the Hainan results, in the short term.

And in turn [indiscernible] (00:28:05) will be a few more months of inventory needed to get inventory down, depending how long these will last. But that transition is also because the pricing of sales are more normal. And so there is more graduality, some consumers, particularly daigou kind of consumer need to get accustomed to that, but they will. So there is a transition, but at the end of this transition, I think things would be better, there would be less promotionality [indiscernible] (00:28:35) business.

Now was the consumer now accustomed to buy Estée Lauder only in promotion, every brand event in promotion? Now every brand is being promoted in this way. You can argue 50% discount or 55%, 45% or 50%, but everything was promoted for the reason I just explained.

So yes, the consumer has been able to access it [indiscernible] (00:29:00) more discounting. But when you look at where there was some travel retailing huge discount, they were in China, 11/11, 18/6, all these tweaks of sales online, which have been historically more discounted than others and those are also outstanding opportunities to recruit more consumers. They are very appealing in Tier 3, Tier 4 cities. So I believe that some up and down of promotionality to attract new consumer in such a growth market where 300 million people will enter the middle class [indiscernible] (00:29:37) will remain, but will be dictated by choices of promotional activity in order to recruit new consumer instead of retailer competition, which is more disruptive.

And I think we transition from promotionality as a non-managed competition between retailers to promotionality as intentional recruitment strategies. That transition will be very positive for the long term – and frankly, this happened in every other market of the world in different level, different level of intensity.

So [indiscernible] (00:30:14) beyond your question, there is also the question about – [indiscernible] (00:30:17) the brand that is – the companies' brand impacts in equity and I think the answer is yes. And the way I can prove in support this thesis is please look at the market share we're building in China and the volumes that we're building in China, compare the sales we do in China mainland, not TR, just mainland. So, sold in department stores, online, Tmall, et cetera, et cetera. 2019, at what we have done in now despite the competition with TR, the competition with Korea, et cetera, et cetera, our net sales have almost doubled. Our market share is increased dramatically. You can compare the market share versus Shanghai [indiscernible] (00:31:10), we are growing. [indiscernible] (00:31:12) we built an enormous amount of [indiscernible] (00:31:18) market share.

So there is really no sign in term of consumer choices that we have strong equity position in China. Second, even in this moment, which is a paradox, the China economy has a moment of softness, personally I have a lot of trust in China, in the future of the China economy, but the government will need time to put this back. And I believe personally, I believe that we'll do it when we see some good results from that. But in this moment it's soft. And so during the softness, the consumer is still buying more luxury. So the brands which are doing the best are the top four, the La Mer, [indiscernible] (00:32:02) and I believe even in our competition for what they see in the market is the luxury.

So it's kind of paradox, the consumers is going for luxury, which is very interesting. So is the consumer buying quality equity aspiration or they're only looking for pricing? I think that's the answer, the consumer continue to look for equity pricing and activation.

The second proof I can bring is the proof of innovation. Our innovation is a story in China. Every time we launch a new product, which is really now well-tailored when Chinese consumer is very appreciated. Now, the [indiscernible] (00:32:43) we just announced on Estée Lauder, [indiscernible] (00:32:46) which is the concept on longevity, the age reversal, new technique and ingredients, is an extraordinary new technology. And this would be amazing in China because that's exactly what the consumer wants and want to see.

So our innovation is strong and the level of positive reaction to innovation in China is probably still the strongest in the world, which show us that the equity are appreciated. And finally, we do a lot of consumer research. By the way you do the same because sometimes I read reports, excellent reports of analyst that shows a certain consumer research. And in this country research, when you ask what are the most desirable brands in China today, what [indiscernible] (00:33:31) TOM FORD, Jo Malone, [indiscernible] (00:33:30) at the top positions of these. So I think our fundamental equity is intact and in the future, the normalization of the discounting patterns will be a positive, they will get this issue out of our way [indiscernible] (00:33:49) in the future, couple of years.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

I'm going to try to sneak in one quickly on North America before we run out of time. You spoke [indiscernible] (00:33:59) already about [indiscernible] (00:33:59) talked a bit about plans for Clinique. MAC has turned the corner very much, though. So they get just the persistent question that I think would balance the whole conversation is when do we start to see market share gains in North America more broadly.

So just beyond the three brands I just mentioned, we've already discussed some, what are sort of the key building blocks or visibility you may have into that would give you confidence in North America and when – just start to aggregate better performance.

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

A

Again thank you for the question. It's very important and first of all, you know that we – you know that we're very focused on North America, it's our home market. And we want to go back to the position where we've been in market share.

However, [indiscernible] (00:34:42) North America, results minus 2% instead of the plus 5% that was planned, this is not the reason for EPS in fiscal year 2023. So I want to clarify we need to do that, we will do that. But this is not what will rebuild our profitability is because at the end, North America business, the region is a profitable business and that is a profitable business and is now growing or was growing double digit in the previous two years, by the way, still losing market share, but growing double digit. Last year was minus 2%. If you made just the calculation [indiscernible] (00:35:20) change completely the results of the company. Now, I want say be clear on that because – because of that reason, we want to do that or we want to do it in the right way, in a way which is sustainable for the long term and not confuse urgency with just doing at any cost, things that we will regret in the long term. So in North America, we are trying to do the right thing for the long term and we need to make some important changes. So the first one is, we need to go back to growth.

So in fiscal year 2024, our already expressed ambition is to go from one year, by the way, of decline, a little bit decline, minus 2%, to a growth year, and then prepare for 2025 and beyond, to go back win the market share. We are not promising committing to go in a few months, go back win the market share. That's why I'm saying we have sense of urgency, but we are going to do it in the correct way [indiscernible] (00:36:26).

So you can expect that our efforts are focused on growing again in North America in fiscal year 2024 and then putting the fundamentals to start rebuilding market share. What we are doing and what we have to do, first of all, our distribution platform has to continue to be adjusted. We will continue to support the excellent department store service model, which is so important for our – for many of our consumer, particularly [indiscernible] (00:36:54) consumer, but we need to do even more in specialty and we are continuing – increasing our distribution, for example, in Ulta with Estée Lauder. We are doing [indiscernible] (00:37:06), so we will continue to penetrate the specialty-multi segment.

Third, we need to now rebuild online, leverage the investment we have done online in [indiscernible] (00:37:18), which is very important. We need to leverage this more and we need to do more online. We have announced that we will go into Tik-Tok short and with The Ordinary, which has been already launched and with Estée Lauder brand soon. Now, this, to be clear, is unusual for Estée Lauder. We've been very conservative in making distribution decisions historically, again with intent of protecting the equity of our brands.

But in this case, we are going to learn in these channels how the consumer react with the brand, which has the most obvious fit, The Ordinary and with the brand doesn't, because the brand that will need to use this channel to conquer more the young consumers. And so we are taking the challenge and we are going for it. So we need to, in general, is just a sign of the fact that we intend to be playing faster and better with the growing channels in the future, rather than being too defensive for brand protection on this market.

So distribution, [ph] leverage of the distribution just (00:38:28), then in the – we have built a lot of the percentage of our advertising in digital is going to increase gradually in all key platform, including Tik-Tok on all brands. And so you are going to be seeing more of Estée Lauder programs tapping into the trend of influencers, celebrities, Tik-Tok and activity like these in general.

So our media efficiency is going to increase and more so importantly, the impact. Now, to be clear, to do that, we have invested in 2023 to prepare for that, for example. To do that strategy, you need many more creative assets. And so you need to be in the capability to go from [indiscernible] (00:39:15) we will have three times the [indiscernible] (00:39:17) asset that we are producing per brand. So [indiscernible] (00:39:21) investment in capabilities, in preparation and in the model. But we are ready now and we have started already this quarter seeing some important results.

The other part is obviously probably the most important is innovation. Now in North America, the challenge beyond the one I've described is that the so-called indie brands, so the new brands, [indiscernible] (00:39:44) a very low barrier to entry. And so there is a lot of competition on new brand. To be clear, many of these new brands are successful for the moment and then they go down, but some remains become important competitors. We have one in our portfolio, which is The Ordinary, which has done exactly that.

So we need definitely in North America to compete with these brands better by a more disruptive innovation, a breakthrough innovation, also in our big brands. So for example, in 2000 – in fiscal year 2023, we started making our innovation R&D, working directly with an automaker, so develop products tailored to the North American business situation. Now the paradox would [indiscernible] (00:40:28) for China and that we realized that maybe it was the time to do it for North America.

Now to be clear, North America has always been the first priority, so [indiscernible] (00:40:40)? So what is the new start? To do innovation tailored to the indie brand competition in North America, that's a new start and that's a new start that would be added to our way to do things in the future. So innovation is a very important thing. The last thing I want to say is that the success of the market in the last year in North America has been a lot about fragrances and we have our fragrance portfolio in luxury, which is doing well, but in North America has been pushed to be less than in the other markets so far. So we are going to accelerate our investments and pushing our luxury portfolio and we're going to reactivate more, also [indiscernible] (00:41:22) and Clinique fragrances in a very efficient way.

So you will see that and these will bring balance because remember, we are still number one in makeup and number one in skincare. Where we are now number five is fragrances. And then we still have Aveda, which is mainly salon business, that has potential for the long-term for hair care. So there is a lot to be leveraged in the fragrance portfolio, but later and then as I said, as I started from it, [indiscernible] (00:41:50) the acceleration on makeup and skincare as I illustrated. So I am confident that we will [indiscernible] (00:41:59) market and then in the near future, we will validate all these improvements, as I've just described and go for market share growth again in our home business in the long term.

In term of profitability, the profitability I want you to know is solid in North America. So, the moment we solve the growth element, we are going to have very important [indiscernible] (00:42:32) very solid for the long term of the company.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Okay. Thank you so much. We have to end there. I could stay all day, but no. Okay. Take care.

Fabrizio Freda

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

Thank you very much.