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# The Estée Lauder Companies, Inc. (EL)

Q1 2025 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning, and welcome to the Estee Lauder Companies Q1 Fiscal 2025 Earnings Release and Conference Call. All participants will be in a listen-only mode. [Operator Instructions] Please also note today's event is being recorded.

At this time, I'd like to turn the floor over to Rainey Mancini, Senior Vice President of Investor Relations. Ma'am, please go ahead.

### Laraine A. Mancini

*Senior Vice President-Finance and Strategy & Head-Investor Relations, The Estée Lauder Companies, Inc.*

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

Since many of our remarks today contain forward-looking statements, let me refer you to our press release and our reports filed with the SEC, where you will find factors that could cause actual results to differ materially from these forward-looking statements.

To facilitate the discussion of our underlying business, the commentary on our financial results and expectations is before restructuring and other charges and adjustments disclosed in our press release. Unless otherwise stated, all organic net sales growth also excludes the non-comparable impacts of acquisitions, divestitures, brand

closures and the impact of foreign currency translation. You can find reconciliations between GAAP and non-GAAP measures in our press release, and on the Investors section of our website.

As a reminder, references to online sales include sales we make directly to our consumers through our brand.com sites and through third-party platforms. It also includes estimated sales of our products through a retailer's websites. Throughout our discussion, our Profit Recovery and Growth Plan will be referred to as our PRGP.

During the Q&A session, we ask that you please limit yourself to one question, so we can respond to all of you within the time scheduled for this call. And now, I'll turn the call over to Fabrizio.

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## Fabrizio Freda

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

Thank you, Rainey. And hello to everyone. For the first quarter, we anticipated a challenging start to fiscal year 2025. Our results today are largely consistent with the outlook for the quarter we offered in August. Organic sales decreased 5% at the low end of the expected range, driven by double-digit declines in Mainland China, global travel retail, primarily owing to Asia and Hong Kong SAR.

Excluding these three areas, sales in the rest of our global business rose 1%, both on a reported and organic basis, while retail sales growth accelerated sequentially from 2% to 3%. A number of markets continued to deliver organic sales growth in our first quarter, led by Japan, where we gained prestige beauty share.

The developed markets in EMEA and our emerging markets also grew organically, while North America declined modestly as it compared to a big innovation launch calendar in the previous year. While we are not satisfied with performance, we are encouraged by initial results from several pillars of our strategic reset that we announced in August, which I'll elaborate on in a few minutes.

Despite the lower level of total company reported sales, adjusted gross margin expanded by over 300 basis points. Initiatives of the PRGP drove improvements as Tracey will describe. We strategically increased A&P spending as a percentage of sales in support of our robust innovation pipeline to realize over 100 basis points of adjusted operating margin expansion, despite significant operating deleverage. We delivered adjusted EPS of \$0.14 better than \$0.11 in the year-ago period, and \$0.04 above the high end of our outlook range.

Looking ahead, as the quarter evolved and through October, it became increasingly apparent that we are facing greater macro headwinds for fiscal year 2025 than we expected in August. First, the prestige beauty industry reported retail sales in Mainland China further weakened sequentially from a 10% decline in our fourth quarter to a mid-teens percentage decrease. Importantly, we gained share in prestige beauty in Mainland China for the second consecutive quarter, driven by industry-leading share gains in Skin Care and a return to share gains in Makeup. Consumer sentiment in Mainland China weakened further our first quarter. While we believe the new economic stimulus measures present medium- to long-term potential for stabilization, and then ultimately growth in prestige beauty, we anticipate still strong declines near term for the industry.

Second, the prestige beauty industry in Asia travel retail continued to be significantly pressured as conversion levels are still far lower than pre-pandemic. Third, the US prestige beauty industry retail sales slowed sequentially from high-single-digit growth in our fourth quarter to mid-single-digit growth as elevated levels of inflation-driven pricing faded. While this is still good growth, the months of August and September posted lower growth than July. Encouragingly, although the US prestige beauty industry retail sales growth decelerated sequentially, our company retail sales growth accelerated, and we further reduced our prestige beauty share loss.

We believe we are well on our way to stabilize shares in the US as we increase our exposure to high-growth channels, and we have our sights set on a return to prestige beauty share growth. With this complex industry landscape, including the particular difficulty in forecasting the timing of market stabilization and recovery in China and Asia travel retail.

And in the context of the retirements of Tracey and myself, we are solely issuing an outlook for the second quarter and withdrawing our fiscal year 2025 outlook. Additionally, we are reducing our dividends to a more appropriate payout ratio, which will also create more financial flexibility for our incoming leadership team to reaccelerate our profitable growth trajectory.

Our second quarter outlook reflects the extensive headwinds at retail in China and Asia travel retail as we do not expect to see benefit from the stimulus in the near term. We intend to continue investing behind our strategic reset, especially in support of our rich innovation pipeline and expanded consumer reach. Our strategic reset at this point in time is focused on continuing to rebalance our regional growth, evolving our exposure to China market volatility, which has already come down by nearly 10 percentage points since fiscal year 2022.

At the strategic reset, core is the PRGP, aimed at restoring sustainable long-term organic sales growth, in part through generating investment opportunities as well as rebuilding profitability and increasing agility. For fiscal year 2025, we are focused on executing the PRGP with excellence. During the first quarter, the focus and dedication of our teams around the world enabled us to establish a strong foundation on delivery for the plan. We have made good progress in operationalizing the PRGP, evident in our gross margin expansion, despite the pressure to mix from Skin Care decline as well as beginning to right-size areas of our organization and address overhead expenses to reflect the lower-than-expected sales growth in the last two fiscal years.

As you know, our strategic reset for fiscal year 2025 also has the following five priorities: reignite Skin Care; capitalize on the multiple growth drivers of high-end Fragrance; move faster in leveraging winning channels; launch accretive innovation, inclusive of new big opportunities; and modernize precision marketing by leveraging data and AI, the latter of which we call our consumer-centric growth model.

Today, let me share our progress across Skin Care, Fragrance as well as leveraging winning channels. For Skin Care, we began to realize our ambitions to drive consumer demand in the ritual of nighttime skin care as we brought exciting innovation to market, appealing to a diverse range of consumer segments. Our Estée Lauder brand has long been a leader in the science of skin recovery during sleep with its Advanced Night Repair serum. Its new advanced night repair overnight treatment drove expanded [indiscernible] (00:09:54) by both loyalists and new consumers. This launch, coupled with a brand-new moisturizer in the Supreme franchise focus on improving signs of collagen loss with overnight visible line reductions, led to high single-digit organic sales growth in Skin Care in the markets of EMEA.

La Mer further contributed to our momentum in nighttime skin care. Its new rejuvenated night cream exceeded our expectation in Asia Pacific, driven by the product's resounding appeal in China, where we saw excellent new consumer acquisition trend, and La Mer realized strong share gains in prestige Skin Care.

For Clinique, among its nighttime innovation is the Smart Clinical Repair AM/PM Retinoid Balm stick. It has been very well received in its initial markets, demonstrating an ability with nighttime skin care to trade consumer app and into the brand with an approachable price point and unique [indiscernible] (00:11:01). Both [indiscernible] (00:11:03) and the franchise new overnight recovery cream plus mask have compelling ingredient stories and strong clinical results, which Clinique's scientists recently featured in the prestigious dermatology conference in Amsterdam.

Indeed, Clinique's focus on nighttime skin care builds upon the strategy it became deploying earlier this calendar year to double down on its authentic dermatologists brand heritage. This strategy has been highly successful, evidenced by the Clinique's fifth consecutive month of prestige beauty share gains in the US through September.

Turning to Fragrance. Our confidence in the category's promising growth opportunity remains strong. For the first quarter of fiscal year 2025, excluding global travel retail, our luxury and artisanal brands delivered mid-single-digit organic sales growth, fueled by gains in every region. Le Labo, Jo Malone London and KILIAN PARIS were standouts. From Le Labo's significant double-digit growth in China to Jo Malone London's impressive results, expanding with the male consumer, to KILIAN PARIS highly sought innovation. And we are thrilled to have launched BALMAIN Beauty during the first quarter, beginning with a sophisticated collection of eight fragrances, four of which are BALMAIN's legacy scents reinvented for the modern era.

As we enter Fragrance's highly important holiday gifting season, we are complementing the strengths of our luxury and artisanal portfolio with activations and innovations from Estée Lauder and Clinique to reaccelerate their growth, as we aim to better capitalize on opportunities in the prestige tier of fragrance.

Let me now move to our pillar of leveraging winning channels. From the Amazon Premium Beauty store in the US to TikTok Shop to Shopee in Southeast Asia, many of our brands expanded their reach to attract new consumers. Alongside these launches, we also strategically expanded the freestanding store footprint of our luxury and artisanal fragrance portfolio, offering elevated experiential shopping. This exciting work continued into the second quarter when last week, our flagship Estée Lauder brand launched in the US Amazon Premium Beauty store.

Before I close, I want to highlight that we recently published our fiscal year 2024 Social Impact and Sustainability Report. As detailed in the report, we achieved several sustainability goals, some ahead of schedule, including surpassing our water withdrawal targets, publishing our first corporate ingredient glossary and reaching our palm oil objectives before our 2025 deadline. For the fifth year in a row, we achieved carbon neutrality across our Scope 1 and Scope 2 greenhouse gas emissions, and sourced 100% renewable electricity globally for our direct operations.

Along with the report, we also published an update to our climate transition plan, which describes our recent progress and evolution towards our 2030 Science Based Targets across our climate actions work streams.

Let me now close by recognizing the evolution of company leadership, following the retirement announcement of Tracey and myself. As you know, tomorrow Akhil Shrivastava becomes the company's CFO. Akhil has been a proven leader at the company for nearly a decade with demonstrated financial acumen. And we look forward to all he will accomplish.

On behalf of the company, I extend our deepest gratitude to Tracey for her significant contributions. Tracey embodies the very best qualities of a leader. And we are a far stronger organization today, given her dedication to all of us. We wish her every joy in her well-earned retirement.

Yesterday, marked an exciting milestone in our company over 75 years of history, as we announced the promotion of Stephane de la Faverie to be our next President and CEO. I'm thrilled to welcome him into his role as of January 1, and look forward to supporting a seamless transition for the next several months. Stephane's deep knowledge of our company and the industry, exceptional strength as a leader and unique ability to combine inspiration, authenticity and strategic insights to drive profitable growth will enable him to move us forward with speed and agility.

To our employees, thank you for your passion for our company and its incredible brands. I'm confident that you and this company that I love will be in great hands.

I will now turn the call over to Tracey.

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## Tracey T. Travis

*Executive Vice President and Chief Financial Officer, The Estée Lauder Companies, Inc.*

Thank you, Fabrizio, and hello, everyone. I'll begin by reviewing our financial results for the first quarter, followed by the outlook that we are prepared to share today. As Fabrizio mentioned, our first quarter organic net sales declined 5% at the lower end of our expectation. Our adjusted earnings per share was \$0.14, which exceeded our initial outlook for the quarter, primarily due to the timing of certain expenses.

Starting with our regions. Organic net sales in our Asia Pacific region decreased 11%, mainly driven by further softening in overall prestige beauty, due in large part to worsened consumer sentiment in Mainland China. In addition, we experienced a net sales decline in Hong Kong SAR, where sales were pressured by lower spending from traveling consumers as well as reduced foot traffic at retail.

These declines were partially offset by continued strength in Japan, where domestic and traveling consumers drove double-digit growth in both brick-and-mortar and online channels. Organic net sales in our Europe, the Middle East and Africa region decreased 4%, driven largely by the ongoing challenges in our Asia travel retail business.

Our global travel retail net sales decreased double digits due to lower replenishment orders in Asia travel retail. This reflected the further retail market deceleration and worsened consumer sentiment in China, resulting in lower conversion rates. Consequently, while we managed to reduce our overall initial – overall inventory levels in the trade, it was a slower pace than we initially expected.

Elsewhere, in EMEA, net sales grew low-single digits, benefiting from commercial activations like Estée Lauder's #NightDoneRight campaign as well as both existing products and new product launches, including the Clinique Pop Lip franchise. Luxury Fragrances was also strong, led by Le Labo. Retailer and pure-play sites drove overall double-digit growth from online channels.

Organic net sales in the Americas decreased 1%. In North America, our retail sales in the US accelerated sequentially. However, our soft retail sales from M·A·C, Aveda, TOM FORD and Too Faced led to overall lower net sales, reflecting fewer replenishment orders for these brands. A strong competitive environment and the continued moderation of growth in prestige beauty in the US also contributed to the net sales decline. Our team remains focused on evolving our channel distribution mix towards fast-growing channels with the consumer as evidenced by the launch of seven brands in the last eight months in Amazon's US Premium Beauty store, including our most recent launch of Estée Lauder, as Fabrizio mentioned. This strategic pivot drove our double-digit online growth in growth in the US.

In Latin America, continued net sales growth in Brazil, led by Makeup, drove double-digit increases in our freestanding stores and specialty multi-channels. From a category standpoint, organic net sales declined 8% in Skin Care and 6% in Hair Care. In Skin Care, the organic net sales decline was largely due to the pressures in Asia Pacific and in our Asia travel retail business, which more than offset the growth we experienced.



In the Americas and the markets of EMEA, including from Estée Lauder with its successful night activations in the West, and shipment for the products launched in Amazon's US Premium Beauty store.

Organic net sales in Makeup decreased 2%, driven by declines from M.A.C and Too Faced primarily reflecting the brand's retail softness in North America. These declines were partially offset by standout performance from Clinique, which saw strong overall double-digit net sales growth, driven by contributions from all regions. The brand's existing products and new innovation in its Clinique Pop and Almost Lipstick product franchises, along with its launch in Amazon's US Premium Beauty store in fiscal 2024 primarily drove the brand's growth in the quarter.

Organic net sales in Fragrance decreased 1%, mainly due to declines from TOM FORD, Clinique and Estée Lauder, driven by pressures in both our Asia travel retail business and North America. These decreases were partially offset by growth from the rest of our luxury fragrances, particularly in the Asia Pacific region and the markets of EMEA, driven by hero products, new innovation and targeted expanded consumer reach.

Our gross margin expanded 310 basis points compared to last year, largely due to a reduction in obsolescence charges as we better aligned our inventory on hand with our shipments throughout last year. We also better capitalized on our strategic pricing initiatives by reducing discounts related to excess production and promotions, while leveraging our pricing power ahead of inflation through an enhanced more granular pricing methodology. This was partially offset by the unfavorable change in mix, particularly the decline in Skin Care and the corresponding fixed cost deleverage.

Our gross margin for the quarter also improved 90 basis points sequentially versus our fourth quarter. With this progress, we are pleased that key initiatives under the PRGP are beginning to address the specific pressures to gross margin that we experienced over the past two years, including the sales pressure we continue to experience in the quarter. We obviously still have much more to do, and the company remains focused on controlling excess and obsolescence through our integrated business planning process to better align our forecast accuracy and demand planning as well as addressing other cost opportunities in the supply chain.

Operating expenses increased 190 basis points as a percent of sales during the quarter, primarily driven by selling expense deleverage and advertising to support new product launches. This deleverage offset the net benefits and expenses realized under the PRGP in the quarter. As I mentioned in August, most of the PRGP's estimated net benefits this year are expected to be realized in improving our gross profit margin with approximately 20% of the benefits realized in reducing certain operating expenses. We expect to achieve greater net benefits and operating expenses for the remainder of the year from the plan as initiatives are further operationalized and as benefits from our restructuring program progress.

Operating income increased 33% to \$144 million, and our operating margin expanded 120 basis points to 4.3% compared to 3.1% last year. Our effective tax rate for the quarter was 38.8%, compared to 17.9% last year. The increase is mainly due to the lower tax base in the prior year, which included the utilization of income tax credits and benefits from previously issued stock-based compensation. Diluted EPS was \$0.14, compared to \$0.11 last year due to the improving operating profit performance.

Our plans under our previously communicated PRGP are on track and advancing well. We also continue to explore additional savings initiatives to offset some of the impacts from the incremental sales pressure we are experiencing globally, as well as mitigate the impact of reduced volume on certain initiatives within the PRGP.

As it relates to our restructuring program, to date, we have taken \$221 million of charges, primarily related to initiatives designed to optimize and right-size our value chain by reducing spans and layers. Additionally, we intend to expand our shared services capabilities to streamline and standardize key processes that should enable us to better leverage our sales growth as it occurs. During the quarter, we utilized \$670 million in net cash flows from operating activities, compared to \$408 million last year. The increase in net cash utilization is mainly due to lower net earnings compared to last year and higher taxes paid.

In addition, from late August through October of this year, we entered into agreements with certain plaintiff law firms to settle approximately 70% of pending talcum powder cases and established annual capped amounts with each participating law firm for potential future claims over the next five years, starting on January 1, 2025. As a result, we recorded a charge of \$159 million related to these agreements. We entered into these agreements in response to the rising number of cases brought against the company, as well as to proactively help to mitigate future risk from the evolving litigation landscape related to talc.

We invested \$141 million in capital expenditures and we returned \$240 million in cash to stockholders through dividends. As you read in our press release this morning, we declared a quarterly dividend of \$0.35 per share, a reduction from our previous quarterly dividend of \$0.66 per share as we reduce our dividend to a more appropriate payout ratio, given our earnings outlook.

And now, turning to our outlook. As Fabrizio mentioned, we have taken the decision to withdraw the full year outlook we provided in August, and are only providing an outlook for the near-term second quarter today. We have not made this decision lightly and believe it is the right action, given the current environment, including the difficulty in forecasting the timing of market stabilization and recovery in China and Asia travel retail, and in the context of upcoming leadership changes.

Let me expand a bit on some of these incremental pressures on the business. First, as we discussed in August, our initial outlook anticipated pressures in both Mainland China and Asia travel retail, expecting these changes to significantly impact our first quarter results, but moderate sequentially throughout the year, including a modest return to net sales growth in the second quarter. While our first quarter results are generally aligned with those expectations, the worsening consumer sentiment in these areas has been greater than anticipated, and is also now expected to persist in the near-term. Although, we are cautiously optimistic about the potential medium to long-term opportunities presented by the new economic stimulus measures in China, we believe both the timing and the magnitude of their impact on our business in the region are uncertain. As a result, we now anticipate continued near-term net sales declines in these areas of our business and overall for the second quarter, adding pressure to our EPS.

Second, continued normalization of prestige beauty growth in other markets post pandemic, along with near-term residual impacts of the previous inflationary period on consumer sentiment, has created some uncertainty about the level at which market stabilization will occur and is expected to further pressure our second quarter results.

As mentioned earlier, we remain focused on realizing net benefits from our PRGP initiatives. Given the anticipated incremental sales pressure, we acknowledge the need to continuously evaluate the plan and, more importantly, take decisive action to maximize its benefits, identify new opportunities for growth and pursue additional savings initiatives. Using October 24 spot rates of \$1.078 for the euro, \$1.293 for the pound, CNY 7.126 for the Chinese yuan, and KRW 1,380 for the Korean won, currency translation is not expected to have a material impact to reported sales and EPS for the second quarter.



We now expect organic net sales for our second quarter to decrease 6% to 8% compared the prior year period, largely due to the ongoing challenges in Mainland China and in Asia travel retail we have discussed, as well as persistent low conversion rates by trailing consumers in Hong Kong SAR.

In terms of gross margin, we expect expansion in the second quarter compared to last year, although it is not expected to be at the same magnitude as the level of expansion we saw in the first quarter. Recall that last year's first quarter gross margin was the lowest of the fiscal year as it was more affected by high obsolescence charges, and discounts than in the other three quarters, and it did not reflect the benefits of the strategic actions we implemented later in year to address these pressures and improve gross margin.

We now expect our second quarter effective tax rate to be approximately 43% compared to 37.7% last year. The increase primarily reflects the unfavorable impact of previously issued stock-based compensation, which tends to have a disproportionate effect in the second quarter due to the timing of equity award vesting and our estimate of lower earnings compared to last year.

We now expect second quarter adjusted EPS of \$0.20 to \$0.35 or a decrease between 60% to 77% versus prior year. This has undoubtedly been a challenging period for our teams and all of us to manage through. However, as Fabrizio mentioned, we are encouraged by some bright spots that we are starting to see from proactive measures we have taken previously. There is clearly more to be done, and we have confidence in our teams, including our new leadership team to continue to drive progress forward.

As I close this earnings call, I want to express my sincere gratitude to our dedicated employees. Your steadfast commitment, hard work, incredible passion for our brands and resilience have been vital to our success over these years and certainly will be in the future. And reflecting on my past 12-plus years with the company, I am immensely proud of the many things that we have accomplished together. To our valued investors, thank you for your continued support. Your patience and confidence in our long-term growth strategy and initial PRGP actions have been instrumental as we navigate through this intense period of volatility and the resulting impact it has had on our performance.

I am optimistic in the company's ability to continue to take the appropriate decisive actions to manage through this prolonged period of volatility and supported by the PRGP and the strong result of our employees to progressively return to more consistent and sustainable sales growth and stronger profitable recovery.

Thank you, and that concludes our prepared remarks. So, we'll be happy to take your questions at this time.

## QUESTION AND ANSWER SECTION

**Operator:** Ladies and gentlemen, we'll now begin our question-and-answer session. [Operator Instructions] Our first question today comes from Dara Mohsenian from Morgan Stanley. Please go ahead with your question.

**Dara Mohsenian**

*Analyst, Morgan Stanley & Co. LLC*

Hey. Good morning.

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**Tracey T. Travis**

*Executive Vice President and Chief Financial Officer, The Estée Lauder Companies, Inc.*

Good morning, Dara.

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**Dara Mohsenian**

*Analyst, Morgan Stanley & Co. LLC*

So, clearly, the – good morning. So, clearly, the external circumstances have worsened in the beauty category, particularly in China and Asia travel retail, as you mentioned. Just wanted to get your perspective on the internal reaction to that, A, just from a productivity standpoint, is there more you can do beyond the PRP (sic) [PRGP] (00:32:53) program? Tracey, you alluded to that in your prepared remarks, but just with the significant pressure on the business and the dividend cut today, can you give us a bit more detail on how much more aggressive you can get on cost structure, the potential areas you're looking at? And then, B, just other side of that, is how much reinvestment might be needed going forward to drive a top line recovery? So, any thoughts there in light of the industry conditions at this point would be helpful. Thanks.

Q

**Tracey T. Travis**

*Executive Vice President and Chief Financial Officer, The Estée Lauder Companies, Inc.*

Sure, Dara. So, obviously, given the situation, and I discussed this a little bit in the prepared remarks, we are evaluating additional actions related to the PRGP and beyond, given the continued pressure on the business. So, we have identified some additional cost savings to offset some of the volume pressure that we saw in the first quarter. There are more plans under discussion as it relates to the PRGP.

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As it relates to investment, we did protect some investment in the first quarter. We actually did experience a bit of deleverage in more of our consumer-facing areas like marketing, advertising and promotion as well as selling. We will do that again in the second quarter. So, that is some of what is embedded in the guidance. And obviously, Stephane and Akhil will be communicating going forward what the plans are that are in process right now being worked on in terms of the new actions that might be incorporated under the PRGP as well as other growth areas as well. But we are very much focused as we have communicated previously, under the PRGP, to free up costs, obviously, not only to improve our margin, but importantly, to fuel additional growth for our brands and more to come on that.

**Fabrizio Freda**

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

And I want just to add that on the reinvestment on top of the amount of funds that we need to reinvest is the improvement of the quality of this investment and on the return on these investments, where we are doing as part of the PRGP a lot of work. And this means, for example, what we call the strategy of increasing our precision

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marketing and our consumer-focused marketing, which is basically the recognition of the improvements we need to do in the digital social media part in the way we go to market in every market of the world in this area. And there are some exciting progress happening as demonstrated by some results in the market share that some new innovation created, while using this precision marketing techniques.

And then is the – also the winning – the acceleration of winning fast in growing channels is obviously a big part of that, because when you are present in the growing winning channels with our brands faster and with more services and clarity, like we are doing, as I explained in my prepared remarks in many markets, this makes the return on the investment that we are doing better and more productive. So, it's a combination of investing more, as Tracey explained, and making every dollar count more.

**Operator:** Our next question comes from Steve Powers from Deutsche Bank. Please go ahead, with your question.

### Steve Powers

*Analyst, Deutsche Bank Securities, Inc.*

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Thank you very much, and good morning. I was hoping we could step back a little bit, just amidst all this volatility, and get some perspective on how see your market share standing across key markets, your expectations for how those market shares should trend into 2Q and over the balance of the fiscal year? And to the extent possible, how you see different regions contributing to the negative 6% to negative 8% organic growth call for second quarter? That would be helpful. Thank you very much.

### Tracey T. Travis

*Executive Vice President and Chief Financial Officer, The Estée Lauder Companies, Inc.*

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Yes. So, in terms of the regions – and, Steve, you know we normally don't give regional guidance, just our overall guidance. But obviously, with down 6% to down 8%, we would expect, as we said, continued pressure from China and travel retail. We've also seen, and I think Fabrizio will touch on this point on the market share, we have seen slowing in other markets as well.

So, when you think about last year, first quarter, we had double-digit growth in several markets in North America and APAC. And we've seen that progressively decelerate, still positive, and I'm talking market now, but progressively decelerate throughout the four quarters. So, part of the uncertainty is whether or not those markets will decelerate again in the second quarter. But we are expecting that China and travel retail will be down meaningfully in the second quarter as they were in the first quarter. And the rest of the business, which Fabrizio talked about what the results were in the first quarter, being a bit of a pickup in the second quarter, but resulting, obviously, in the Q2 guidance that we gave.

### Fabrizio Freda

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

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Yeah. And in market share, I mean, maybe I should – we can speak about the market share plans in every single region of the world. But let me focus on what will make a big difference with China, US, Japan, so the big markets. And so, in China, I think this quarter, in a declining market, we had proved that when we focus on the strategy that we just discussed, meaning focusing on Skin Care in the case of China, the night skin care, focusing on winning in the growing channels, focusing on improving our precision marketing and focusing on leveraging very strong innovation, we can get market share growth in a very difficult market situation.

In China, the growth we got in Skin Care, which is more than 1 full point of market share growth in Skin Care is very, very strong. And this is driven by this innovation, for example, the La Mer brand and their own innovation. We grew also market share in Makeup, where the activity, for example, was less than in Skin Care – our activity was less than in Skin Care. We still grew market share. This shows at least the clear strengths of our brand equities that, when activated correctly, create market share growth. So, in China, we are optimistic on the opportunity in the future.

Japan was another great example, where we focused, particularly in the case of Japan, on our Fragrance portfolio in the new Le Labo store and with the new Jo Malone stores in Tokyo that are flagship stores, and the result has been an extraordinary, frankly, 200 points of market share gain in Fragrance, and becoming the number one fragrance company in Japan in only one quarter. Again, shows that the focus, when we put the focus on the activation of these strategy drivers, we get extraordinary results. So those are, frankly, green points that shows how the underlying brand equity is strong and, when activated correctly, we get what we need to get.

And finally, on America, I want to say that is our retail trends in America was strong, was accelerated from 2% in the quarter four to 3% this quarter, so improving and improving in a declining market growth, as Tracey just explained. So the market growth went from 9% to 5%. So, in a still growth but declining level of growth, we were growing better and accelerated in retail, which means practically in America, we are reducing the market share growth. And as I said in my prepared remarks, we look forward to a stabilization.

And the tactics which are working here, and again, very visible in what is the reaction of our Clinique brand, which obviously a classic brand, a brand which is there for many years, is the market leader in Skin Care, in the market and is growing now market share for five months in a row, driven by the big repositioning and leveraging the trends in derma, Skin Care, particularly, but also leveraging the huge success in Makeup in this moment, as we explained in the prepared remarks.

And also, it's been driven obviously by the Amazon distribution. But I want to notice that at the same time, the success of Clinique in Ulta has been very, very strong, showing that the Amazon is bringing the new customers. It's not just sticking to the same customer. It's adding market share, adding new customers and allowing all our new channels partners like Amazon or historical strong partners like Ulta to get success on the same brands. And this is happening also in Fragrances and many other activities we have in the market.

So, we are focused on continue accelerating market share gains in markets like China and Japan and focus on achieving further stabilization and then gain market share also in the US. And there are many other markets of the world, emerging markets or specific markets, where when we look at the last 12 months, we did progress market share. And we will continue to accelerate. Together with the answer that Tracey and I gave to the previous question, which is the increased investment and increased precision of these investments, I hope you see the full picture of what we are trying to do even in a moment where the bottom of the markets, but in China and travel retail are dropping under us, we are keeping the focus on this recovery of market share in every single market.

**Operator:** Our next question comes from Lauren Lieberman from Barclays. Please go ahead with your question.

**Lauren R. Lieberman**

*Analyst, Barclays Capital, Inc.*



Great. Thanks. Good morning, everyone. I wanted to talk a bit about the dividend cut, both in terms of timing and kind of the message. So, first is in terms of timing, why not clean this up back in August? I know that China worsened during the quarter. But I would argue it's not to the degree that dividend should have come into question. And then, the second thing is just on message. Should we be thinking here about it because of timeline

and magnitude of earnings recovery when we think out over the next several years? Should we be thinking about cash and reinvestment needs because there's hardly a leverage problem, there's not a balance sheet problem, but this is a pretty big change? So, timing and sort of the message and how we should be thinking through this beyond this is just being room for new leadership? Thank you.

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**Tracey T. Travis**

*Executive Vice President and Chief Financial Officer, The Estée Lauder Companies, Inc.*

A

Yeah. No. Thanks, Lauren, for the question. Look, reducing our dividend is not an indication at all of what we think about our long-term growth opportunities. Given the pressures, not only in the first quarter, which, to your point, we expected, but in the second quarter, which is a difference, obviously, than where we were in August.

As we looked at recognizing the level of uncertainty that we are experiencing for the balance of the year, which caused us to pull our guidance, we thought it's appropriate at this time as well to look at the dividend. When you think about paying \$0.66 dividend with the earnings, the \$0.14 that we had in the quarter, and obviously, what we guided for the second quarter, it was appropriate for us to right-size the dividend at this time to make sure. Obviously, we don't have a liquidity problem to your point, but recognizing the prolonged situation in terms of pressure in our markets, right-sizing the dividend, still a very good dividend yield for investors. But right-sizing it was the appropriate thing to do to protect the cash that will be needed, obviously, for additional actions that we may take under the PRGP as well as additional investments we may make to support growth.

So, really looking at it in totality in terms of total shareholder return and figuring out what's the best way for us to invest back in the business as well as obviously continue to return a nice yield in terms of dividend to our shareholders.

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**Operator:** Our next question comes from Bryan Spillane from Bank of America. Please go ahead with your question.

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**Bryan D. Spillane**

*Analyst, BofA Securities, Inc.*

Q

Thanks, operator. Good morning, Tracey. Good morning, Fabrizio.

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**Fabrizio Freda**

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

A

Good morning.

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**Bryan D. Spillane**

*Analyst, BofA Securities, Inc.*

Q

I guess, my question is more related to the management change and qualities and skill sets that both you and Tracey were looking for in terms of replacements. And I asked that in the context of you both have been around this company as it was effectively turned around and brought it to a very amazing peak. And the landscape's changed a little bit for sure. Maybe that understates it. And so, just I think people are trying to understand what comes next. And not asking about the people specifically, but just the qualities, the skill sets you were looking for. And I guess how it informs like what you think needs to be different, right, as the company kind of charters through these next few years relative to maybe what you all brought to the party over last 10-plus years?

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

A

Yes, it's – first of all – let me say, first of all, what has to be different in the business. As you know, we have announced what we believe is the strategy reset, and we are working hard to rebalance the growth model of the company, and avoiding in the future overexposures to areas of the global world that becoming too volatile and more uncertain, and so is the rebalancing for the certainty of growth. Just to make an example of this – because this acts in many areas. This concept of balance growth, better exposing to the company to the growth trends of the world is referred to countries, but it's also referred to channels, referred to consumer segments in a very broad way. And obviously, in this moment, it is referred to the overall Asia travel retail and overall China market volatility, where we have rebalanced 10 points in only two years already. And this year, more rebalance will happen. And then, this refer to channels where the proportion, for example, of global department stores versus the other channels, which in this moment are growing faster, is changing in favor of the winning channels and et cetera.

So, all this work – by the way, on consumers, obviously, the penetration of young consumers to mention one. So, all these important strategic rebalancing elements is something that we believe we need to continue to do. And we need leadership that has the characteristic that can really look at the business in this way. And so, a big understanding of the global market dynamics and understanding on global consumers and continuing the work that we have started of focusing the company on the consumers, and on the big consumer changes that are happening around the world, leadership that will focus with a good understanding of the global business and being able to leverage global growth wherever growth happens.

And also, we are a company of brands, and it's very important that our leadership team continue to be an outstanding brand builder and been able to build brand equities, but also innovation and the quality of the brand of responding to different targets around the world, and the ability of brands to adapt to various market consumer segments around the world with the concept that we called in the past, local relevance that is becoming even more important. For example, the actions that correspond to this intention are building in China, research centers in Shanghai or building factories in Asia that will bring talents to our portfolio in the future. So, those are the part of the strategy needs to be continued.

And there is then the need of accelerating these strategies. And there is the need also, as told, as part of the PRGP, to make the organization faster, in reacting to trends, but also faster in making decisions across the globe and aligning on the changes that are needed to react, so, what we call, the increase of speed and increase of agility, which are just two words. But behind those two words, there's a lot of specific changes that new leadership will intend to bring in the organization is already frankly working on it, and need to be capable of doing this.

That's why I'm personally very happy that the board, at the end selected internal succession, because the internal succession in that area of the ability to bring this organization fast to important changes with the right speed and also the ability to understand what has to be changed in order to increase agility, frankly, visibility is stronger in very talented internal leaders than with the external, but again, that's my point of view.

And then, the understanding of how to better allocate our resources to the big changing trends of the world is also a characteristic that the new leadership needs to have, and that is supported by the quality, obviously, of what the board chose for future leadership, but also by the knowledge of these people about the internal systems and where we are. So net, we believe we need brand builders, but we need also people that will act with urgency, speed, courage to make the needed changes.

I will support this courage – this change in my transition work with the team, and we are looking forward for the new team to add a fast impact in what has to change, but also for the new team to recognize the strengths that



you mentioned in your question. There are the strengths, not only the Tracey and I built in the last many years together in the company, but also the strength that has always been in this company, the values of this company, the long-term quality of the brands and the strength that's part of heritage of this company. So, these historical strengths will be retained, but there will be some fast change in reacting to the new realities. And I personally believe that the new leadership team will be able to bring the kind of improvements and acceleration that, obviously, all of you are expecting from us in the next years.

**Operator:** Our next question comes from Rupesh Parikh from Oppenheimer. Please go ahead with your question.

**Rupesh Parikh**

*Analyst, Oppenheimer & Co., Inc.*

Q

Good morning, and thanks for taking my question. I just wanted to go to the cash flow statement. So, I just want to get a sense of if there's opportunities to further reduce CapEx to better align with the weaker earnings part of the business currently? And then, I just wanted to also get your thoughts on the health of inventory as you see it today?

**Tracey T. Travis**

*Executive Vice President and Chief Financial Officer, The Estée Lauder Companies, Inc.*

A

Yeah. So – and I'll start with CapEx. We have already reduced CapEx from what we had initially expected to invest this year, and that is certainly one of the areas that we're looking at as it relates to cash, along with obviously, improvements in working capital. We made some big improvements last year as it relates to inventory. So, our inventories are in pretty good shape. But, obviously, given the further sales declines, that is something that we are very much focused on in terms of making sure we are faster to react and respond to sales declines in our markets, and keeping the obsolescence in discounting under tighter control. So, we've gotten much more agility in our planning processes and the connection with certainly our supply chain to make sure that we're making the right – taking the right decisions as it relates to production as well as the overall management of the network.

**Operator:** Our next question comes from Bonnie Herzog from Goldman Sachs. Please go ahead with your question.

**Bonnie Herzog**

*Analyst, Goldman Sachs & Co. LLC*

Q

Hi, Thank you. Good morning, everyone. I actually wanted to circle back to Asia travel retail with a question. You mentioned the lower replenishment orders. So, could you give us a sense of maybe where retail inventory levels are currently maybe versus a year ago? And how much further destocking you expect? I guess, ultimately, how do you expect sell-in, sell-out trends to evolve throughout the balance of the year? Thank you.

**Tracey T. Travis**

*Executive Vice President and Chief Financial Officer, The Estée Lauder Companies, Inc.*

A

Yeah. We definitely have lower levels of inventory in trade relative to last year and even last quarter. So, we have made progress, as I said in the prepared remarks, as it relates to bringing down the inventory and trade in Asia travel retail. Because of deceleration of the market, we didn't make as much progress as we had expected. So it is taking a little bit longer. But again, we're not giving guidance for the second half of the year, but we do expect

even in Q2 to be able to make, assuming no more significant change than what we've reflected in our Q2 guidance, some more progress in terms of inventory in the trade.

Right now, it's really a function of the market volatility. Some of the trade that had built up or the inventory that had built up during the pandemic years, we have managed that down. And now, it's a matter of the current market fluctuations that's impacting the levels of inventory that we have in the trade, but we're in a much healthier place than we were certainly a year ago, given the significant actions that we took, particularly in the first half of the year to bring our inventory levels down.

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**Fabrizio Freda**

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

A

And to give a dimensionalization, just to add what Tracey is saying, is we actually have the level in the last several years, but the market is lower than it was in the previous year. So, we should need to continue doing some work. But definitely, there's been extraordinary progress, and I would like everyone to know that the team is very focused in this progress and also our vision of quarter two reflect the need to continue this and never let pass more than a few months when we decided to reflect the market trend also in the level of inventories.

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**Bonnie Herzog**

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. Thank you.

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**Operator:** And our next question comes from Olivia Tong from Raymond James. Please go ahead with your question.

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**Olivia Tong**

*Analyst, Raymond James Financial, Inc.*

Q

Great. Thank you. I wanted to ask more about the Q2 outlook, more so for profit than sales and whether you could talk about what's embedded from a deleveraging aspect versus maintaining investment versus perhaps more difficulty in achieving savings as part of the PRGP. Effectively, just helping us bridge from sales to EPS, because it looks like a much bigger sequential dollar increase than in the years past and up pretty considerably on a year-over-year basis as well. So essentially, what's driving costs up so much in Q2 to help us assess what that pressure looks like in the second half of the year when you're not giving us additional color? Thank you.

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**Tracey T. Travis**

*Executive Vice President and Chief Financial Officer, The Estée Lauder Companies, Inc.*

A

Okay. So, I'll give it a shot, Olivia. So, I would start with gross margin. We expect that gross margin will continue to improve in the second quarter, as I said in the prepared remarks, not as much year-over-year as in the first quarter, but from first quarter to second quarter, we will expect – we do expect even on declining sales, a further improvement in gross margin. On a 6% to 8% decline in sales and that being in China and travel retail and travel retail, in particular, that does put pressure on our expense base. We have talked in the past about both China and travel retail being quite profitable areas for us, given the productivity per door in that region. And so, that is putting some additional pressure on our expense base, but we also are protecting some investments very selectively in areas of the business that are working. And so, it's a big quarter for us, obviously, with holiday.

We do have some new innovative advertising that we are doing behind some of our faster growth areas in order to make sure that we do set up the business to have the best holiday possible in light of the declining sales and 11/11 as well as, obviously, going forward into the second half of the year. So, advertising is one area that is

continuing to deleverage, selling as well, making sure that we have the right staff in our channels of brick-and-mortar distribution in order to execute the sales.

And then, the other area that we've protected strategically this year and continue to do so, obviously, rationalizing that as we see performance come through is store investments. And so, we have brands like Le Labo and Jo Malone, who are freestanding store brands in addition to other channels of distribution. But doing quite well and growing, and we are investing in their store base as well. And so, those are the areas predominantly that we are protecting from an investment standpoint.

As it relates to the PRGP, what we had said previously, and again, I'll reiterate it, is we expected the first half of this year and really much of this year to see PRGP benefits in our gross margin, which we're obviously seeing and more benefits starting in the second half of the year as it relates to some of the restructuring activities that we are taking under the program. And so, the cadence of when to actually see some of those expenses reflected, obviously, being offset with some of the sales declines in the first half of the year would be in the second half of the year. But again, be mindful that the – when you have mid-single-digit declines in your business, it does create deleverage on the rest of the business that the PRGP is helping, but it's still deleveraging.

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**Fabrizio Freda**

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

**A**

And the only thing I want to add, again for perspective to what Tracey explained, is the fact that there is a mix factor, because where the markets declined, the majority of the change we are proposing is as we explained China market and travel retail Asia market. These are two markets where we have big market shares and with big market share comes scale. And with scale comes profitability. So, those are important profitable markets with us where the decline is happening. And this important decline of markets where we have scale, market share and profitability, obviously, is more painful in terms of mix impact on a single quarter, by quarter two, that if the decline was more average around the world, which is not, in this case, is very focused on those two issues.

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**Operator:** And ladies and gentlemen, with that, we've reached the end of the allotted time for today's question-and-answer session and today's conference call. We do thank you for attending today's presentation. You may now disconnect your lines.

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