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The Estée Lauder Companies, Inc. (EL)

Q2 2026 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to The Estée Lauder Companies Fiscal 2026 Second Quarter Conference Call. Today's webcast is being recorded.

For opening remarks and introductions, I would like to turn the call over to the Senior Vice President of Investor Relations, Ms. Rainey Mancini.

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

Hello. On today's webcast are Stéphane De la Faverie, President and Chief Executive Officer; and Akhil Shrivastava, 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'll find factors that could cause actual results to differ materially from those 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. Retail sales performance discussed is based on information available as of January 29th,

2026. As a reminder, references to online sales include sales we make directly to our consumers through our brand dot-com sites and through third-party platforms. It also includes estimated sales of our products through our retailers' websites. Throughout our discussion, the 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 webcast.

Now, I'll turn the webcast over to Stéphane.

Stéphane de la Faverie

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

Thank you, Rainey, and hello to everyone today. We reported strong second quarter results, marked one-year anniversary of Beauty Reimagined and raised our fiscal 2026 outlook. Our second quarter performance further exemplified the momentum we have created across our five action plan priorities. Having delivered 4% organic sales growth, our growth and operating margin expanded and EPS grew 43%, showcasing once again our ability to manage expenses. For the first year we made promises and we kept promises as we expanded our consumer coverage across online and brick-and-mortar in every region; overhauled our innovation engine with new leadership, faster to market launches, and a renewed consumer first mindset; increased consumer-facing investment every quarter to accelerate recruitment, enabled by significant savings from the PRGP; and created one ELC, one new operating model, aligning brands, regions and functions as one team with one culture and one operating ecosystem.

When we introduced Beauty Reimagined, our ambition was bold, execute the biggest operational leadership and cultural transformation in our history to become the best consumer-centric prestige beauty company. Thanks to the passion, creativity and resilience of our team around the world, we have come far in one year. Yes, there is more work to do, but much has been accomplished. In the first half of fiscal 2026, our global retail sales trend improved from the first to the second quarter, from down 4% to flat as the decline in travel retail moderated. Even more encouraging, our retail sales grew 4% in the first half, excluding travel retail. In Mainland China, we outperformed prestige beauty in the quarter, again, with double-digit growth. We gained share for the quarter and calendar year 2025, led by La Mer and TOM FORD, showcasing the strong desirability of our brands, compared to international and local peers.

In Hainan, our retail sales grew high single digit in the quarter, led by Estée Lauder and La Mer. In Japan, we outperformed prestige beauty in the quarter, driven by M·A·C and Le Labo. For calendar 2025, we gained share in Fragrance to strengthen our number one category rank. In the US, for the quarter and calendar 2025, we gained volume share in total prestige beauty. We also grew value share for the quarter and calendar 2025 in Skin Care led by The Ordinary and Hair Care. In addition, Estée Lauder gained share in Makeup for calendar 2025. These retail results and share trend reflects the exceptional execution of Beauty Reimagined over the last year. For our first action plan priority, we moved rapidly to expand our portfolio presence in consumer preferred, high growth channels, market, media and price tiers. We expanded our presence on Amazon Premium Beauty stores now with 12 brands across 10 markets.

We also announced our brand reach on TikTok Shop in the US and South East Asia, and launched our first brand in the UK and Germany. This work, coupled with strong performance on Tmall, Douyin, JD, Notino and Trendyol, drove high single-digit online organic sales growth in the first half, leading us to believe we outperformed prestige beauty in the channel. For fiscal 2026, online is on track to exceed the 31% of reported sales reach in fiscal 2025 as we increasingly tapped into the full potential of this high-growth channel. We increased our presence in travel retail across the west, including with Duty Free Americas, as well as new and upgraded doors for our luxury fragrance in European and Middle Eastern airports, contributing to double-digit retail sales growth for Fragrance across several major retailers in the first half of fiscal 2026.

This strategic expansion is providing a double win, driving growth and diversifying our travel retail business. As we expanded our pharmacy reach in Europe and entered the channel in Latin America, while strengthening our ties in specialty-multi with M·A·C's up and coming launch in the US, Sephora. For our second action plan priority, create transformative innovation. We focused on three areas of breakthrough, on-trend, and commercial. In China, innovation resonated especially strongly. Estée Lauder's three breakthrough launches in the longevity skin care science space contributed to its double-digit organic sales growth in skin care in the market. Our China Innovation Labs created Re-Nutriv's Oil in 15 months, quick for skin care and demonstrating how we are accelerating our speed to market.

And TOM FORD's strong double digit organic sales growth in China was driven by highly sought-after, on-trend launches in lip and face as well as fragrance. Globally, The Ordinary's innovation and expanded consumer reach drove strong double-digit retail sales growth in the first half, demonstrating that our new model allows us to support growth for our own indie brands to drive greater scale. For Makeup, Estée Lauder Double Wear Concealer has been a game-changer in the US, achieving the top ranked new product in prestige makeup based on unit for calendar year 2025. Within Hair Care, Aveda's new Miraculous Oil catapulted to be the brand's top-selling product through the first half. For fiscal 2026, we are on track for innovation to represent at least 25% of sales.

And as we work toward increase the percentage of innovation launched in less than a year from 10% to 30%, we are tracking to 19% for fiscal 2026, above the 16% we initially expected. Turning to our third action plan priority, we boosted consumer-facing investment focused on high ROI opportunities. We invested in our freestanding stores, opening new door for our luxury fragrance brands to showcase their unit experiential retail while selectively closing doors for M·A·C and Origins to drive a more productive fleet. Impressively, Le Labo's strong double-digit organic sales growth in the first half of fiscal 2026 reflects its expanded reach as well as double-digit like-for-like door. We also invested in groundbreaking campaigns for commercial innovation with several on the table for M·A·C, which contributed to the brand's return to organic sales growth in the first half of fiscal 2026.

La Mer campaigns for 11/11 shopping festival and holiday also proved to be a winning investment, contributing to La Mer being our best-performing brand for the first half of fiscal 2026 given its organic sales growth. For our fourth action plan priority, fuel sustainable growth through bold efficiencies, we continue to realize strong savings from the PRGP which Akhil will describe. I want to personally thank the team for working together with speed to bring this to fruition. Finally, for our fifth action plan priority, our step to re-imagine the way we work evolves today as we unveil one ELC, our new operating model aligning brands, region, and function as one team with one culture and one operating ecosystem. We have simplified our structure in support of one team with fewer layers and silos, along with clearer ownership to make it easier to get things done and done well.

And guided by our newly announced beauty commitment to our team, we are leaning into one culture of bold thinking, accountability, agility, unity, and focus. Lastly, we have advanced our work to create a robust operating ecosystem for more connected and scalable enterprise. In the second quarter, we've established our new Enterprise Business Services, selecting Accenture to transform how we deliver shared services globally as we accelerate the deployment of AI throughout the organization. This exciting partnership adds to the ecosystem we are building with leading technology providers, including Microsoft, Google, and Shopify, to fuel our ambition to be the best consumer-centric prestige beauty company.

With the momentum of Beauty Reimagined and our first half results, we are raising our fiscal 2026 outlook today by narrowing the organic sales growth range towards the high end, increasing operating margin expansion from 165 basis points to 200 basis points at the midpoint, reflecting previously expected headwind like tariffs and now greater consumer-facing investment, and raising EPS growth from 33% to 43% at the midpoint. This outlook reflects the confidence in our turnaround as well as the significant work that we still have ahead to drive better performance in the US as well as in the UK despite its return to growth in the second quarter. And while the macroeconomic environment is challenging in the Western Europe market, we see opportunities to improve our results.

For China, we are encouraged by the strong desirability of our brands and innovation, but cognizant of still subdued consumer sentiment. In our priority emerging market, after a significant acceleration to double-digit organic sales growth in the second quarter, we are confident that our new organizational design is enabling us to better tap into growth opportunities. For the second half of fiscal 2026, we have a rich slate of innovation. Already out in Skin Care, Clinique launched its new dermatologists-developed skin care line and La Mer introduced an eye cream to pair with its successful rejuvenating night cream. For Makeup, Estée Lauder's Double Wear is launching next-generation matte foundation with more wear, more shade, more benefits. The brand is already the leader in foundation and looking to strengthen its leadership around the world. And Clinique is fueling the nostalgia trend with the Chubby Stick launch.

For Fragrance, newness from KILIAN PARIS, Le Labo and TOM FORD builds on the category's terrific first half as our best-performing category with 10% organic sales growth. In Hair Care, Bumble and bumble introduced a styling product at an exciting time as it enters SalonCentric in the US. In closing, for fiscal 2026, we expect return to organic sales growth and expand our operating margin for the first time in four years, setting the stage to restore sustainable sales growth and a solid double-digit adjusted operating margin in the next few years. I am immensely grateful for the opportunity to lead this great company, especially as we celebrate the 80th of our founding. We have an extraordinary team, an extraordinary portfolio of brands, and we have momentum onward and upward.

I will now turn the call over to Akhil.

Akhil Shrivastava

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

Thank you, Stéphane. Hello, everyone, and thank you for joining us today. Enabled by Beauty Reimagined, our focus continues to be on long-term consumer-centric value creation through sales growth, margin improvement and strong cash generation. We are delivering solid progress across all three priorities, driven by the team's unwavering determination to build on a strong foundation, advance key initiatives and increase organizational speed and agility. While there is more work ahead, we remain focused on disciplined execution and are well positioned to drive sustainable, long-term value. Before sharing our updated full-year outlook, I'll start with a recap of our second quarter performance. For more details on our second quarter results, please refer to a press release issued this morning. Starting with organic net sales, we grew 4% year-on-year.

This was led by 6% growth in both, Skin Care and Fragrance, which was supported by increased consumer-facing investments behind go-to-market activities and innovation. Targeted expanded consumer reach also drove growth as we continued to execute against our Beauty Reimagined action plan to accelerate best-in-class consumer coverage. These category results fueled double-digit growth in both Mainland China and collectively in a priority emerging markets. In North America, sales were flat, with sequential improvement from the first quarter. Growth online from our continued expansion was offset by a decline in brick-and-mortar. Turning now to margins, gross margin for the quarter was 76.5%, an expansion of 40 basis points compared to last year.

Our expansion was again driven by strong net benefits from our PRGP, including operational efficiencies and within excess and obsolescence, ongoing reductions through a zero waste initiatives. Our improved sales leverage also contributed to expansion in the quarter. These results helped offset headwinds from incremental tariffs, change in a mix of business and inflation. Turning to operating margin, we expanded 290 basis points, delivering 14.4% compared to 11.5% last year. Our disciplined investment allocation and PRGP net benefits drove a 3% reduction in non-consumer facing expenses, even with the normalization of employee incentive costs, helping us to maintain cost efficiency and operating leverage. This funded a 7% increase in consumer-facing investments, driving growth and continuing to strengthen brand equity. Our effective tax rate for the quarter was 39.8%, down from 42.6% last year.

This was primarily due to lower tax expense related to previously issued stock-based compensation. Our rate in the quarter also reflects the estimated unfavorable impact of recently enacted US tax legislation, along with a higher effective tax rate on foreign operations due to new valuation allowances on certain deferred tax assets, primarily in Latin America. Sales growth and cost leverage drove diluted EPS growth of 43% versus last year. EPS increased to $0.89 from $0.62 last year. Looking at our overall PRGP, we continue to execute with focus and discipline, advancing initiatives to better position the company to improve its cost structure, fuel growth and deliver sustainable long-term value. This quarter we made significant progress in advancing our restructuring component of our PRGP, entering into a strategic agreement for enterprise business services in connection with the historic transformation of a global operating ecosystem.

As Stéphane mentioned, this global initiative includes consolidating certain service providers, expanding outsource services, and standardizing end-to-end processes using advanced technology. This enables us to unlock greater productivity and efficiency across the organization. Expected charges for these initiatives include professional service fees, employee costs, and contract terminations. We expect these initiatives to deliver net benefits that ramp up over time as the transition progresses, and service levels normalize. As we execute the migration, we do expect some near-term cost pressure as we operate in parallel with benefits building thereafter. As operational scale and efficiencies are realized, they are expected to drive OpEx improvement and keep us on track to achieve our overall PRGP savings and margin progression.

In terms of restructuring costs through December 31, we recorded $904 million of total cumulative charges, primarily in employee-related costs. Turning now to cash flows, a key priority, for the six months we generated $785 million in net cash flows from operating activities. This is a significant improvement compared to the $387 million generated last year, primarily reflecting higher earnings excluding non-cash items. Also contributing to the improvement was a favorable change in operating assets and liabilities despite the meaningful increase in restructuring payments. We invested $204 million in CapEx, continuing to prioritize consumer-facing investments to fuel growth, while optimizing all other CapEx investments. For the six months, CapEx was down 25% versus last year, reflecting the phasing of projects. These results underscore a strategic focus on improving free cash flow.

Turning now to our expectations for the remainder of the year, we are raising our fiscal 2026 outlook. We remain cautious of potential near-term headwinds, including those from macroeconomic, geopolitical and retailer specific uncertainties though we are encouraged by our momentum and year-to-date performance. Starting with organic net sales, we are narrowing our range and now expect full year sales to increase in the range of 1% to 3% compared to last year. At the midpoint of our outlook range, we assume growth across all regions except for the Americas, where sales are expected to be flat. In the second half, we expect organic net sales to increase low single digits with higher growth anticipated in the fourth quarter relative to the third.

This reflects an incremental transitory headwind in the second half of the year in Asia travel retail from the change of duty free retailers servicing the Beijing and Shanghai airports, including the related online businesses. Turning now to our outlook on margin and EPS. We now assume an operating margin between 9.8% and 10.2%, up from our previous assumption of 9.4% to 9.9%. This improvement reflects both our strong first half performance, and greater gross margin expansion than previously expected. We anticipate operating margin expansion in the second half. This reflects third quarter contraction of approximately 50 basis points, compared to last year, as we invest more in consumer-facing programs to support our largest innovation schedule for the year. This contraction also reflects tariff headwinds.

Diluted EPS is now expected to range between $2.05 and $2.25, up from a previous range of $1.90 and $2.10. This assumes a weighted average share count of approximately 365 million shares and reflects year-on-year growth of 36% to 49%. Please refer to our press release issued this morning for other assumptions included in our fiscal 2026 full year outlook, including those regarding evolving trade policies and enacted tariffs. In closing, as we mark the one-year anniversary of a Beauty Reimagined strategic vision, we are energized by our performance and progress towards restoring sustainable growth, a solid double-digit operating margin, and strong cash generation. We remain focused on disciplined execution and long-term value creation. To our teams around the world, thank you for your dedication, passion, and unwavering commitment to be the best consumer-centric beauty company, together as one ELC.

That concludes our prepared remarks. I'll now turn it over to the operator to begin the Q&A session.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for questions. [Operator instructions] The first question today comes from Bonnie Herzog with Goldman Sachs. Please go ahead.

Bonnie Herzog
Analyst, Goldman Sachs & Co. LLC

Q

Thank you and good morning everyone.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Good morning Bonnie.

Bonnie Herzog
Analyst, Goldman Sachs & Co. LLC

Q

Good morning. I guess I have a question on Americas where you just mentioned that you expect growth to be flat in the year. I guess it does appear a little light in context, I guess, of the much easier comps from last year and then the progress you've been making with launches on Amazon, et cetera. So, just curious how you're thinking about the underlying performance in the Americas? And what are some of the key moving parts to keep in mind? And then if you could just also provide any color on the cadence of growth, will it be more balanced or skewed towards FQ4, just thinking about in the context of the full company guidance? Thank you.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

No, thank you, Bonnie. I'll take that and Akhil can add some. So, look just – let me just go back a little bit in North America first and obviously, I'll talk about the Americas in total. We come out of 10 years of market share loss in the Americas and I'm really proud of actually the momentum that the team have put into this market because when you look at the calendar 2025, we've been able to gain share in volume. And that was very important and I've said it multiple times. We needed to reengage our brand to recruit consumers, and we've been able to do it across many of our categories and many of our brands. So, we are now in a volume market share gain. And on top of it, we are also in a share gain in value in Skin Care, led by The Ordinary and many of our brands that are pulling the total.

So, we are seeing some momentum, but we are coming out of [ph] obviously (00:27:08) having a lot of, like, you know, market share loss over the years. So, we still are the number one brand and the number two brand in Skin Care, the number one and number two brands in Makeup with Clinique and The Ordinary in Skin Care and Clinique and M·A·C in Makeup. We're seeing a lot of strong performance with Estée Lauder and M·A·C at Ulta. Very excited, and I've communicated it in October-November that we were entering M·A·C US at Sephora, and this is actually a big milestone for us after many, many years of not playing in like all specialty-multi universe. So yes, we are seeing great momentum, and we are moving, Bonnie, in the right direction when it comes to North America. That being said, there's still a rebalancing of all the channels that we are in the process of doing, as highlighted by Beauty Reimagined.

We've moved fast with Amazon. We are repositioning the department stores, we know, and we are exiting distribution as the distribution erodes, and we are moving fast into the specialty-multi. So I believe there is great momentum, and I see a lot of more momentum going forward for our brand overall. Now the Americas is also a combination of North America and also Latin America. While Latin America has been very strong at the beginning of the calendar 2025, we've seen a slowdown of consumer consumption in the market. And I think one of the main challenges that we see is the enacted tariffs are starting to hurt consumer confidence in Latin America. But overall, I want to say I feel very strong, we have momentum in the market, volume share is back, and we are moving our brands. So I do believe we will see additional momentum going forward into the market.

And to the second part of your question about the cadence, and we've indicated it in the prepared remarks and in the press release, we see a stronger Q4 than we see in Q3 overall for the company because of some of the adjustments that we are seeing, especially in the East with travel retail. One other thing that we are experiencing in travel retail is still some level of disruption, especially when it comes to Beijing, Shanghai airports, but also the online business with Sunrise. As you know, certainly, Sunrise has stopped operation. All the operations have been transferred with a mix of China Duty Free, Avolta and Wangfujing. So there's a little bit of a transition that we felt in Q2 that goes into Q3, but I really believe that there's going to be strong normalization based on the great relationship that we have had.

And I want to just remind that Q2 once delivered a very strong Q2 that beat our expectation despite actually challenging in travel retail, thanks to very strong performance in China and acceleration also in some markets in the West. So I think, again, we have momentum and there's a rebalancing of growth, but our ambition is really to deliver the top end of the guidance that we've put in top line and in bottom line. So we've narrowed the midpoint, but really our objective clearly stated today is to deliver the top end of the guidance.

Bonnie Herzog
Analyst, Goldman Sachs & Co. LLC

Q

All right. Thank you very much.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.
A

Thanks, Bonnie.

Operator: The next question comes from Filippo Falorni with Citi. Please go ahead.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.
A

Good morning, Filippo.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.
Q

Hi, good morning, everyone. Morning. Stéphane, I was hoping you could expand a bit on the travel retail business, if you can give us a state of the union of the total travel retail business. And especially in Hainan, we've seen clearly an improvement in conversion rates in spending in duty-free stores. So what gives – what's the outlook as you think going forward for that part of the business? And maybe can you comment a bit on the other parts of the travel retail business in North Asia, especially South Korea and Japan? And especially as we think about the back half of the year, where when you think about on a two-year basis, you're comping more normalized shipment levels. So, how are you thinking that could play out in the back half of the year? Thank you.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.
A

Thank you, Filippo. And I'll try to make a state of the union that doesn't last too long, because it's a very complex things that is happening in travel retail. Now, the one thing I would say, let me start from where we really have strong momentum and I see like travel retail accelerating, it is indeed in Hainan. And I think it is clearly documented that traffic is picking up in Hainan, and I'm really strong and really happy with the work that the team did in Hainan. In calendar 2025, we are growing and we are ahead of the department, and we are – so we are gaining market share. What I'm excited also, we're gaining market share across a more diverse portfolio of brands that we have done it in the past, which if you remember, all our growth was coming from Lauder and La Mer.

Now we have Lauder, we have La Mer, we have M·A·C, we have Jo Malone, we have TOM FORD that are really performing in the channel very well. And one of the reasons why we've seen this performance and we are back at driving retail with a lot of eventing, because the traffic is there, but conversion is still low. When you are there and you create really retail entertainment, we are able to convert the consumer. And I'm happy to report today that the month of January in Hainan was in high double-digit for us, again, gaining market share across many of our brands. So very excited by – especially going into the Chinese New Year timeframe, it is very important, very clear indication that we are back, able to convert traffic into sale. Now, I want to be very clear, Hainan is only a part of travel retail East, and I think this is where maybe there's a little bit of a misconception of how big is Hainan in the total.

The travel retail East is a combination of Hainan, again, the airport of Beijing and Shanghai, the universal app where people can buy online products. But there is also, frankly, the rest of APAC that is highly disrupted Korea, and we are seeing some recovery in the rest of APAC, but it's still very small in comparison of the China ecosystem. So, now, let me just explain what happened in Q2, our Q2, the last quarter of the calendar year in the ecosystem of Shanghai and Beijing, and the universal app. Obviously, you know that all of this business is being in the midst of being transferred from Sunrise like I said to CDF, Wangfujing, and Avolta. There's a bit of a disruption in the market happening in this moment in time as we are transitioning, and that's the normal course of doing business. Concessions sometimes move from one retailer to another.

But the universal app that was a significant part of the business was shut down in Q2 and remain shut down as we speak. So, obviously, our ability to just like convert is more limited. Now, if you look at China Mainland and travel retail, we outperform in China Mainland in Q2. And in the total travel retail, to your expectation, maybe we delivered less. My point is it's an entire ecosystem that we need to look at where we are capturing the sales. The going forward is very strong. I want to be very clear. It is actually this change is a good thing, especially at the time where we are managing our inventory very carefully. We are shipping only to the demand, and we see this change being the right thing. We have very strong partnership with CDF, with Wangfujing, with Avolta locally and globally.

And we are in the process of putting the right [ph] GBP (00:35:24) to make sure that we can accelerate in the course, the remaining course of this fiscal year, but frankly beyond. And the second part of your question, obviously like Japan and the rest. Japan, actually I'm really happy because we are demonstrating in this moment in time that even in a disrupted market because you know obviously there's some geopolitical tension between various markets in the region, we've seen a dramatic reduction of traffic even though we've been able to just gain market share. And this is the number one thing that we are focused. No matter if there is growth or no growth, we want to be in a market share position, in a market share growth and that's what we are demonstrating.

Now early into this calendar year, we're seeing a shift from Japan to Korea and other market in the region, and we are ready to welcome the consumers with all our brands really fully deployed. So, I want to – even though there's a bit of a disruption in Q4 into Q2, we remain extremely confident about the momentum that we are building and our ability to just convert traffic into sales across all our brands.

Akhil Shrivastava
Executive Vice President & Chief Financial Officer, The Estée Lauder Companies, Inc.
A

And one thing just to add quickly, Filippo, the untold story which Stéphane is basically double clicking here is the outperformance by ELC in the channel. It is in the West where we had stated early on where Stéphane had said we'll win in West TR. We are winning there. We are winning in Hainan by quite a distance and we are winning in markets like Japan, Thailand and other places. So, the outperformance by ELC in travel retail, parts of travel retail, along with China is the significant encouragement we take for our business as we look forward.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.
Q

Great. Thank you so much guys.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.
A

Thanks, Filippo.

Operator: The next question comes from Steve Powers with Deutsche Bank. Please go ahead.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.
Q

Great. Good morning. Thank you.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Good morning, Steve.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Good morning. I wanted to pivot, if I could, to profitability in the quarter which, as you highlighted, was strong both on gross and operating margin. If I drill in on there a bit, though, Skin Care delivered most of the upside, if not all the upside. Fragrance is also positive but more in line, I think. I think on the other side of the coin was Makeup which is still essentially kind of operating at a breakeven level. Maybe you could just talk about what you're seeing in that segment and how you see the progression of profitability for Makeup to contribute more as we go forward? Thank you.

Akhil Shrivastava
Executive Vice President & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

Thank you. Thank you, Steve. Couple of things. As we are looking to go to solid double-digit margin, we are looking to improve margins across the board, across categories, and across regions. Now specifically answering your question on the Makeup profitability this quarter, it was also impacted by the return we took on the innovation that is coming in quarter three. So, there is a temporary effect there which understates Makeup profitability for the quarter. However, your broader point on Makeup profitability is very clear to us. And as Stéphane and I have communicated, this is an area where we believe we can have significantly better margins overall. No reason why it should be very dissimilar to other categories over a period of time.

Through the work we are doing on rightsizing our fixed cost in these categories, through the work on PRGP and through the acceleration we are now starting to see even in this category on sales and with the big launch coming up of Double Wear and some of the improvement we are seeing on Makeup, we expect to see profitability to improve. But this is a key pillar that we are working on, Steve. In quarter two, you did notice a little bit of a one-time due to the return we took on this innovation, but those are the – some of the salient points.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Just one thing, Steve, on the Makeup because I think it's very important and, look, we've been always transparent. We have a lot more work to do on Makeup and we are with the team here in New York. And frankly, with all our teams around the world, we're continuing to just improve things. I'm not going to repeat what Akhil said, but lot of things that we are doing in this moment in time related to our strategy on Beauty Reimagined is to expand distribution. We've entered TikTok Shop in the US with Clinique and M·A·C, which has allowed actually M·A·C to just already be in the market share gain in the lip category which is so important for M·A·C in the US. M·A·C has entered TikTok Shop in Germany. I said it again, we are about to enter. We are weeks away to enter Sephora US with M. A. C, which is going to be a big game changer for the brand and we are working on more opportunities.

Innovation is being ramping up. One of the things I've mentioned in my opening remarks is the fast acceleration of the innovation coming in less than a year. Remember, I've committed to triple that. We're already exceeding our expectations this year. We were thinking about 16% of our innovation was going to come in less than a year, [ph] it's currently (00:40:43) 19%. The majority of this innovation is coming from Makeup. Obviously, we can go much faster in Makeup than we can do in the other categories, so we are going fast. We are deploying our Makeup brand in the right distribution. We are rationalizing distribution, I think I also mentioned it in my prepared remarks in terms of the freestanding store, to make sure that we are more profitable and we are going to have all the added benefit of the PRGP that continues to flow through, like, you know, the P&L this year and in fiscal 2027.

Because while the PRGP ends at the end of this fiscal year, the execution of it will continue into fiscal 2027, and we will basically get some benefit. So we are on a path for recovery. It is true that Skin Care is growing faster because of the scale. We're very pleased with the progress that we are doing in Fragrance. I think Makeup requires more scale and this is why we are deploying our brand and accelerating innovation to be able to just resolve also this issue that we have with the Makeup category. Thanks, Steve.

Operator: The next question comes from Lauren Lieberman with Barclays. Please go ahead.

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

Thanks. Good morning, everyone.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.
A

Morning, Lauren.

Akhil Shrivastava
Executive Vice President & Chief Financial Officer, The Estée Lauder Companies, Inc.
A

Morning, Lauren.

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

Wanted to ask a little bit about China. You called out, not just the obviously strong results, but in the release, you talked about the period around 11/11 being a big component of that. So was curious if you could talk about the promotional environment around 11/11, what you're expecting in that regard for Chinese New Year? I think the market overall, lots of beauty players have talked about wanting the – wishing the environment could be less centered around those big selling moments and more balanced across the year. So just curious, sort of, what you're doing to drive stronger, let's call it like everyday performance and to generate excitement outside of those key – historically key holiday periods. Thanks.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.
A

Well, thank you Lauren. It's obviously a very important discussion that we're having with the team. So yes, and thank you for acknowledging the very strong performance that we have had in China. I want to say it's now fourth consecutive quarter that we grew share in all four categories in China. And that's very important. And yes, the big period like 11/11, like 6/18 are more promotional than others. But it is – these are highly concentrated level of sales and the good news is during this period, the Estée Lauder brand became again the number one prestige brand on Tmall and Douyin. La Mer is the number one brand in luxury on Tmall and Jo Malone, the number one brand in Prestige Fragrance on Tmall. So, it is important for us to be present and to be strong during this moment because it allows us also to recruit a lot of consumers and retain them through the year.

But the interesting thing, when you go into China, every day is a moment, okay, there's every day that there is a shopping festival in some sort. Obviously, Chinese New Year, we are about to enter, we are into it because it starts on February 15th and it's a little bit later this year. That's why there's a bit of disruption in the month of January. We have to look at January and February together. But it's actually traditional period that is less promotional. It is about more gifting. It is about more experience that we are bringing to the consumers. And that's what I mentioned, like, you know, earlier when we had the question on travel retail about also creating retailtainment. So, our team, both in travel retail China and in China Mainland are laser-focused in creating, eventing VVIP reach to the consumer.

So, we depend less on the high promotionality of the two major shopping festival being 6/18 and 11/11. And there's plenty of others, there's like International Valentine's Day, there's Chinese Valentine's Day, there's Women's Day. I could go on and on, on the number of events. We are also driving our freestanding store fleet. We are accelerating the number of freestanding store in the market. And this is certainly the part of the distribution we've accelerated the most that allows us to just bring experience to the consumer, so we don't rely so much on the high traffic promotional moment. So, I feel we are in a good position. Just to quote few results, we've gained in Q2, 22 basis points in Skin Care, 87 basis points in Makeup, 100 basis points in Fragrance, 85 basis points in Hair Care. These are not small gains by any means.

And frankly, that was not only driven by 11/11, but also the post 11/11 going into December in the preparation of Chinese New Year. So, rest reassure that we are laser-focused on balancing the year so we can continue to raise the consumer facing price in the markets as well as really increasing the number of experience and connections we are creating with the consumers. But the momentum is good. I've been also very clear that China, calendar 2025, we were lapsing two years of negative trend. The good news is that we've accelerated and we've accelerated above the market. The consumer sentiment is still subdued, but when we create the right experience, not only through promotion, we are able to convert them. So, we are thinking that 2026, there's still a lot of opportunities, but we are now starting to lapse much stronger base of 2025 into 2026.

Akhil Shrivastava
Executive Vice President & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

And one thing just to add, Lauren, that our discount levels in China are coming down, while we are driving this outstanding growth and outperformance of the market. So, not only is, of course, sales coming, discounts are reducing and then, of course, profitability is improving.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

And we are doing the same in travel retail China. Also, we are just like cutting the discount. The retailers also and in the midst of this transition with the new retailers, this is obviously like a conversation to just make sure that there's less discount in the market and we drive more conversion through experience going forward. All the channel is evolving to be much more experiential, which I think is a good thing for the long term of our brands.

Operator: The next question comes from Rupesh Parikh with Oppenheimer. Please go ahead.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Good morning and thanks for taking my question. So I just wanted to go back to the North America segment. I was hoping to get more color just in terms of some of the dynamics between sell-in and sell-out and whether you expect that gap to be improved as you – or close as you exit the fiscal year. Thank you.

Akhil Shrivastava
Executive Vice President & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

So Rupesh, thank you. And when we did quarter one, we did have a significant gap, which we talked about on the call, we had about 5-point gap, and Stéphane and I had said that this gap should reduce. In quarter two, this gap has significantly reduced and should continue to be lower than where we were in Q1. We do expect a going gap of a couple of points mainly driven by the fact that as we move to these online platforms, some of the media that we are investing, which is the A&P on these channels, gets a reduction from sales line versus in OpEx line. So this is not – this doesn't impact profitability. It's simply the arrangement or the contract which reduces sales. So, when these channels are in growth mode year-on-year, that mix causes that.

The other factor has been inventory where we have made significant progress. So our inventory, frankly, everywhere in the world are lower or in line with where we need it to be, including in North America. Now North America is, of course, a shifting retail landscape so we have to constantly manage it. But what we are seeing is a clear improvement and difference between retail growth and net growth. And I also wanted to follow up on Bonnie's comment earlier which is that, look, North America first quarter was down. Second quarter is a positive and we said full year would be flattish, which means the rest of the year after quarter one should be positive for North America. So we – and that's what we are working towards. So of course, when we combine quarter one net sales growth, which was a negative, we had the full year flat.

So, North America trends are also improving and should – quarter two to quarter three to quarter four we expect more in positive versus flat, including quarter one the full year was flat. Hopefully, that clarifies, Rupesh.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you.

Akhil Shrivastava
Executive Vice President & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

Thanks.

Rupesh Parikh
Analyst, Oppenheimer & Co., Inc.

Q

Thank you.

Operator: The next question comes from Dara Mohsenian with Morgan Stanley. Please go ahead.

Dara Mohsenian
Analyst, Morgan Stanley & Co. LLC

Q

Hey, good morning. So, I just want to follow up on the US Could you give us a sense now that calendar 2025 is in the books how much of your business has shifted more to the – what you characterize as higher growth channels versus the percent of mix that's maybe in some of the heritage channels that [ph] aren't (00:50:07) performing as well? And just give us an update on where you stand in the brand evolution as you move some of the brands towards – increasingly towards these higher-growth channels and just where we stand in that evolution and what the plans are going forward?

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Yeah. No, thank you. Thank you, Dara, for the question. So look, in North America, today, and I think we've mentioned it, we are continuing to decrease the penetration of department store in our total business. That's your question. And today, it's like at 30% or less. Frankly, it is way less than some brands. Obviously, Lauder, Clinique, and M·A·C are still brands that have like a higher penetration in the department store than other brands that have a very limited penetration. We are, as demonstrated, increasing really fast our penetration to the online players like Amazon and now TikTok Shop. We've moved a lot of brands. We have 12 brands in the US on Amazon US, so this is really outstanding to have been able to just move that quickly in the channel. Again, M·A·C is moving into Sephora, but we have really strong partnership with like Ulta and with many of our brands there.

So, like the penetration of specialty-multi is increasing, the penetration of the online player is increasing. The penetration of our direct-to-consumer business is also increasing, especially our brand dot-com but also freestanding stores in luxury fragrance. We've opened some stores and we are planning to open more in the future as the consumer, the luxury consumer is gravitating towards, even in the US, towards more experience, unique brand proposition selling environment. So, we are really on the right path to just like being able to just like make this move and to be less and less dependent. Now, I want to be very clear. Department store remains a very important and strategic channel for some of our brands. And we are working with our partners, all the way from like Macy's to Bloomingdale's to like even Saks in this moment in time to just make sure that we capture the consumer.

We have very strong position, often leading position in this department stores and we need to just protect it. But at the same time, we have clearly stated as part of our Beauty Reimagined that we are moving where the consumer is moving. There like no decision there. So I feel good. That's why we've been able to just maintain our market share. And frankly, most of the volume growth that we have had and the gain in volume is coming from the high-growth channels. A lot of this growth, it's not hard to just see that it's also coming from the high and very strong performance of The Ordinary that is in high double-digit growth in this market. That is 100% in high-growth channel and this is actually one of the strengths, having the brand from La Mer to The Ordinary that are positioned in all these channels being able to just capture the consumer where they are. Thanks, Dara.

Operator: The next question comes from Chris Carey with Wells Fargo. Please go ahead.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Hey, Chris.

Chris Carey
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning, everyone.

Akhil Shrivastava
Executive Vice President & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

Good morning, Chris.

Chris Carey
Analyst, Wells Fargo Securities LLC

Q

I wanted to ask about Europe. We've seen some stabilization in the sequential improvement in the market. Can you just expand about State of the Union and specifically comment on the UK and your outlook for the market in the medium-term?

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.
A

Yeah, no. Thank you, Chris. Thank you for noticing the sequential improvement. Europe is a tale of multiple cities. Obviously, our region is UK and I want to remind everybody in Europe, the UK is obviously an emerging market. So, if I look at the sequential improvement that we are seeing in the total area is really coming from the emerging markets but also from the UK going back into positive territory into the last quarter. I've said it multiple times. The UK, we were actually not where we should have been. We have still a lot of work to do, but at least we are moving in the right direction. Europe consumer sentiment is still very subdued. We've seen a lot of challenges in France, in Germany to name like few markets.

But at the same time actually really strong performance in markets like Spain or Italy where we are gaining share in Fragrance. And this region of the world is highly penetrated in the category of perfume, so it's very good for us to be able to demonstrate that we are able to just gain market share in this category. So we have a lot of work to do. I'm actually pleased with the beginning of momentum that we are getting into the UK, and many of the playbook that we've used in the US, we are applying to the UK. We've moved some of our brands into the Amazon platform in the UK. We're rationalizing distribution. We are accelerating the work we are doing with specialty-multi. We've had really great support and great performance at Sephora UK, obviously, like Boots are our historical partner to name a few. So great, great momentum.

And frankly, where I am the most excited based on the new organization we've put in place are the emerging markets. Our priority, emerging markets delivered double-digit growth into the quarter, which is a sequential improvement. And it's driven by Turkey, by Middle East, by Thailand, and even mid single-digit in India. That is such a very strategic market for us. So I think it's a tale of, Chris, of so many different cities and stories. Sorry, like about like this very complex region. But again, it's moving in the right direction. More work to do. But the team is laser-focused on activating with excellence all the launches. And I think things from Clinique to Lauder innovation that are coming in the second half of this fiscal year are so important for this region and our Double Wear is the leading foundation in many of these markets.

And we expect, a lot of things from this launch and hopefully some continuous sequential improvement in this geography. Thank you.

Operator: Next question comes from Peter Grom with UBS. Please go ahead.

Peter Grom
Analyst, UBS Securities LLC
Q

Great. Thank you. Good morning, everybody.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.
A

Hi, Peter. Good morning, Peter.

Peter Grom
Analyst, UBS Securities LLC
Q

Hey, good morning. So I was hoping to just get a sense on kind of the top line trajectory in the back half of the year and just the expectation for higher growth in the fourth quarter versus the third quarter. Can you maybe frame the difference you would expect between the quarters? And I guess as we think about the fourth quarter, are there still some of these disruptions or repositioning changes that will be impacting growth? And I ask this more in context around the exit rate and maybe how this should inform our view on the top line trajectory as we look out to 2027? Thanks.

Akhil Shrivastava
Executive Vice President & Chief Financial Officer, The Estée Lauder Companies, Inc.

A

Yeah, thanks. Thanks, Peter. So essentially look we had a strong first half plus 3%. Right at the beginning of the year, we had telegraphed that we would have a back half in Asia, especially in both in China and travel retail will be anniversaring more larger bases. So we had said that at the beginning of the year. It was a part of our guidance which we had communicated. Now to your point around back half, like Stéphane said, we expect to see continued mid single growth in China or better. But some of this is the stimulus that the Chinese economy had which is anniversaring. Our goal is to outperform that market, but we expect market itself to take a little bit of a back step from the from the double-digit type growth we put together. That's one.

Secondly, the other point is that when you look at our APAC and TR segment, you see that the largest base period was quarter three. So we do see a little bit of that in the quarter three to quarter four phasing. And then as we communicated, there is this transition which Stéphane and I talked about of retailers which is not a longer term item to your point around exit rates, but it's a transition where one retailer takes business from another. You have ordering transition that goes on. So these are the main things that impact slightly in the back half. Of course, as we exit the year, our expectation is that we had said beauty market would be 2 to 3 this year. That was including travel retail, which has been challenged. As travel retail bases of that period, beauty market itself should be better, assuming other things remain the same in the West and China continues to do mid-single.

And then our goal, our stated mission very clearly is which we are demonstrating in China, in US, in Japan is that we want to start leading these markets in a very clear way, which we are already doing unquestionably in China, in Japan, in parts of emerging markets. So, I think that is basically what is underlying our back half guide. And then of course, what you should expect going forward.

Stéphane de la Faverie
President, Chief Executive Officer & Director, The Estée Lauder Companies, Inc.

A

Yeah. And Peter, I want to be very clear that there's no misunderstanding from anybody. We are going for the top end of the new guidance that we are giving, both in top line and bottom line for this fiscal year, okay. So that's very clear. That's the mission that we have. We're going for it. Obviously, we are giving ourselves a range because of, like, you know, volatility that we all have to manage. And you know frankly being able to deliver this very strong first six months of the year with the amount of volatility that we have had and consumer sentiment being subdued, I think I'm really proud, frankly, of what our team has done. And I think it's showing the momentum that we have on Beauty Reimagined, and I think should give you the confidence that on the long term, we are in the right trajectory.

We are accelerating, we are doing the right thing and we are rebalancing also our growth between geographies, between brands. And frankly, we're putting the one operating ecosystem in place for us to just be much more agile. And in this midst of time, we are refreshing our long range plan, and you can expect us when we come at the end of the fiscal year in August, that we will give you more visibility of our mid to long-term growth. But I've also said it and I repeat it today. Our objective past this transition year is to gain market share. That's what we are doing this transformation. This is why we are diversifying our growth. This is why we are simplifying the ways of working. We've brought a lot of new partners in the house today. We've talked about Accenture. We've talked in the past about Shopify.

We have great partners like Google, Microsoft and so many others that are helping us to really act with speed and agility and let alone all the PRGP, where the saving will continue to flow through this year and into next year and create a lot more efficiency. So, I feel really good about what we've done in this first year of Beauty Reimagined. The momentum in the first half is strong. Even the retail sales ex travel retail at plus 4%, leaders believe that we are gaining market share in many, many markets as demonstrated in China, in the US, in volume and so on and so forth. So, I feel good. We are going for it. We're going for the top of the guidance. And that's the mission that we every single of the employees of the Estée Lauder Companies have today. And we're going for it.

Operator: That concludes today's question-and-answer session. If you were unable to join the entire webcast, a playback will be available at 1 PM Eastern today through February 19. Please visit the investor section of the company's website to view a replay of the webcast. That concludes today's Estée Lauder conference call. I would just like to thank you all for your participation and wish you all a good day.