Estee Lauder Companies Inc.

Just Asking: Where are investors focused into the print?

Maintain Rating: NEUTRAL | PO: 150.00 USD | Price: 134.43 USD

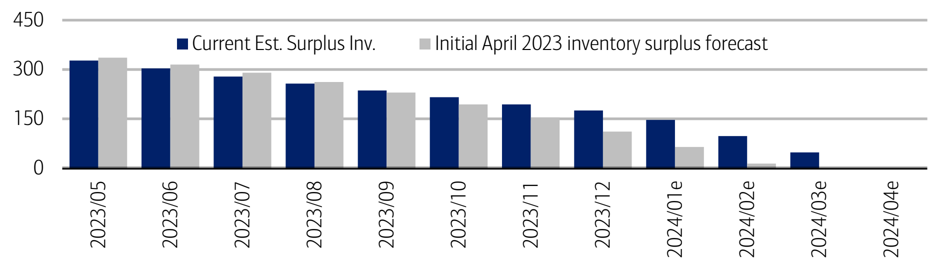
Where are our estimates into 2Q24?

Estee Lauder is scheduled to report 2Q24 results on February 5th. We are forecasting -11% organic sales decline, slightly below the low range of management's guidance of -8% to -10% YoY, factoring in expected weakness in the 11/11 holiday, China market softening recently and Mid-East disruption. Our $0.50 EPS estimate is at the low end of the $0.48 to $0.58 guide given potential for shipping disruptions and channel mix drag. Maintain Neutral rating and $150 PO, reflecting the balance between uncertainty around recovery timing and magnitude balanced by strong underlying growth catalysts.

Is there further risk to FY24 guidance?

With investor interest running hot into the print, the recurring questions posed to us have been around guidance. At the midpoint, EL rebased its FY24 EPS outlook $1.50 lower between August and November, including 22c of Mid-East disruption and 89c of implied demand degradation, along with more onerous FX given hyperinflationary emerging markets. In our view, potential risks to guidance are 1) China market softening into the beginning of this year could impact underlying sales once inventory clears (PG and CL implied deceleration in China); 2) Red Sea disruptions and potentially delayed Asia travel retail inventory replenishment as the most likely downside catalysts to the guide. What we want to know: How much disruption was baked into the initial 22c headwind from Mid-East disruption? How much of EL's shipping transits through the Red Sea and what alternatives can EL source?

Exhibit 1: Retail cosmetics inventory projections: Initial April ests. vs current (Dec. 2023)
We expect China Travel Retail inventory will have to replenish before April



Source: data.stats.gov.cn, BofA Global Research

BofA GLOBAL RESEARCH

What's happening in Travel Retail?

Global travel retail declined -51% YoY in 1Q24 given the combined impact of trade inventory reduction and efforts to contain the market and shift to individual consumers from Daigou resellers. In November, management estimated Asia travel retail inventory would reset by the end of 3Q24, with our most recent forecasts corroborating replenishment ahead of April depletion (see above). What we want to know: how is prestige beauty consumption comparing between travel retail and Mainland China, which grew +2% YoY last quarter? What is the timing of inventory replenishment for Japan and Korea travel retail channels? What kind of demand-building efforts are underway, and does that imply a structural change to segment margins from here?

01 February 2024

Equity

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Stock Data

Price	134.43 USD
Price Objective	150.00 USD
Date Established	15-Dec-2023
Investment Opinion	B-2-7
52-Week Range	102.22 USD - 283.62 USD
Mrkt Val (mn) / Shares Out (mn)	48,583 USD / 361.4
Free Float	92.5%
Average Daily Value (mn)	337.75 USD
BofA Ticker / Exchange	EL / NYS
Bloomberg / Reuters	EL US / EL.N
ROE (2024E)	16.2%
Net Dbt to Eqty (Jun-2023A)	63.7%
ESGMeter™	High

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What's happening in Mainland China?

Management moderated their expectations for FY24 sell-through in Mainland China last quarter to reflect a weaker prestige beauty category, with a muted 11/11 selling holiday expected to be a drag on 2Q24 results. Consumption in Mainland China was flat last quarter and ahead of sell-through, but still lagged +2% growth in the prestige beauty category. Mainland China is comping a low-single digit decline in both 1Q and 2Q this year, though management indicated sequential improvement in October 2023. What we want to know: What does management see so far in terms of consumption for this February's Chinese New Year celebration? How does the later timing of the holiday impact shipments/replenishments between 2Q and 3Q? How is the health of the prestige beauty category faring compared to EL's initial trajectory assumptions at the beginning of the year?

What's happening in the US?

EL management named reacceleration of US growth as one of its four strategic imperatives in its 4Q23 earnings call and has so far delivered mid-single digit growth in North America in 1Q24. We estimate that US growth was down single digits in both quarters of 1H23 setting up another quarter of North America organic sales growth this coming quarter. We do note however that 2Q23 North America sales improved month over month through the quarter making for a less favorable comp base than 1Q. Management also tempered expectations for the US, signaling FY24 would be a year of reinvestment in order to enter FY25 on solid footing to close market share gaps. What we want to know: how has market share trended through the holiday season in the US? Where have brands shown strength and how have they responded to stepped-up A&P?

What's happening with gross and operating margins

Gross margin still expected to be pressured in 2Q24 by obsolescence charges and higher manufacturing overhead but expected to improve YoY in 2H24 as they lap year-ago obsolescence charges, benefit from the rebuild of China inventory that leans towards high-margin categories and channels. Operating margin expected to sequentially improve through FY24 despite increasing number of in-store beauty advisors and supporting A&P spend in recovery markets. What we want to know: How are inflation and/or Red Sea disruptions affecting COGS? Has EL seen early signs of positive SG&A leverage beginning to show already, or will it be more of a step-function improvement?

Price objective basis & risk

Estee Lauder Companies Inc. (EL)

Our $150 PO is based on a target P/E multiple of 30x our CY25e EPS (+5x vs prior target, reflecting what we see as materially rebased earnings at low risk of further downward revision). Our multiple implies a +20% relative premium vs. a group of EL's beauty peers, up from a +5% implied discount previously and near EL's 3yr average premium of 14% as they retool their cost structure and channel exposure in light of what now appears to be a more muted Chinese consumption environment.

Downside risks to our price objective are persistent weakness in developed markets over the long term, a slowdown in EL's faster-growth channels and geographies, higher brand investment needs, recession, prolonged impact of the COVID-19 pandemic, a deceleration in organic sales, subsequent erosion of EL's valuation premium and acquisition of TOM FORD does not materialize. Risks to the upside are faster-then-expected recovery in Makeup, particularly in the US, an accelerated return to global international travel, and middle-class consumption in burgeoning developing markets.

Analyst Certification

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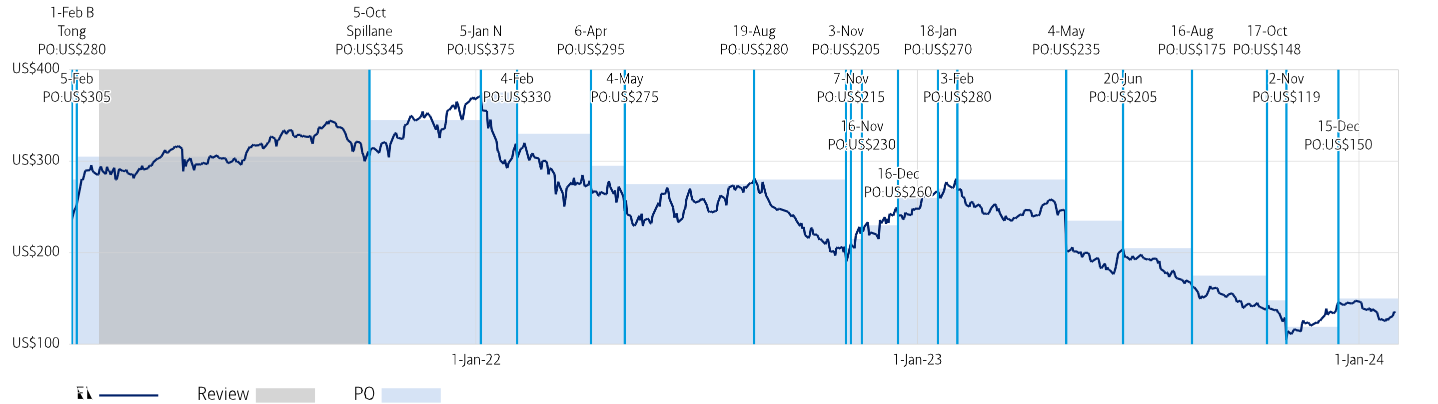
Estee Lauder (EL) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Coverage Universe	Count	Percent	Inv. Banking Relationships R1	Count	Percent
Buy	32	50.00%	Buy	16	50.00%
Hold	19	29.69%	Hold	8	42.11%
Sell	13	20.31%	Sell	7	53.85%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

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Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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