FY2019 Annual Results Webcast

Company Participants

- Reinold Geiger, Chairman and Chief Executive Officer
- André Hoffmann, Vice Chairman
- Thomas Levilion, Chief Financial Officer
- Janis Lai, Investor Relations Director

Other Participants

- Tiffany Feng, Citigroup
- Mandy Li, Buena Vista Fund Management
- Emily Lee, Nomura International
- Nobuaki Murayama, Mitsubishi UFJ Kokusai Asset Management

Presentation

Janis Lai

Good afternoon, everyone, and welcome to L'Occitane International's annual results presentation for the year ended 31 March 2019. With me here today is our Vice Chairman, Mr. André Hoffmann, and on teleconference is our Chairman and CEO, Mr. Reinold Geiger, and our Group CFO, Mr Thomas Levilion. As usual, Thomas will first walk us through the presentation before we open up for Q&A. For those joining online, you may submit a question by clicking the ask-a-question link on the bottom right-hand corner of the webcast page. Without further ado, we'll pass it over to Thomas to start the presentation. Thank you.

Thomas Levilion

Thank you, Janis. Good afternoon. The first highlight that I would like to make is that the Group delivered solid results to the shareholders, with increase in earnings per share by 22.7%. Under a highly competitive global cosmetics market, the Group's sales grew by 8.1% - that's reported rates - and 8.7% at constant rates, and all of our brands posted healthy growth rates.

The gross profit margin remained high at 83.2%, and meanwhile, our operating profit margin was basically stable with a slight decrease of 0.1 points, even with the tough trading conditions and the investment in LimeLife. In fact, if excluding LimeLife, the Group's operating profit margin improved by 0.8 points. The net profit margin for the year improved by 0.9 points to 8.2% of sales, and in view of the solid cash inflow from operations, the Board is pleased to propose a final dividend of €0.0297 per share, and that's the same amount as last year.

Net sales breakdown, sell-out sales accounted for 75% of the Group's sales, and sell-in for 25%, so the percentage share remains stable over last year. L'Occitane en Provence remains our core brand, with more than €1.2 billion and accounted for 87% of the Group's

overall sales. It grew by 3.5% at constant rates, so that's a nice improvement from 2.7% last year, and this is testament to the Group's targeted investments. Meanwhile, LimeLife ended the year with roughly €84 million sales and accounted for 6% of the Group. The unaudited year-over-year growth of LimeLife was around 18%. The emerging brands together contributed around 7% of the total sales, showing good growth of about 11%. Finally, in terms of geographical areas, the US is now the largest market, followed by Japan, China and Hong Kong.

Comparable stores grew at a healthy 2% for the year, contributed from both retail stores and our own e-commerce. The 26% growth in non-comparable stores and others was mostly thanks to LimeLife and the encouraging growth of marketplace channels in China and Korea. Sell-in sales increased by 6%, and that was mainly from web partners, travel retail and distribution. Finally, the overall exchange rates impact for the year dropped to minus 0.6%, so that's further down from minus 2.1% in the first nine months.

Sales growth by geographies, with the Americas and Europe first, despite the tough market environment, France and UK ended the year with slightly positive sales growth, and both markets also saw good progress with Erborian. The US, the 32% growth was mostly contributed by LimeLife. For L'Occitane en Provence, the sales decreased for the whole year, due mainly to the closure of 12 underperforming retail stores and also a difficult Q4, with hostile weather and sluggish consumer spending.

In Brazil on the contrary, L'Occitane au Brésil continued the strong momentum, with double-digit growth in same store, in retail and distribution channels. L'Occitane en Provence also achieved good growth in Brazil and further expanded its wholesale channels through premium pharmacies and wholesales chains. Russia recorded one of the highest growth rates at 12%. Erborian also continued strong performance, propelling Russia to become the second-largest market for the brand, after France.

Over in Asia, Japan's overall sales was flattish, yet retail sales of L'Occitane en Provence grew at a low single-digit rate. Melvita continued double-digit growth but was more challenged than last year. In Hong Kong, retail deteriorated in Q4. That was in line with the market trend, but we were able to mitigate some of the weakness with a sustained marketing push of Reset. On the other hand, travel retail still remained strong, with mid-teen growth rate.

China was an outperformer throughout the year. Retail was strong, even though we net closed seven stores. Among the key countries, China also had the highest web sell-out growth of nearly 30%. Retail in Taiwan remained sluggish in the fourth quarter, so that the overall growth was minus 2.7%, in line with the market trend here again. In other countries, the sales growth accelerated to 5%, thanks to the acceleration of same-store sales growth. The highest contributing countries included Malaysia, Canada and Australia, with impressive growth rates of 33%, 15% and 9%, respectively.

Overall, same-store sales grew at 1.8% for the year, versus 1.7% of last year. Then the major contributing countries were China, the other countries and Brazil. China posted the highest growth rate for the year at 6.9%. The other countries accelerated their growth to 2.2%, and Brazil, with improvement in both L'Occitane en Provence and L'Occitane au Brésil, further accelerated to 5.9%. Yet the fourth quarter slowed down in some countries, notably in Japan, Hong Kong and Taiwan, but France and the UK and other European countries turned slightly positive in the fourth quarter.

We are turning now to the profitability analysis, and as I said before, the gross and operating margins were essentially stable at 83.2% and 10.6%, respectively. Looking at the operating expenses, we had a higher distribution expenses percentage to sales, which

was a result of brand mix and investment in large stores and store staff. Yet the increase in distribution expenses was offset by the reduction in marketing expenses by more disciplined and targeted spending, as well as favourable brand mix effects, and research and development and general and administrative expenses remained stable as compared to FY2018. We'll go of course into more details in the next slides, first with the gross margin.

The slight decrease in gross margin percentage is explained by the net effect of the following factors. First of all, there was an unfavourable brand mix, mainly from LimeLife for 0.2 points, as LimeLife has a slightly lower gross margin than the other brands. Other factors and rounding, which also increased cost by 0.2 points, and we had a slight increase in the use of mini-products and pouches and boxes - gift boxes - for 0.1 points. But the increases in cost of sales were mitigated by the continuous reduction in production costs and also in improvement in freight and custom charges for 0.3 points, and as usual, price increase and product mix effects also improved the margin by 0.1 points.

The distribution expenses increased by 0.6 points to 49.1%. This higher percentage cost is attributable primarily to an unfavourable brand mix for 0.6 points, though this is mainly from LimeLife and this is explained by its specific business model with the commissions paid to the Beauty Guides. Then we also increased investment in compensation and incentives in retail teams and the travel retail workforce for a total of 0.4 points. We also had higher investments in rental of large stores, which accounted for 0.3 points of the increase, and there was also an increase of 0.2 points due to higher usage of promotional tools at stores and some others, as well. Lastly, the full-year running cost of the Asian warehouse and higher freight costs in Japan accounted for 0.1 points.

The increase is partly offset by very a favourable channel mix for 0.5 points, and that's coming from the higher share of travel retail and web in our sales, and also lower preopening and closing costs this year for another 0.5 points. So again, the increase in distribution expenses was compensated by a decrease in marketing expenses.

The marketing expenses ended the year at 13% of net sales, so that's a decrease of 0.6 points, and the improvement is mainly contributed by a favourable brand mix, mostly from LimeLife, for 0.3 points, but also we were more targeted in our spending in advertising, marketing events and promotional tools for 0.2 points, and we had a higher leverage and some efficiency gains for another 0.2 points.

General and administrative expenses remained stable at 9.3% of net sales, but here again we have an unfavourable brand mix effect, mainly from investment in LimeLife for 0.6 points, and yet the unfavourable impact was mitigated by higher leverage, lower personnel incentive costs and reclassification and rounding for 0.2 points each. And finally, the exchange rates also posted a positive impact of 0.1 point for the year.

So in sum, our operating profit margin was essentially stable at 10.6%, despite the tough trading environment and also the investment in LimeLife. So the slight decrease of 0.1 point is explained by the following two factors, essentially. The main impact of 1.1 points was from the negative brand mix, mainly from the investment in LimeLife, and there were also higher investments - both in the large retail stores and also in the retail and travel retail workforce for minus 0.7 points. But the negative impacts were almost offset by first higher leverage and efficiency gains for 0.5 points, lower preopening and closing costs this year for another 0.5 points. I said before we had a favourable channel mix for 0.4 points, basically from the higher proportion of travel retail and web activities, more efficient marketing spending, price increase and product mix and also the exchange rates, which turned favourable at the end of the year, and in fact, as already mentioned, if we excluded the investment in LimeLife, the operating profit margin would have improved by 0.8 points, which is the first time in a few years.

The tax rate, the effective tax rate, dropped sharply from the historic high of 29% last year to 20.7% this year, and the improvement is explained by first, last year, one-off effects, essentially the US tax rate cut, as you recall, for 5.5 points, with some favourable country mix effects for 3.2 points, and some positive exchange rates and some other factors for 1 point and 0.8 points, respectively, and this improvement is slightly reduced by the derecognition of tax credits in Brazil for 2.2 points.

Capital expenditures, we spent 86 - sorry, €86 million this year, net cash, as compared to €93 million last year, so that's a decrease of €7 million. The decrease in the store CAPEX is explained by the key money and construction for the flagship stores in Paris and London last year. In IT during the year, we had increased investments, particularly for hardware and software upgrade relating to the CRM, the e-commerce platforms, order management systems, as well as the automatisation of the existing business intelligence reporting and finance system, and we also started the development of software for LimeLife.

The €24 million capital expenditures in factories and research and development was mainly due to the installation of new production lines for fragrance and face care and for the extension of production capacity in our factories in France and Brazil, and obviously the chart above excludes the acquisitions of subsidiaries and financial investments in FY2019, mainly for ELEMIS.

In terms of inventory, the value increased by €46 million to €203 million as at 31 March 2019. The increase in turnover days by 30 days was essentially due to the LimeLife and ELEMIS, so LimeLife, the increased inventory represented 17 days, so that's due mainly to the anticipation of future sales growth and also to the low inventory last year as a result of the stock clearance for rebranding LimeLight to LimeLife, as you remember. ELEMIS, we have included inventory at year end, but we have no cost of sales, so that's the reason why we had this increase of 12 days. For the existing brands, inventory turnover indeed dropped by 7 days, yet the improvement was cancelled out by lower inventory positions for 3 days and an unfavourable exchange rates impact for 5 days.

In terms of the balance sheet ratios, the return on capital employed in FY2020 increased to 15.9%, so almost 16%, and this increase is a result of the increase in net operating profit after tax by 24%, combined with an increase of 18% in capital employed. I would just like to clarify that now that the acquisition of ELEMIS is completed, which it was completed actually in March '19, so the balance sheet of ELEMIS was consolidated at year end. However, its profit will only be consolidated in FY20 onwards. Hence, the return on capital employed ratio excluded the goodwill on ELEMIS to avoid distortion. Finally, the gearing ratio increased to 29.4% after the financing of the ELEMIS acquisition.

Our strategic review, FY2019 was a significant year for the Group, to say the least. We introduced the Pulse strategy, we acquired the new brand, and we launched one of our most successful products ever. In the first year of implementing the Pulse strategy, we have already seen some early results. Despite the investment in LimeLife, we managed to keep our profitability stable thanks to the Group's determination to invest in a targeted and disciplined manner. One of the highlights this year was the acquisition of ELEMIS, obviously, so ELEMIS is a premium skincare brand that complements our existing channel and product portfolio. We are confident it will continue to drive our face care profile segment that saw nice growth due to the highly successful launch of *Immortelle Reset*.

Meanwhile, we also focused on creating genuine connections with customers through engaging marketing campaigns and memorable omni-channel experiences. At the same time, we intend to build an even more agile, efficient and entrepreneurial organisation. This is shown, for instance, through our new incentive scheme for managers and different

operating improvements, such as the regional distribution centres and the implementation of ship-from-store capabilities. Lastly, sustainability is at the centre of everything we do, as you know. An important step this year was the signing of an agreement with Loop Industries to transition to 100% sustainable PET plastic packaging.

In FY2020, the Pulse strategy will continue to guide our plans and our actions. We expect to see enhanced profitability with our targeted investments and the consolidation of ELEMIS. We now have six brands under our umbrella. We now operate as a multi-brand group where we celebrate unique brand identities and share common values. We encourage all the brands to stay autonomous and agile while seeking synergies. Meanwhile, we look forward to launching more exciting products with an emphasis on face care. The Group remains confident to become a leader in the affordable premium beauty space and deliver long-term value for our shareholders. So this concludes my presentation. I suggest we start the Q&A session. Thank you very much for your attention.

Questions And Answers

Janis Lai

Thank you, Thomas. Now, we will start the Q&A session. We will first take any questions from the audience before moving on to any questions online - if online, you can again click the ask-a-question link on the bottom right-hand corner. Now, we can first take any questions from the live audience here. Yes, Tiffany in the front.

Tiffany Feng

[Inaudible – microphone inaccessible]

Thomas Levilion

Sorry. We don't hear you, Tiffany.

Janis Lai

So, Thomas, she was asking about quarter-to-date performance.

Thomas Levilion

Okay, hello, Tiffany. So this is Thomas speaking, and I will let, of course, Reinold and André complement my answer. I would say that in the first quarter so far - we will be more specific in July - we have seen a continued strong performance in Asia, a very nice improvement in Europe, so that's very good news, and I'm talking all countries in Europe. We continue to see strong results in Brazil and Russia, and I will say that the US was a little more struggling, although we have seen very recently some improvements, so we are positive I would say for the first quarter - to be confirmed.

Tiffany Feng

So for the US, we see a decline for the last quarter because of the high base, so how's the trend for the last two months' sales performance?

Thomas Levilion

So again in the US, the performance was soft in the first let's say month and a half. But we have seen some improvement recently, so I hope this will be confirmed. I don't know if you want to add to this, Reinold?

Reinold Geiger

No. What I think is important to add is about the two relatively big acquisitions. First, LimeLife is performing like we planned, so - and ELEMIS, which is obviously for us a very expensive acquisition, and where we expect aggressive growth at the same time in sales and in profit, and for the time being, they are performing as anticipated.

Tiffany Feng

Okay, thank you, and my second question is, yes, a follow up on ELEMIS, so how's recent sales performance and how can we expect the potential contribution from ELEMIS for the financial year FY2020 regarding the top line and bottom line?

And my third question is regarding the operating margin outlook for this year, as well as effective tax rate, because I noticed a big decline of the tax rate – the U.S. tax cut. So how can we expect for this year? Thank you.

Thomas Levilion

Yes, this is Thomas speaking. So again, as Reinold just mentioned, ELEMIS sales in the first quarter are evolving according to plan, and the plan is that they should deliver a very strong growth. We target a growth of 25%-plus, as compared to last year, so that should be - should deliver - they should deliver sales of above €150 million, and here again, as we said when we announced the acquisition of ELEMIS, we expect ELEMIS to continue to deliver its very high profitability, which as you recall is 25%-plus here again, so that's what we also expect from the brand this year. So that's challenging, but I believe it's consistent with the momentum that we have seen that they have delivered last year, in the previous years, so we are very confident that ELEMIS will be results accretive this year, already in the first year of consolidation, because with such a high profitability and our low financing costs, this should be quite positive.

And your last question was about the tax rate, so again, the tax rate, we had in FY2018 at 29% was exceptional, exceptionally high, and notably was related to the US tax cut at the time, so we don't have this effect this year. We also have some positive from the brand mix, so we'll see how this evolves in FY2020, but I would bet on the traditional 23% to 25% tax rate, effective tax rate, for FY2020.

So I think you had also a question in terms of where we expect to be globally as a Group, so the guidance if I can say so for FY2020. So with the combination of the healthy growth from the different brands and also the addition of ELEMIS, our sales growth should be like mid-teens or mid-to-high teens, let's say, with an operating margin of 12%-plus. That would be the type of targets that we give ourselves for FY2020.

Janis Lai

Thank you, Thomas. Do we have a next question from the live audience here? If we do not, I think we can move on to online questions.

Operator

The first one's from Mandy Li of Buena Vista Fund Management, also related to the operating margin. She says, they're wondering why the operating margin excluding LimeLife was not able to come back to 12.5%. They know that in FY2018 there was a big promotional drag, but marketing was more moderated in FY2019.

Thomas Levilion

Maybe I can try to answer these questions - this question as well. I think we did not commit to a 12.5% margin for the other brands in FY2019. We mentioned an incremental gain. I think we are doing better than that, even though, as we said, the trading conditions were a bit tough, we still managed to deliver a stronger operating margin than we expected, so that we consider this as very good news. As we said, we have implemented this new Pulse strategy with much more focus on not only top-line growth but also profitability. I think this through many, many different actions is starting to play out, as compared to the investments we did in the past with some decrease, to be honest, in the margin and profitability in the past few years. This is the first time we see this clear turnaround, and we are very happy about this.

Janis Lai

Thank you, Thomas. Yes.

Operator

Emily Lee at Nomura has two questions. First is that she's asking if you can provide a gross margin and operating margin breakdown for LimeLife and ELEMIS. And the second, she'd just like you to confirm when those financials will be consolidated. Thank you.

Thomas Levilion

Okay. This is Thomas again. So we don't disclose such precise details about ELEMIS and LimeLife. Let me just give you a rough overview of this. LimeLife is a totally different model from what we have today be it in retail or in sell-in, so it's a softer, slightly softer gross margin than the rest of the activities, but there is also lower costs in general in the business model, like in the U.S., where things are with a sufficient scale, so there's much more operating - distribution expenses, sorry, and almost no marketing expenses. So the point with LimeLife is that we are investing in developing new countries. As you know, it's for - it was purely a U.S. brand, so we believe that the model can be very successful outside of the U.S. as well, but for the time being we are creating the entities to distribute in several countries outside of the U.S.

So for the time being, we have the cost, but we have limited sales to offset the cost, so that's why for the moment we have lower profitability for LimeLife than the rest of the Group. LimeLife was actually losing a little money, €3 million to €4 million in FY2019, and we expect it to be positive in FY2020 and onwards. Honestly, there are good chances to do that. As far as ELEMIS is concerned, ELEMIS looks much more like the sell-in business of L'Occitane, so I think it's easy to derive the parameters from there.

I would say that beyond that, ELEMIS has proven to be able to deliver growth, working with a very lean organisation, very efficient in terms of production, in terms of everything that it is doing, actually, so that it delivers this, as we said, 25%-plus profitability, which I believe they should be able to continue to deliver in the next few years. This is their plan, so I think this gives you a better picture on - of the two brands.

Operator
From Nobuaki Maruyama of Mitsubishi UFJ Kokusai Asset Management, he'd like to know how you plan to maintain the strong growth rate of ELEMIS. Thank you.

Thomas Levilion
Maybe André, you may want to answer this question?

André Hoffmann
Sure. ELEMIS - today, ELEMIS business is mainly concentrated in the U.S. and the UK, and I think those two markets alone are close to 75%, maybe 80%, of the total business, and in Asia, they're doing 1% or 2%, so there's an enormous potential for us to launch ELEMIS. The first country we hope to launch in will be China, with Tmall Global. We're in the process of registering products, and we think next year we can actually enter the local market. We're looking at several other countries in the region. We also plan to start a limited travel retail project. This alone will deliver lots of growth, but also using the L'Occitane distribution network, we're entering several new markets outside of Asia, which frankly were not in the budget at the time we started the year. So I think there will be ample growth coming, and then there's the existing markets, which were continuing to grow very strongly in the start of the new year.

Janis Lai
Thank you. Thank you, management. Do we have any last questions from the live audience here? Good. If we don't have any more questions, I now announce the end of the presentation today. Thank you, everyone, for joining us today here and also online. Have a great evening ahead. Thank you.

Thomas Levilion
Thank you very much. Goodbye.

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