Q2 2022 Earnings Call

Company Participants

- Laurent Mercier, Chief Financial Officer
- Sue Nabi, Chief Executive Officer

Other Participants

- Andrea Teixeira, Analyst
- Lauren Lieberman, Analyst
- Olivia Tong, Analyst
- Robert Ottenstein, Analyst
- Steph Wissink, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. My name is Britney, and I'll be your conference operator today. At this time, I would like to welcome everyone to Coty's Second Quarter Fiscal 2022 Results Conference Call. As a reminder, this conference call is being recorded today, February 8, 2022.

On today's call are, Sue Nabi, Chief Executive Officer; and Laurent Mercier, Chief Financial Officer. I would like to remind you that many of the comments today may contain forward-looking statements. Please refer to Coty's earnings release and the reports filed in the SEC where the company lists factors that could cause actual results to differ materially from these forward-looking statements. In addition, except where noted, the discussion of Coty's financial results and Coty's expectations reflect certain adjustments as specified in the non-GAAP financial measures section of the company's release.

Sue Nabi {BIO 21845588 <GO>}

Ladies and gentlemen with the completion of the first half of fiscal '22, it's clear that we are delivering on our short-term objectives while simultaneously strengthening the foundations to achieve the medium-term objectives we outlined during our November Investor Day. As you recall, our objective is to make Coty into a true beauty powerhouse, which includes sustainably growing our sales ahead of the beauty markets, growing our profits ahead of sales and steadily deleveraging our balance sheet.

The results of the last six months has confirmed that we are well on track with these ambitions as we enter the virtuous cycle with strong revenue growth combined with gross margin and cost initiatives, simultaneously huge profit expansion and strategic reinvestments which in turn drive future growth momentum.

There are a few takeaways I want you to leave with. First, our first half fiscal '22 revenues and sell out both grew in the mid teens, consistent with our expectations. We had flagged last quarter that our focus in Q2 was on driving sell out as revenue trends in Q1 and Q2 were impacted by the timing of launch pipe sale and this is exactly what has played out.

Importantly, the growth we've achieved in the past six months was fully supported by strong growth in consumer beauty as we saw clear signs of turnaround in our key mass cosmetics brands. Second, we had great performance on profit and cash. We saw exceptional growth in our gross margin this quarter with close to 600 basis points of growth year-on-year, another 100 basis points of growth versus the first quarter. Achieving this against an increasingly difficult inflationary backdrop speaks to the strength of our business model and the many levers we have at our disposal to steadily drive our gross margin higher in the coming years. At the same time, our strong focus on cash generation and deleveraging has allowed us to reach leverage below five times ahead of expectations.

Third, we continue to execute and make progress across each of our six strategic growth pillars. The particular highlight this quarter was consumer beauty where for the first time in five years the business grew market share on a global basis. Additionally, as part of our strategic focus on becoming the leader in sustainability, I'm honored to share that we've recently completed our first production run using sustainable at cycle of ethanol, putting us ahead of schedule against our goal to integrate sustainable ethanol into a majority of our fragrance portfolio by 2023.

I will share more details on our progress across each of our strategic pillars later on the call.

Fourth, the strong and steady set of growth in the mid teens through the first half of '22 sets the stage of our revenue growth to accelerate in the second half of '22 and we are already seeing this play out in the cost of today's sales trends in Q3. This in turn drives our increased fiscal '22 sales outlook coupled with higher EPS.

I will now take a few moments to cover our revenue trends during the quarter before Laurent takes you through our financials. Then I will finish with an update on our strategic progress and our outlook.

Our Q2 revenue grew 12% like-for-like in line with our guidance, following the strong Q1 (inaudible) when we launched our key initiatives Gucci Flora, Gorgeous Gardenia, and Burberry Hero.

As we discussed on the last earnings call, while the revenue trend was expected to be choppy the underlying set out trends were consistent and our goal was to step up our investment in the highest ROI opportunities during the critical Q2 holiday period to fuel acceleration in our sell out and prepare for a strong Q3,. The results played out as expected. Our overall sell out improved from the low to mid-teens in Q1 to mid to high teens in Q2, resulting in full alignment between our first half fiscal '22 sell in and sell out in the mid-teens and these sell-in and sell-out results were achieved even as we continue to reduce low quality sales.

Underpinning this six months trend is 21% like-for-like growth in Prestige fueled by the tremendous success of Gucci across fragrances and makeup, Burberry and Marc Jacobs. The sales growth level we saw over the past six months, as in Prestige, brings us on par with other key Prestige beauty players showing that Coty is executing on par with the industry even as we remain under indexed to skincare and China.

At the same time consumer beauty also registered strong 8% like-for-like growth in the first half of '22 driven by broad-based growth and the clear turnaround of our key cosmetic brands CoverGirl, Rimmel, Sally Hansen and Max Factor.

Moving to sales by region, we saw growth across all regions. Over the past six months, though travel retail in the US and China continued to outperform. The Americas region grew 15% like-for-like in the first half and 9% in Q2 supported by strength in the US, Canada, and Mexico. EMEA sales rose 14% like-for-like in the first half and 13% in Q2 with growth in all key markets, as well as local travel retail. The Asia Pacific region increased 22% like-for-like in the first half and 16% in Q2, fueled by China and local travel retail.

It's worth noting that we have now a new growth engine materializing in Asia-Pacific as Chloe Atelier de Fleurs is becoming a key brand next to Gucci in Asia Pacific travel retail.

As a reminder, the (inaudible) phasing dynamics in Q1 and Q2 impacted the cost of the sales dynamics in each of our regions as well.

I will now hand the call over to Laurent, to take you through our financial results.

Laurent Mercier {BIO 22079608 <GO>}

Thank you, Sue. I am very pleased with our second quarter results which continued our strong pace of profit delivery with EBITDA coming in nicely ahead of our guidance. This quarter again demonstrated yet to circle [ph] we set out to create.

Starting with gross margin. Our Q2 adjusted gross margin of 64.6% increased by nearly 600 basis points from last year and 120 basis points from last quarter. This marks our fourth consecutive quarter of gross margin above 60%. Our gross margin performance was driven by margin improvement in both the Prestige and Consumer Beauty businesses which was supported by favorable mix, pricing and revenue management, productivity and E&O improvements and higher absorption on the increased sales volume.

As we have previously detailed, we continue to be very focused on further driving gross margin expansion both this year and in the years to come. However, please note that we do not expect to experience a similar level of gross margin expansion in the back half of the year as we did in the first half for a number of reasons.

First, seasonally the second half is a lower gross margin period given the lower Prestige sales volumes as compared to the first half. Second, in the H2, we will be lapping one-time gross margin benefits of over 100 basis points that we don't expect to repeat this year. And finally as indicated before we expect inflation impact to step up in the back half of the year.

Despite this our multipronged, multi year gross margin attack plan is in place, while we also expect further benefits from positive channel, category and regional mix shift. Gross margin expansion remains key to what's driving the virtuous cycle we have created.

I would like to now give a brief update on the topics of inflation and supply chain.

Coty continues to successfully navigate this uncertain environment. In fact, since we last spoke, our outlook remains largely unchanged with strong mitigation efforts in place on both components and any potential supply chain bottlenecks. On this point, I am proud to share that Walgreens has awarded Coty the 2021 Supply Chain Award speaking to the exceptional coordination between our supply operations and commercial teams in a difficult environment.

On freight, the majority of our freight is under contract and not reliant on spot markets, while our teams also proactively increase transportation lead times and secure the capacity in advance.

Meanwhile we are mitigating the impact of material inflation, some pricing actions, as well as through our material cost reduction program. Importantly, these actions resulted in a very solid Q2 service level in the low 90s, while also delivering revenues in line with our guidance and gross margins that were up 590 basis points.

As highlighted last quarter, we continue to expect the impacts of inflation to be higher during the second half. However, we remain confident that the actions we continue to take will allow us to deliver on our higher fiscal year '22 sales outlook while also delivering gross margin expansion for the year.

Moving to our marketing investments in the quarter. During Q2, we further stepped up our agency investment to approximately 30% of sales, which is in line with the plan we discussed last quarter. Our A&CP level was increased to capitalize on the strong momentum of our key brands in both Prestige and Consumer Beauty. This was undoubtedly the right decision as evidenced by the strong sell-out performance Sue described earlier. The increase in A&CP continued to be driven by working media, which more than doubled year-on-year. Importantly, we are seeing that behind the higher ROI opportunity, while maintaining flexibility to reallocate investment as needed.

Specifically, we continue to invest behind our key innovation which are already successful such as Burberry Hero and Gucci Flora. We also continue to expand into white space opportunity such as Prestige makeup and China where we grew six times the market rate. We are invested behind our key consumer beauty brand resulting in a true turnaround of the business.

As we head into the second half, we fully intend to keep this momentum going with the high 20s percentage A&CP level.

During Q2, we continued to execute our cost reduction program, which is another lever allowing us to fund marketing and right profit growth. Specifically, our fixed cost declined by 5% year-over-year in Q2. We achieved over $40 million of cost savings in the quarter with the primary drivers being gross margin and lower fixed cost.

For fiscal '22, we remain on track to achieve over $90 million of net savings, which we have fully delivered in the first half.

Given the very strong front loaded savings we have achieved year to-date, I want to explain the dynamics of our cost savings program in H2. As we discussed last quarter, we expect neutral net savings in second half of fiscal '22 as our cost savings initiatives were concentrated in the first half. However, beginning in fiscal '23, a number of new savings initiatives will start to kick in. At the same time, we expect to more than offset the increased inflationary impact in H2 '22, some portfolio mix and pricing actions.

Importantly, even as we monitor inflationary impact on different areas of our P&L, we remain on track to achieve our fiscal '24 savings target of $675 million as we continue to implement our all into in [ph] savings program coupled with mix and pricing initiatives in fiscal '23 and beyond.

Moving to our profit delivery in Q2 and H1. For the quarter, adjusted EBITDA increased to $311 million with a flat EBITDA margin, which is particularly strong in light of A&CP increasing by 10 percentage points and reaching 30% of sales.

For the first half of fiscal '22, our adjusted EBITDA delivery was exceptionally strong rising 30% year-over-year to $590 million with a margin of 20%. This significant improvement in profit was a result of strong sales growth, robust gross margin expansion and continued fixed cost leverage. The performance we delivered this quarter and in H1 demonstrates our virtuous cycle and improved financial trajectory we are now on.

Now moving to our EPS which included the following drivers. Adjusted EBITDA for Q2 of $311 million, depreciation of $76 million, net interest of $61 million, income tax expense of $16 million, equating to a tax rate of approximately 10%, which was below our expectation due to revaluation of deferred tax assets, stemming from the change in Dutch tax law and $2 million of adjusted preferred dividends. As a result, our Q2 diluted adjusted EPS ended at $0.17, which includes $0.02 from the aforementioned certain tax benefits.

For the first half of fiscal '22, the diluted adjusted EPS totaled $0.26. While not included in our adjusted EPS, during the quarter Wella's fair market value rose by $128 million.

Looking ahead to Q3 and the remainder of fiscal '22, I would like to provide some more context on the different drivers of our adjusted EPS. First, we continue to expect interest expense in the mid $200 million for fiscal '22, reflecting a lower net debt balance offset by somewhat higher cost of debt post the recent refinancing.

Second, we anticipate an adjusted effective tax rate for fiscal '22 in the low 20 percentage level, an increase from the 18% effective tax rate in H1 '22 as we anticipate some discrete tax cost that will hurt EPS by approximately $0.01 in H2 '22. However, we know there is a high degree of uncertainty with the effective tax rate projection in the current environment.

Third, on the preferred dividend following the full exit of KKR's ownership, only $146 million of preferred shares are outstanding. Assuming no further conversion of this preferred share, we expect roughly $3 million quarterly run rate for the preferred dividend going forward.

Moving to free cash flow. I am very pleased to say the free cash flow delivery in Q2 and during the first half was exceptional. In addition to the strong profit delivery, we made improvements across receivables, inventory, and payables, all key work streams of the cash in and peaks [ph] program. We continue to have very strict management of CapEx and our one-time cost. As a result, Q2 free cash flow came in at $408 million, while free cash flow for the first half was $649 million.

During the second half of fiscal '22 many of these work streams will remain in place. With others set to commence, we should partially mitigate the typical seasonal cash outflow.

Moving on to our capital structure. We ended Q2 with the financial net debt of approximately $4.45 billion, which is a decline of about $500 million from Q1. This decline was driven by two key factors. The strong free cash flow generation as well as approximately $117 million of cash generated primarily from the sale of real estate assets and to a lesser extent repeat of contingent consideration related to Wella business tax credit after finalization of the purchase price true-up [ph] related to the Wella business thing [ph].

As a result, we ended calendar of 2021 with a leverage of 4.9 times. I am proud to say, this came in ahead of initial target which was to end of calendar year with leverage towards five times.

Factoring in our 26% stake of Wella, at quarter end valued at approximately $1.18 billion, we ended the quarter with economic net debt of around $3.28 billion. While I believe we have numerous workstreams that will allow us to reach our four times leverage target organically, I am pleased to say that entering Q3 Wella has completed a refinancing of it's existing debt in order to fund the shareholder distribution. We expect this will result in approximately $175 million of cash proceeds to Coty.

We intend to utilize this distribution plus excess cash on the balance sheet to redeem our 2023 EUR550 million unsecured bonds in full following the times that the bond call premium drops to par on April 15, 2022. This is clearly a significant step in helping us reach leverage target of approximately four times by the end of calendar year '22. This moves us further towards our ultimate goal of two times by calendar '25.

Before I hand the call back to Sue, I want to briefly provide an update on the partial Brazil IPO we had been exploring. In light of the current economic volatility and adverse financial market conditions in Brazil, we have decided to withdraw from the LPO registration application process for the time being. We will continue to monitor market conditions evaluating future possibility to proceed with a partial IPO in Brazil in the new opportune window.

I will now turn the call back to Sue.

Sue Nabi {BIO 21845588 <GO>}

Thank you, Laurent. We continue to make strong tangible progress across our six strategic pillars in Q2 with many additional initiatives in the works. Let's start with our first strategic pillar stabilizing and growing our Consumer Beauty brands.

I think the charts on this slide perfectly encapsulate the lightning speed with which we are turning around this business, something that few would have anticipated a year ago. For the first time in five years, which is as far as our internal data goes but likely much longer, Coty Consumer Beauty business has not only stabilized share, but is gaining market share on a global basis.

This is underpinned by strong momentum in our color cosmetics brands, which together account for roughly two-third of our Consumer Beauty business. While the global mass cosmetics category grew in the low to mid single digits, our sell out grew over 10% in mass cosmetics and high single digits in the mass beauty overall. As a result over the past three months we have gained roughly 60 basis points of share in the mass color cosmetics category globally and close to 100 basis points of share in November and December. At the same time our Brazil business maintain momentum with double-digit sell out growth supported by key new innovations behind Monange body care and Risque nail color. While the path to sustain consumer beauty expansion may not be Rimmel, these exceptional results confirm that our consumer beauty brands as relevant as ever and with the right products, communication strategy, in-store execution and the right teams we can truly excel.

Drilling a bit deeper into the momentum we are seeing in mass color cosmetics. While we began our consumer beauty turnaround with our biggest brand CoverGirl, I am proud to say that our four biggest color cosmetics brands CoverGirl, Rimmel, Sally Hansen and Max Factor are now all gaining market share on a global basis. As you know, we relaunched CoverGirl in March of 2021 with new communication assets, new brand ambassadors and doubling down on CoverGirl's heritage in clean makeup and skin side [ph] makeup.

Now roughly 10 months into the launch, CoverGirl has gained market share in 26 of the last 14 weeks.

On the Rimmel, we began the brand positioning over the summer with a new brand activities at (inaudible) and a new communication. Our events communication and execution are clearly resonating with consumers in key markets as Rimmel is now winning share globally led by share momentum in the UK, Australia, Spain and Poland. As a next step, we have leveraged the CoverGirl playbook for Rimmel with the recent launch of Rimmel's clean and vegan make up line called "Kind and Free".

However, it's important to note that the line began appearing on fixtures in key markets in January with the TV media support beginning now in February. So the benefits to Rimmel market share momentum from the revolutionary launch will only come in our fiscal Q3.

On Sally Hansen, the brand was already successful over the past couple of years and we have continued to fuel this strength through innovative launches like "It Takes Two" and supporting key franchises like Miracle Gel and Insta Dry. As a result Sally Hansen is gaining share across the UK where it has recently overtaken SE as well as gaining share in Australia and Spain.

Finally Max Factor's repositioning began in the fall with Priyanka Chopra Jonas as the new brand ambassador. The revamped communication and in-store execution coupled with the revamped Face Finity foundation have returned Max Factor to market share gains globally led by the UK, Spain, Poland and Russia.

To reiterate, while we do not anticipate a linear path of share gains for every brand in every market in every month, what is quite clear is that we have developed the right formulas and playbooks to turnaround our Consumer Beauty business and less than a year into our execution we are already seeing strong success.

Turning to the second pillar of our strategy. Accelerating our luxury fragrance business. It's important to highlight here that the market backdrop of Prestige Fragrances remains quite favorable, even as trends vary by region. Specifically, we estimate the global Prestige Fragrance market is up double digits in Q2 both year-on-year and versus 2019. This is supported by very strong momentum in the US and China.

Importantly, while we are monitoring the US market closely as we start lapping the high growth figures of the prior year, we have not yet seen any signs of slowdown. In China, the fragrance growth is being driven by Chinese consumers truly discovering the fragrance category, which is often viewed as an extension of luxury fashion. We see the fragrance momentum in China continuing for many years to come given the incredibly low fragrance penetration in the market and see a clear path for China to move from the number five fragrance market today to the second market in the next few years.

On the other hand, while Prestige Fragrances are up solidlyl in Europe year-on-year, the category is only now stabilizing versus 2019 suggesting that as the European markets reopen there is more momentum in store for the fragrance category in Europe.

Similarly in travel retail, while the year-on-year growth remains robust, the two-year trends are still negative, which will also provide another leg of growth for fragrances in the coming years. Against this attractive backdrop, Coty is launching market leading innovation. Gucci Flora Gorgeous Gardenia is performing exceptionally well and resonating globally. While the fragrance was only launched in early fall 2021, Gucci Flora Gorgeous Gardenia is officially the number one fragrance launch in the US and Canada for all of calendar 2021. This marks the second consecutive year where Coty has claimed the number one fragrance launch in the US with Marc Jacobs Perfect holding the number one spot in calendar 2020. Gucci Flora has also truly resonated with Chinese consumers becoming the number seven female frangrande on TMall in December.

The male fragrance side Burberry Hero, which also launched in early fall has claimed the fourth spot in the US amongst new fragrances launches in all of calendar 2021. And similarly on TMall the line became the number seven men's fragrance on TMall in December. It's clear that Gucci Flora and Burberry Hero are on track to become global fragrance icon and this speaks to the new capability and operational discipline we have built within Coty over the last year and half with a team of experts, identifying the right spend profiles and pipeline of innovation and rigorously testing all fragrances to reach both industry leading scores before launching in markets.

I'm confident this enhanced capabilities in our fragrance business will assure that as a leader in fragrances Coty's success rate for launches will be higher than the industry and Coty's success rate historically.

Part of the second strategic pillar is also becoming a key player in Prestige makeup and we are making very strong strides here. Our Prestige makeup sales in the first half of '22 approximately doubled year-on-year led by Gucci makeup and Kylie cosmetics.

As you can see in the video on this slide showing the Burberry Beauty store in China, we are rapidly growing our footprint for Prestige makeup brands with eye-catching distinctive stores and counters, differentiated packaging and communication and locally relevant designs, such as the Red Tiger to coincide with Chinese New Year. As a result of this momentum, Prestige makeup grew from less than 3% of our total sales in the first half to over 4% of our sales in the first half of '22 and we continue to target approximately 10% penetration by fiscal '25.

Focusing on our biggest opportunity in Prestige cosmetics, Gucci makeup both in Q2 and in first half '22 Gucci makeup sales more than doubled year-on-year and as we've discussed at our Investors Day, our focus is on growing our Prestige makeup business in a profitable way by opening highly productive flagship stores in the highest traffic locations and supplementing this with robust e-commerce sales. Our Gucci makeup business in the US is a clear example that this strategy is working.

In recent months we had doubled year-on-year the number of Gucci makeup doors [ph], but we are also seeing that comparable store sales are doubling as well with e-com accounting for over 50% of the sales. In China, Gucci remains a highly desired brand as evidenced by the long lines, you can see in this photo outside of one of our Gucci Beauty locations. Our strong activations have driven our Gucci makeup sales in China to triple year-on-year.

In fact as we advance our strategy of building Gucci into a truly two axis brand, Gucci makeup sales in China now exceed Gucci fragrance sales.

Turning to our third pillar building out our skincare business. As we highlighted during our Investor Day, we see fiscal '23 as the year of skincare acceleration focusing. In the meantime, we are laying the foundation for strategic skincare initiatives. Let me start with our strategic focus brand Lancaster.

As you know our strategy to turn Lancaster into a scientific skincare brand excelling in repair and protection, it's focus first on Hainan and Mainland China. We have been actively opening Lancaster counters and focus in Hainan with beautiful fixtures such as the one you see here. We hosted VIP events with leading dermatologists, celebrities and key opinion leaders, while also engaging consumers with (inaudible). And we are seeing these efforts translate to sell out. Since opening the initial three doors in Hainan in May 2021, Lancaster's monthly sales there have nearly doubled as of December. This confirms our view that with the right support and activation the Lancaster brand equity and product trends truly resonate with Chinese consumers.

At the same time in Mainland China, Lancaster has become China's Sephora's second exclusive brand with strong double-digit sale out growth in the recent period.

We are also progressing our skincare ambitions with the next key milestone, the launch of CoverGirl skincare. As you recall, we first announced the launch of CoverGirl first ever skincare line in November at the same time as we announced America Ferrera as the newest COVERGIRL brand ambassador. Last week we formally unveiled the new dual language campaign with America Ferrera in both English and Spanish to coincide with the national rollout of the COVERGIRL Clean Fresh Skincare line wherever the brand is sold. Let's take a look at the new campaign video now.

(Video Presentation).

I want to emphasize that we pre-tested the COVERGIRL skincare line up, communication and campaign extensively and have seen exceptional results on our tests. We are excited about this new initiative for COVERGIRL, and we look forward to updating you on the initial results at the next earnings call in May.

Turning to our fourth strategic pillar building our e-commerce and direct to consumer expertise. Focusing on our e-com results, we continue to make strong progress with e-com sales in the first half at 16% including particularly strong growth in consumer beauty.

As a result, our e-com penetration for the first half reached high teens including mid 20s penetration in Prestige and approximately 10% penetration in consumer beauty. However, as you heard from, Jean-Denis, our Chief Digital Officer in November, our digital transformation encapsulates so much more than just e-com and we've made many strides across multiple areas over the last few months. As part of our partnership with (inaudible), today we announced an advanced virtual (inaudible) tool for Sally Hansen allowing consumers to see hundreds of Sally Hansen shades on the live moving image of their own hands before making their purchase.

We have also been doubling down on beauty advisor live streaming across our key markets, training our BA's to engage with our client base through digital storytelling and brand building, and this is driving real results. For example in the US, we have successfully participated in a program by Amazon, the Amazon Holiday Gift Guide live stream with COVERGIRL and Sally Hansen resulting in 1.6 million views and 3 million impressions. Similarly, our very strong sales results on TMall in December were in part fuelled by our BAs whose live streams contributed to a double-digit percentage of our TMall sales up from single digit in previous months and recruited thousands of consumers to our friend [ph] list.

This makes us not only less reliant on more promotional live streams by the high-profile live streamers, but also innovate the image and quality of our beautiful brands.

Moving on to China. We continue to make strong progress on this fifth strategic pillar. Following a very strong Q1, we maintained strong double-digit sales growth in Q2, even as the resurgence of COVID in parts of the country led to slowing beauty sales broadly. In fact, this was the second quarter in a row where Coty Prestige business sell out was the fastest growing amongst the top 10 beauty companies in China.

Our Q2 prestige sell-out grew over 30% which is six times the growth rate of the Prestige beauty market while in overall calendar '21, our Prestige sell-out was four times faster than the market. Our TMall revenues in the quarter grew over three times year-on-year and I'm proud to say that only 10 months after launching the brand on TMall, Gucci reached the number 10th spot on TMall in December. All of this gives me strong confidence that we have the right brands, people and capabilities to win in China and reach our ambition to drive China sales to 10% of our total revenues by fiscal '25.

That now brings me to our outlook for the year. We have detailed how our sales in Q2, which mid to high teens and how January like-for-like sales growth accelerated from Q2 levels to plus 13%. All of this gives us confidence that revenue growth should accelerate in the coming quarters and we now expect Q3 and overall the second half of '22 like-for-like sales growth in the mid teens. At the same time ForEx is becoming a more serious headwind with an estimated 3% to 4% negative impact to our sales in the second half of '22.

From a profit perspective, while we had spectacular gross margin performance in the first half of fiscal '22, as Laurent discussed, our gross margins are usually seasonally lower in the second half compared to the first half while the year-on-year growth will be constrained by one-time benefits in the prior year and the step up in inflation. As a result, we would expect fairly limited gross margin expansion in the second half '22 as compared to the prior year. However, when you couple this with the fantastic 530 basis points of adjusted gross margin expansion in the first half of '22, we continue to expect a significant uplift in gross margins for fiscal '22 as compared to the 60s in fiscal '21.

Moving down the P&L, following the active reinvestments in Q2, we would expect A&CP levels to normalize to the high '20s. And as Laurent mentioned on the tax rate we expect some discrete tax headwinds in the second half of '22 to lead to a fiscal '22 adjusted effective tax rate in the low 20s. in total we now see fiscal '22 like-for-like sales at the upper end of our guidance range of low to mid-teens growth assuming no significant deterioration in the global COVID situation or macro environment.

We again comfortably confirm our fiscal '22 adjusted EBITDA of $900 million at the minimum at constant currency as we continue to monitor cost environment, while also fueling growth initiatives. Here we would note that ForEx benefited our first half EBITDA by approximately 2.5% or $11 million in the first half, while in the back half we currently expect foreign hurt of roughly similar dollar magnitude or a mid-single digit percent, which in total should drive a relatively limited ForEx impact on EBITDA for total fiscal '22. And with the strong delivery to date on EPS, we are increasing our fiscal '22 adjusted EPS guidance to 0.22 to 0.26.

This takes into account, approximately $0.01 of net discrete tax benefits for the year, including a $0.02 benefit in Q2, followed by a $0.01 hurt expected in the second half of this fiscal.

Lastly, we continue to expect to in calendar 2022 with leverage of around four times with the expected $175 million Wella distribution a strong step towards reaching this target.

To conclude now, we entered fiscal '22 with the goal of further building upon the great success we delivered last year and our first half results confirm we are moving full speed ahead on this objective. We grew sales and sell-out strongly in the first half with broad based strength across Prestige and Consumer Beauty. We delivered gross margin, profit and cash ahead of expectations, setting the stage for strong delivery for the total year. We continue to make progress across each of our strategic pillars with many more exciting initiatives ahead and the progress we have made is giving us confidence in an even stronger second half.

In short, we are maintaining our pattern of consistent strong delivery as we progress on our ambitions to become a true beauty powerhouse.

Thank you for your time today. We are now happy to take your questions.

Questions And Answers

Operator

(Operator Instructions). And we will take our first question from Olivia Tang, -- I'm sorry, Olivia Tong with Raymond James. Your line is now open.

Q - Olivia Tong {BIO 22252574 <GO>}

Great. Thanks, good morning. I wonder if you could dig deeper into EBITDA, both this quarter and your expectations for the remainder of the year. Obviously came in nicely ahead of our expectations and your first half expectations with gross profit obviously meaningfully better. So can you talk a little bit about what came in better than you expected. And what you expect to continue into the second half. You mentioned more tempered expectations in the second half. But I assume you still expect gross margin expansion in the second half, just not at the same magnitude, as in the first half. So if you can clarify that.

And then on EBITDA, I'm curious how you expect investors to read the unchanged guidance. I realize the upper end of the guide is open-ended. But to the extent that you have gross margin upside. How do you think about whether you choose to key brands support levels potentially at that 30% level in fiscal Q2? Your view on how much flex you want to leave to invest at higher rate if you choose and the flexibility in case other things happen. Thanks so much. Appreciate it.

A - Laurent Mercier {BIO 22079608 <GO>}

Thank you, Olivia. So I'll start with the first part on Q2, what came in and better than expected. Definitely, I will give you few of the key drivers, number one is growth definitely and you remember during Investor Day, when we explained really how we are uniting the flywheel, definitely that starting with growth and how do we fuel the growth is really with the gross margin expansion and at the same time we keep strong discipline on fixed cost. These are definitely. I mean the two engines gross margins. So as I explained, what's driving this gross margin expansion, it's mix and we explained also in Q1. So we continue mix all the drivers with Prestige, Prestige makeup, China, e-commerce, skincare, all what we are building is really accretive for the mid.

I want also to comment, which is super important is that it's not only category mix, it's also within the category and I want to mention on consumer beauty innovations that we are kicking off in consumer beauty, they are very accretive in terms of gross margin.

So it's really combination of all these initiatives, expanding gross margin combined with pricing and revenue management we started already last year, we continue, we even amplify to contain also inflation. And third is we keep working of course on productivity on all initiatives as part of the all into in initiatives. So gross margin is really a key component, key element of our equation, fixed cost as we started last year and we continue minus 5% fixed cost in the Q2 and then fueling A&CP as I shared. we are at the level of 30% of net revenue of A&CP.

So it's really, this combination of all these elements, discipline on gross margin, fixed cost, fueling A&CP, media and then generating growth. So that's really the engine. And now, definitely moving to H2 indeed as you know, gross margin there is a seasonality on the gross margin. H2 gross margins are lower than H1, basically the key element is that there is a seasonality from a net revenue standpoint, which is also on volume. Number two is, last year we had one time help of about 100 basis points, so which is creating also high base and the inflation indeed will even continue of course in H2, but at the same time, we have all the pricing amplification.

As we say H2 gross margin expansion will not be at the same level as we experienced in H1, which is really tremendous result. But on the total year, of course, gross margin expansion will be significant. So that's really important to understand this, the model of H1 Q2 and where we are moving to in H2.

Now on the second question which is EBITDA guidance. We confirm our guidance what we shared last time. I mean, we construct and we confirm 900 at a minimum and we continue this flywheel. Definitely discipline in gross margin, discipline on fixed cost and fueling the growth. Sue explained, shared a lot of very concrete tangible examples where we are seeing some success, market share gain, both on Prestige and Consumer Beauty. So we continue this model and fueling the support again always in a very pragmatic approach, always with KPIs, return on investment and we don't compromise on the way we are (inaudible).

That's really the discipline rigor that we are keeping and of course I mean keeping a strong eye on inflation, and managing through pricing revenue management and (inaudible).

Operator

And we will take our next question from Steph Wissink with Jefferies. Your line is now open.

Q - Steph Wissink {BIO 17692025 <GO>}

Thank you. Good morning, everyone. Sue, I've a question for you. And this is really more contextual, but I'm curious how your conversations with your retail partners are evolving as you outperform the category. Are you finding that they're coming to you for new opportunities for shelf space or promotional events? Maybe give us some context of how those conversations are changing and evolving. And then Laurent one for you is just on the A&CP, in response to Olivia's question you talked a little bit about the dollars and a percent changing in the back half. But can you talk about that in relation to your accelerated sales growth targets? Are you finding more efficiency out of your A&CP,.so you feel like you can pull back a little bit as a percentage of sales, but you can still see acceleration in the overall sales performance? Thank you.

A - Sue Nabi {BIO 21845588 <GO>}

Hi, Steph. Good morning, everyone. So this is Sue speaking now. So, yeah, that's a very interesting question. That's true that we see very, I would say, a strong change in the discussions we're having with retailers since now, I would say, a year and it's accelerating. If I may say it like this. We see a lot of incredible opportunities given our way of creating innovation. Again, the idea is not to launch just another mascara or another moisturizer, Coty's vision is to build categories hand-in-hand with retailers and this is precisely what we have been doing on Consumer Beauty and this gives me the opportunity to again insist again on why CoverGirl is regaining traction and visibility and market share gains in the US since now 26 weeks among the last 40 weeks because we decided that we will category captain [ph] in a way the clean beauty category and we are doing now, the clean skincare launch in mass environment, which is another step into this direction of owning hand-in-hand with our partners in retail, the category. We're doing exactly the same thing. If I take the example of Gucci makeup. Gucci makeup a lot of retailers see it as what's missing in the portfolio of brands, they say that they have on one side the heritage Gucci brands and the more younger in the niche brands and they think that Gucci has both at the same time, which makes the brand, very unique and which makes us suddenly a partner with our retailers in terms of creating new categories that are going to bring new consumers to the stores.

Last but not least, I have to say that this crystallizes even stronger online specifically for consumer beauty when it comes to retailers, such as Amazon, where they are really helping us to build the clean beauty category online and the results here again of CoverGirl are also that we are seeing in the rest of in Europe with kind the latest launch from Rimmel are exactly a great discretion [ph] of this vision that we are working on hand-in-hand with the caterers.

So it gives us a lot of opportunities and to conclude on this the rebirth of Max Factor to take this example is also opening a lot of opportunities. This brand that's the European centric brand, a lot of countries around the world are now seeing the re-launched very, very successful gaining market share in a lot of countries, very, very strong image. The only I would say mass business brand that has Prestige look and feel with makeup artistry at its heart, and this is clearly I would say a destination that a lot of retailers around the world are willing to have in the stores. The second part for Laurent, I will let Laurent in.

A - Laurent Mercier {BIO 22079608 <GO>}

Yes, hello Steph. On A&CP what's important is first is really to remind that our level of A&CP in Q2 was at 30% and these 30% drove very strong sell-out what Sue explained really this is peak season and we are again with the equation with gross margin fixes, we were able, really to fuel Consumer Beauty initiative and Prestige initiatives. So that's why we have struck in Q3 with generally with very...

Operator

Please standby. Please standby, we are experiencing technical difficulties.

A - Laurent Mercier {BIO 22079608 <GO>}

Hello.

Operator

And we are live.

A - Laurent Mercier {BIO 22079608 <GO>}

Hello. We are back. When was it cut?

Operator

Laurent, you were just starting the answer to your question.

A - Laurent Mercier {BIO 22079608 <GO>}

Okay. I will do it again. That's fine. So, yes on your question on A&CP starting first in A&CP in Q2 was at the level of 30% and again with the significant increase and thanks to the high level of A&CP we could drive very strong sell out in Q2 as Sue explained and this translated into very strong reorder and sales growth in Q3 and that's why we are starting January in very good shape and (inaudible) in Q3 and Q4. That's a key reason why we shared that we will be at the high end of our guidance, low to mid-teens on fiscal year '22.

Why is really our daily obsession. We are reviewing all the initiatives, we are testing the Coty's as you know, we have very disciplined teams and (inaudible) So we are making sure that any initiative is built on strong analytics and ROI. If some test are not at the level expected, then we simply rework or stop so that we make sure that any dollar we are investing there is a very strong ROI. So this is a work we started last year. We see the results, we continue and will amplify even this discipline in H2 both on Prestige and consumer beauty and that's why this disciplined ROI combined with level of A&CP which remain in the high 20s in H2 and all these elements are driving streams strong sell out in both Prestige and Consumer Beauty.

Operator

And we will take our next question from Andrea Teixeira with JPMorgan. Your line is now open.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Hi, good morning. Thank you. I was hoping if you can unpack your like-for-like guidance not to take away the merits of it, but you raised in light of your two year stack acceleration in Q2 and I appreciate that obviously, the sell-out and sell in dynamics are not a straight line. But you guided also that January like-for-like was 13, so your new guide implies mid-teens for the full fiscal year and you're facing a much tougher comps in Q4.. What gives us you confidence and I know throughout this call, you have given a lot of the evidence for (inaudible) and all of that, but if you can please unpack those dynamics in terms of sell-in, sell-out in order to make your two year stack reaccelerate in the last five months of the fiscal. Thank you.

A - Sue Nabi {BIO 21845588 <GO>}

Good morning, Andreas. So, yes, you're right, we again this gives me the occasion in fact to quickly come back on the very robust results we got during the second quarter on all metrics, and also, of course, you spoke about this, the significant momentum beginning of quarter three with the Jan being an acceleration of our sales versus Q2, that's quite clear. What we see is that the sell-out of the second quarter has been very strong. It is exactly the story that we've told you when we reported the first quarter results. Q1 was a (inaudible), I would say cost up. Q2 was sell out cost up and there we have outstanding. I would say, results based in Prestige in the 20% growth and in mass market where there has been a very, very strong acceleration of our sell-in and sell-out and you've seen the region wise because of CoverGirl continuing to gain market share and now something new Max Factor and Rimmel next to Sally Hansen gaining also market share. So this, I would say optimism that we have because of this acceleration of sales when it comes to Consumer Beauty, this is precisely translated into what you are seeing in the plus 13% in Jan and we are clearly very confident that the second half will be in line with the fiscal year mid-teens outlook that we shared with you on the press earnings release.

So the confidence comes from again, you know, our Prestige business since, let's say, may be two or three quarters is growing at a very high base. Prestige fragrances are booming worldwide, Coty is doing very well on this area, we have the new engine of Prestige makeup and there between Kylie cosmetics on one side Gucci and Burberry cosmetics on the other side, we do have the right brands to accelerate on the segment we are starting a new story on skincare in Prestige with Lancaster or in mass with CoverGirl skincare that's just starting to have advertising behind in Q3.

Next to a better, much better oriented makeup brands globally again the COVERGIRL, Rimmel, Sally Hansen, and Max Factor. At the end of the day when both divisions are going in the same direction it's giving us this confidence that there is no reason for us not to go where we want to go. Last but not least key launches are rising in Q3. One of them is Kind and Free, which we applied the playbook of COVERGIRL Clean Fresh success to email in the rest of the world, and this is going to be the biggest launch of Consumer Beauty in Q3 and Q4.

Advertising started a week ago, or maybe a few days ago, if I'm not wrong. We have COVERGIRL skincare also advertising just started in the US a few days ago, and we have also strong initiatives on Prestige, on Hugo Boss you know that the brand has just launched on the fashion side. This is clearly going to benefit us globally on the beauty side, I have to say and we are putting at the moment a strong push behind Buzz [ph] which is the younger franchise of Buzz. We have a lot of initiatives on Gucci fragrances. We have a lot of initiatives on Burberry fragrances, and we have also Kylie cosmetics launching new initiatives.

So overall, we had a kind of momentum starting beginning of this fiscal and we are accelerating this momentum thanks to new initiatives arising in Q3 and Q4.

Operator

And we will take our next question from Rob Ottenstein wth Evercore. Your line is now open.

Q - Robert Ottenstein {BIO 1498660 <GO>}

Great. Thank you very much. I'd like to focus on the US consumer in Consumer Beauty and just try to get your sense of the state of the consumer given Omicron, given food inflation, what their appetite is for new brands, clearly you're doing very well, but trying to get a little more granularity on on how you see the consumer and how you're positioned for the consumer with these sorts of inflationary pressures. And then secondly, if you could talk a little bit more about COVERGIRL skincare, the kind of shelf space that you're getting, maybe initial reactions. I know it's really early, but your initial reactions of how big that brand could be. Thank you.

A - Sue Nabi {BIO 21845588 <GO>}

Good morning, Rob and thank you for your question. So, yeah, what we are seeing, which is not just US based. I have to say that this is globally, something we are seeing across many regions is that consumers are more than ever, looking for new ways to consume beauty more online sales but brick and mortar is quite strong i have to say, which is great news for everyone. I have to say, but also on the consumer way of buying products you clearly see that what I call healthy, some people call it clean beauty, some people call it skinified cosmetics of beauty. This is what people are shopping more and more, you know they got used to different ways of wearing makeup. They get used to where more skincare and therefore when they are back to make up consumption, which is the big part of our business in the US, there are really favoring what I call clean or skinified option. And that's clearly explaining the back to growth in market share of COVERGIRL on one side with clean fresh skin tins with lush Brazilian mascara, but also on the other side with simply ageless which has been one of our most successful, I would say, growth engine for COVERGIRL in America.

We do see re-consumption in lip color mainly focused on non-transfer long lasting lip color. We've seen for example that next to clean makeup and simply ageless, on COVERGIRL outlast franchise for lips is doing very well, without any kind of advertising, which means that when people are buying that color specifically for the lip area they are shopping into long and non-transfer products and we are seeing more or less the same trend on another of our Prestige brands, which is Kylie cosmetics where the lip kit, which is really, you know this matt long lasting almost non-transfer kits with the liner and the liquid color is more or less, having the same performance quality when it comes to not staining the mass [ph].

So clearly make up business and specifically for us is back to growth thanks to these categories. On Prestige, what we are seeing very strongly is fragrance consumption again. This is at an ever high and we haven't seen any signs of slowdown. I have to say of this category in the US or anywhere else. In fact, it's starting to pick up in Europe and in China, you know the story, the level of consumption is so low there and this market today is the fifth markets around the world and in the last quarter the fragrance category in China outpaced the growth of skin care category and of makeup category. So again, there are many things that are in a way, giving a strong confidence that key categories where the company is positioned on are having the right, I would say tailwinds behind.

When it comes to COVERGIRL skincare and shelf space, we have very positive initial results specifically online, I have to say where the brand started at Amazon. We hve been doing TikTok using TikTok dermatologist et-cetera. And the great news is that if you look to the ratings, which is a very, very important item in skincare, our ratings are between 4.5 and 4.7 on 5, and 5 usually is stake ratings, under 4.5 sometimes you need to look at what's not doing well, but 4.5 to 4.7 is exactly what is considered as a very, very strong rating from consumers specifically on our star product, which is the weightless water cream. That's the one that's been advertised by America Ferrera.

So we're very very confident that this launch is not only going to give us attractiveness to COVERGIRL in an even stronger way both makeup and skincare because the idea is also to benefit from the halo effect of being stretched in cap on makeup also. But in terms of space, we are not having today additional space for skincare. We're starting in the makeup aisle which is precisely at the end of the advertising, that you have seen, if you could read at the end of the ad shop it at COVERGIRL space. So that's very clear for consumers, but this is a great opportunity I guess for us as I answered the first question, at the very beginning around retailers from Steph that we will use this to create categories hand in hand with our retailers, the clean skincare category is clearly a key one and COVERGIRL in the US and hopefully other of our brands in the rest of the world are going to lead this story.

Operator

And we will take our next question from Lauren Lieberman with Barclays. Your line is now open.

Q - Lauren Lieberman {BIO 4832525 <GO>}

Great, thanks, good morning. I had two questions. One was, Laurent you gave some color on productivity and cost savings from here, but I still was just curious, a little bit more detail on why there isn't more productivity slated for the back half. I fully understand, I mean you were able to reach our target earlier in the year, which is great. But typically, I think about companies programs are a bit more rolling in nature, so I just was looking for any additional color there was to offer on that point. And then secondly, there has been management change since the Investor Day, Andrew leaving for clearly great opportunity to be CEO of a public company. But I was just curious if you could offer anything on the thought process behind how you've replaced his seat and any timeline delays that might lead to with some of the activity with the Kardashian brands. Thanks.

A - Sue Nabi {BIO 21845588 <GO>}

So maybe Laurent can start with the first part, which is around savings and I'll take the second part.

A - Laurent Mercier {BIO 22079608 <GO>}

Sure. I will take. Good morning, Lauren. So on savings, so basically is really that most of the initiatives indeed, so we delivered in H1. And we have a new pipe of key initiatives, which will really kick in beginning of fiscal '23. So to give you some concrete examples we have now a specific program which is full review of material value analysis and this will translate into concrete savings in fiscal '23 combined with procurement savings, we are seeing also the team has now built a very strong (inaudible) one.

On top of this the supply chain we have also program and automation, which will bring additional savings in '23 and also element talking about manufacturing as you know, we made the decision to close a factory on fragrance. I mean, the plan is put in place and we will see also the benefit in fiscal '23. Also the elements for you to have in mind is that we will also benefit from lower depreciation. So indeed strong H1 and then we have really very strong initiatives. So that's why we are confirming the $600 million net savings plan by fiscal '23 and on terms of 75 we announced for fiscal '24.

A - Sue Nabi {BIO 21845588 <GO>}

So quickly to complement on Laurent's answer on this first part of the question. We are continuing to do productivity gains during the second half, which are going to be used as hand in hand with pricing to offset inflation for the second half. And so it's not opposed, it's really that it's going to be used to offset inflation for the second half of this fiscal. So to answer your question around management changes. So first, it's a great opportunity for Andrew, this everyone can understand it and is a great opportunity for Coty, I have to say this is clearly giving us the opportunity to take the next generation of leaders to the highest level of the company.

You know that the US business is run today by our Former Canadian General Manager, Debbie Ericsson has been with Coty for years and years. She is an outstanding leader and she is running today the number one country for Coty around the world and she's a woman, which is I think something very, very strong at Coty, something we committed on earlier. Same thing in Canada, it's another woman part of the management that's becoming the general manager of Canada. And last but not least, Anna von Bayern has become the CEO of the joint ventures and Anna is with Coty and myself since one year and a half and the relationship that Anna and myself are having with the Kardashians in New York, is clearly big, big asset into accelerating in fact the relationship and I have to say that when you say is this is going to delay things, in fact it's exactly the opposite that may happen. Since we have separated the role of taking care of the biggest country of Coty around the world and taking account of joint venture so that today Anna, Vanessa and other teams around the work and focus fully to continue the huge potential we have been behind Kylie and the upcoming Kim Kardashian skincare launch at the end of the fiscal year.

So thank you very much. If there are any concluding remarks Laurent on your side, maybe that's the right moment for me, I have to say that I am super, super proud of this fixed cost up of improvements across all metrics. This is really, really I think something that makes the teams at Coty super, super proud. We are very, very excited to be into the second half of the year and we are more even excited to start to prepare the skincare year as I call it, which is fiscal '23. Thank you very much for your questions and hope to talk to you soon. Bye-bye.

A - Laurent Mercier {BIO 22079608 <GO>}

Thank you. Bye-bye.