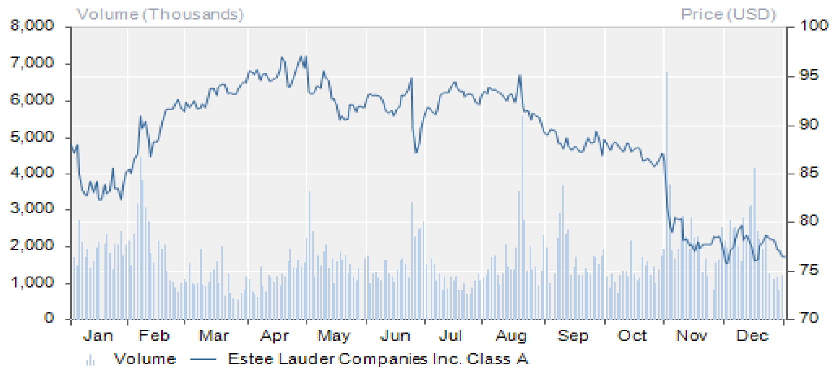
Analyst: Karissa Zanoni

Recommendation	**SELL**
Target (today's value)	$78
Current Price	$77.26
52 week range	$75.30-$97.48

Personal Care and Household Products

Estee Lauder

Share Data	
Ticker:	EL
Market Cap. (Billion):	28.5B
Inside Ownership	1.36%
Inst. Ownership	42.76%
Beta	0.71
Dividend Yield	1.4%
Payout Ratio	41.0%
Cons. Long-Term Growth Rate	11.4%



Source: FactSet Prices

	'14	'15	'16	'17E	'18E
Sales (billions)					
Year	11.0	10.8	11.3	11.9	12.6
Gr %		-1.7%	4.5%	6.1%	5.1%
Cons				$11.9	$12.6
EPS					
Year	$3.12	$2.87	$3.01	$3.29	$3.59
Gr %		-7.9%	4.9%	9.0%	9.2%
Cons				$3.30	$3.82

Summary: I calculate a price target of $78, so I recommend a sell. Estee Lauder leads its industry in stable growth and outperformance of the market, but has many risks from operating globally, entering unstable emerging markets, and continued acquisition of new brands. Core business performance is average among peers, although inventory turnover remains a long-term struggle. The stock is fairly valued now, but there are few catalysts to recognize this value.

Ratio	'14	'15	'16	'17E	'18E
ROE (%)	29%	29%	30%	34%	38%
Industry	6.8%	16.4%	17.0%	26.7%	19%
NPM (%)	10.1%	10.1%	9.9%	10.7%	11%
Industry	5.4%	4.1%	4.3%	8.0%	7.9%
A. T/O	1.34	1.34	1.29	1.22	1.22
ROA (%)	1.04	1.03	1.02	1.02	1.03
Industry	13.5%	13.5%	12.8%	13.1%	13%
A/E	19.9%	21.8%	26.7%		

Valuation	'15	'16	'17E	'18E
P/E	28.0	28.8	26.0	23.9
Industry	37.4	29.2	55.7	26.0
P/S	3.04	3.02	2.53	2.49
P/B	8.5	8.7	7.7	8.1
P/CF	19.0	18.0	42.2	16.6
EV/EBITDA	21.3	21.3	19.3	18.2

Performance	Stock	Industry
1 Month	-1.6%	-1.7%
3 Month	-13.6%	9.4%
YTD	-13.1%	25.4%
52-week	-14.1%	24.7%
3-year	-0.9%	15.1%

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Key Drivers:

- Emerging Markets: 21% of Estee Lauder's revenue is exposed to emerging markets and their uncertainty. This is an opportunity, but weak economic growth and FX risk limits sales growth potential.
- Distribution Channels: As foot traffic in department stores decreases, Estee Lauder has focused on expanding its exposure to consumers through E&M (mobile devices) commerce as well as through expansion of freestanding stores.
- Translation Exposure: Nearly 60% of revenues come from outside of the US, so a stronger dollar reduced sales by 4.8% and 4.3% in 2015 and 2016, respectively.
- Acquisitions and New Products: To continue competitiveness, Estee Lauder continues to acquire brands and develop new innovative products. In 2016, new products constituted 25% of sales and R&D is growing.
- Competitive Analysis: The competition is strong, but EL is growing faster than the competition.
- Initiatives: Leading Beauty Forward is a restructuring plan aimed to improve operations, saving $300 million per year, but it may cost up to $600 million by 2021.

Valuation: Using a relative valuation approach, Estee Lauder appears to be overvalued in comparison to the household and personal care products industry. DCF analysis yields an $82 target. A combination of the approaches suggests that Estee Lauder is overvalued, as the stock's value is about $78 and the shares trade at $77.26.

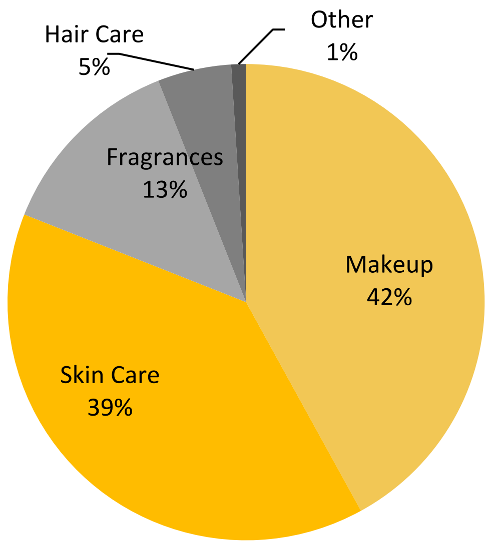
Risks: Business risks include a highly competitive industry, possible inability to anticipate and respond to market trends, general economic downturns, foreign operation risk, the populism movement in Europe, and a possible trade war.

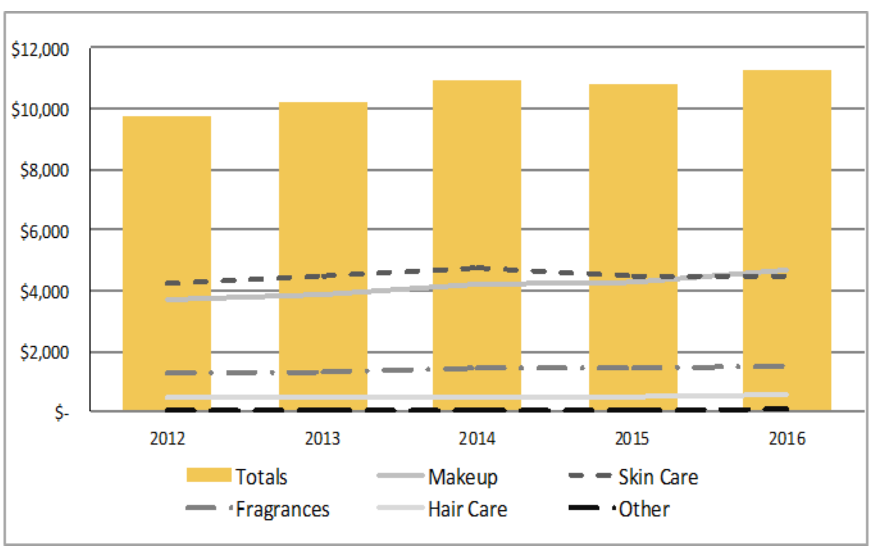
Company Overview

Estee Lauder (EL), established in 1946, is a manufacturer and marketer of personal care products including skin-care, make-up, fragrance and hair care. EL began with a single line of four skin-care products and now contains a product portfolio of twenty-five plus prestige brands. Every brand is unique and high-quality in order to attract a diverse consumer base of both women, particularly Millennials and Gen X, and men of the middle class. Products are priced, on the low end, around $20, to upwards of $3000. EL operates in over 150 countries, with the majority of revenues from the United States, China, Germany and the United Kingdom. Products are distributed through high-end or mid-tier department stores, multi or specialty retail stores, freestanding stores and E&M commerce. EL creates innovative and personalized products in order to adapt to consumer trends and demands.

- **Skin-Care** was the largest net sales segment of EL until the 2016 fiscal year. Large skin care brands held by EL include Clinique, Estee Lauder, La Mer, Origins, GLAMGLOW, and RODIN olio lusso. In order to strengthen skin care product sales, EL will direct attention toward expanding their travel retail locations.
- **Make-up** has grown 10% over fiscal year 2016. EL holds several high-end brands of make-up such as Estee Lauder, Clinique, M•A•C, Smashbox, and Bobbi Brown. These brands are mostly targeted toward Millennials and the incoming Generation X. EL believes this segment has large growth potential in future years, therefore, EL will focus on producing more effective channels for consumers to access. EL will also continue to create personalized products, experiences, and provide services with the company through mobile apps, websites, and up-to-trend products.
- **Fragrances**, over the past five years, have grown about 4% Y/Y in net sales. With continued access to create perfumes under names such as Tommy Hilfiger, DKNY, Donna Karan NY, etc., and holding brands such as Aramis and Ja Malone, EL has a portfolio of fragrances that will continue to attract consumers. In the next fiscal year, EL will focus on expanding Ja Malone due to its success.
- **Hair-Care** contains the competitive brands Aveda and Bumble and bumble. EL sells these products through all channels, including over 9,000 salons and spas. EL will continue hair care growth by releasing new products and distributing products in more regions.
- **Ancillary Services** consistently make up 1% or lower of EL sales.

Figure 1: Revenue sources in millions (left) and Figure 2: Y/Y change (right)





Source: FactSet

Business/Industry Drivers

Though several factors may contribute to Estee Lauder's future success, the following are the most important business drivers:

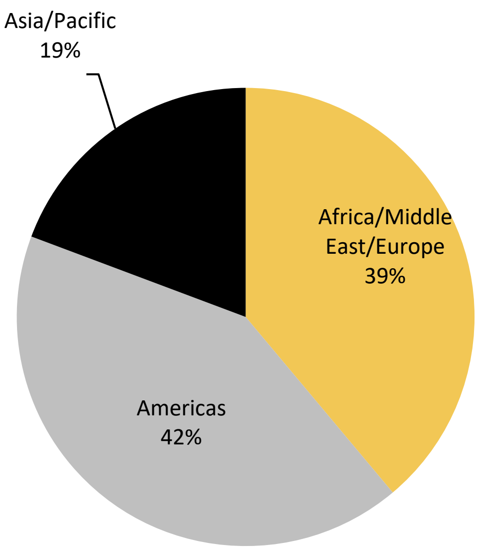
1) Emerging Markets
2) Distribution Channels
3) Translation Exposure
4) Acquisitions and New Products
5) Competition
6) Initiatives: LBF, SMI, GTI

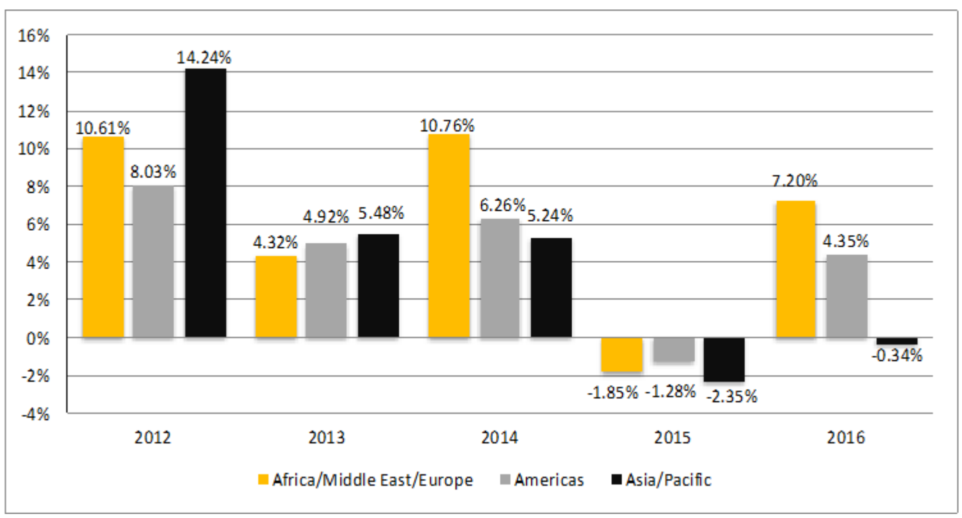
<u>Emerging Markets</u>

Emerging markets for EL grew 15%, but excluding China they grew 25%.

21% of EL's revenue is exposed to emerging markets. There is substantial opportunity to grow in these areas as competition is low and as its large population becomes more affluent, allowing people to buy more cosmetics. Early entry in these markets will enable EL to gain share, brand exposure, and a solid competitive position.EL has had past success entering countries such as Mexico and the United Kingdom, and will continue to look for ways to expand in China, the Middle East, Eastern Europe, Brazil, Russia, India, Mexico, and South Africa. Estee Lauder will most likely focus on expanding the brands Jo Malone, M•A•C, Smashbox, and GLAMGLOW due to their prior success.

Figure 3: 2016 Percentage Net Sales by Region (left), Figure 4: Region Y/Y Growth (right)





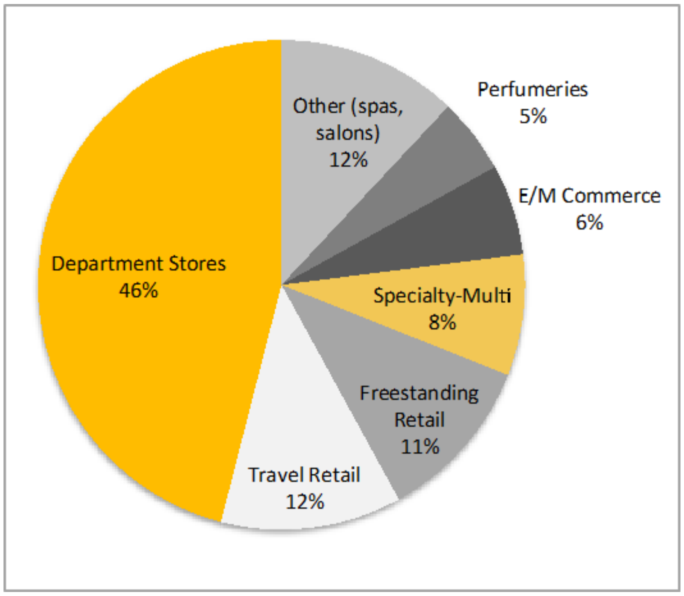
Source: FactSet

The chart above shows recent growth outside the US has been sluggish. This is due to slow economic growth, plus the strong dollar has hurt sales. EL is considered high quality and prestigious, but in a strong dollar environment, consumers may trade-down with personal care products. A survey in China showed that personal care products per household has risen by about 25% ("Chinese Survey Has More Bad News Than Good for Estee Lauder", Jim Swanson). Unfortunately, the survey also discussed that intent to trade up with skin care had declined from 32% in 2015 to 17% in 2016. EL reported that terrorist attacks in Europe limited growth in France. On the other hand, the Middle East experienced high sales growth with the brands Estee Lauder and Smashbox. The heritage brands have done well in these markets; I expect, if marketed properly, newly acquired brands owned by Estee Lauder will also succeed.

Distribution Channels

Estee Lauder distributes its products through high-end and mid-tier department stores, specialty and multi retail stores, freestanding stores, travel retail and E&M commerce. Different channels in different locations are strategically chosen for each brand based targeted consumers. For example, more mature women are inclined to shop at stores like Nordstrom and Boston store, which sell Estee Lauder, Clinique, Bobbi Brown, and Origins products. Millennials and Generation X, on the other hand, are targeted to buy brands like M•A•C, Smashbox, and Bobbi Brown; therefore, EL creates unique freestanding stores that draw in the targeted consumer. EL strategically markets its products in order to maximize profits.

Figure 5: Channels of Distribution



Source: FactSet

As department store traffic has declined, so have sales. Macy's accounts for 9% of EL's consolidated sales and 12% of EL's accounts receivables. Lower foot traffic from JC Penny and Boston Store is also limiting growth. To maintain sales growth, Estee Lauder is adjusting by finding new ways to market the products sold in department stores. I believe EL will be able to adjust to consumer shopping preferences because it has brands people want, and its products are high-quality and innovative.

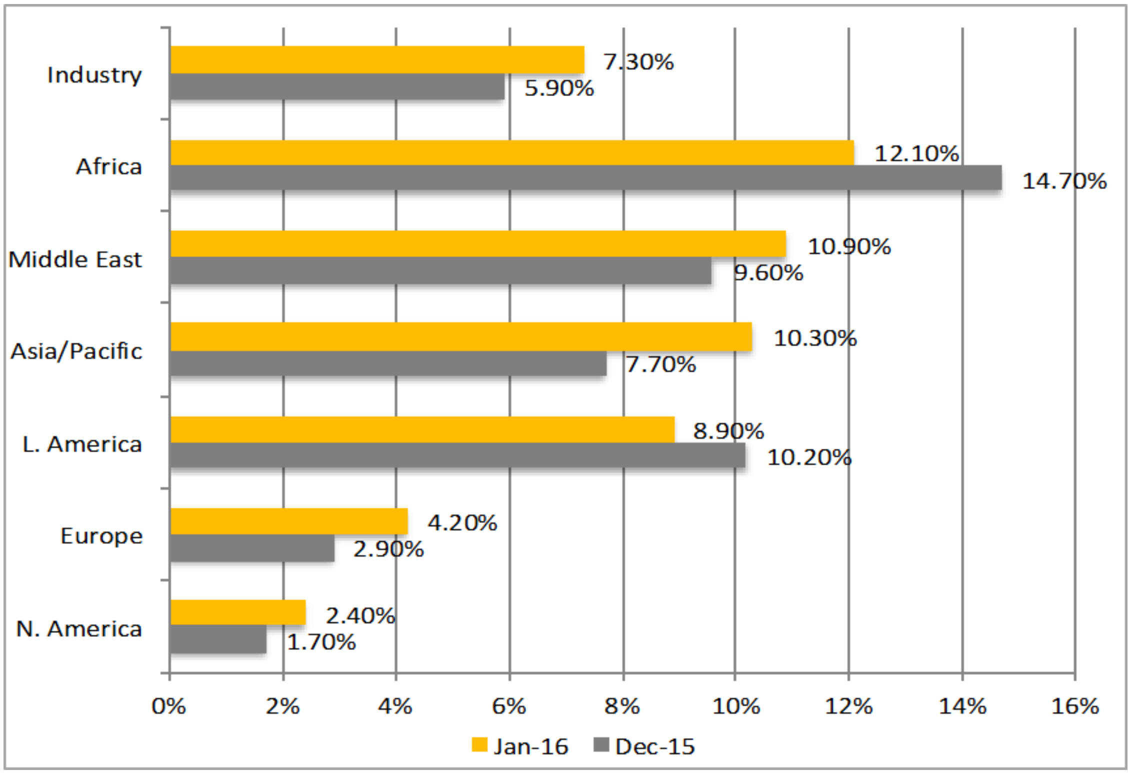
Increased Sales in E&M commerce could improve overall margins due to lower SG&A costs associated with this distribution channel.

EL sales are growing from the E&M commerce platform. As the newer generations enter the market, they expect a smooth online and mobile experience. EL reached the $1-billion-mile stone in online sales in fiscal year 2016. I expect online sales to continue to grow due to the accessibility of online-shopping. FY2016 net sales rose 27% in retail e-commerce and brands.

Personal care product companies are looking to increase their profit margin in travel retail which includes airports, airlines, cruises, downtown locations, and border shops. Travel traffic is expected to increase 5% for the next three years. Although the outlook on travel retail is positive, the risks include currency fluctuations and the consumers' willingness to spend while traveling. Companies considering this growth opportunity include Estee Lauder, L'Oréal, Sheisedo, and L'Occitane. EL aims to expand into many different airports and travel locations due to its success in other travel retail locations. Many brands have performed well, but boutique space is limited and there is high competition for personal care companies to obtain this space.

Figure 6: International Passenger Growth by Carrier Region of Registration (% year on year)

Expanding travel retail in Asia, the Middle East, and Europe will help EL growth.



Source: IATA.org

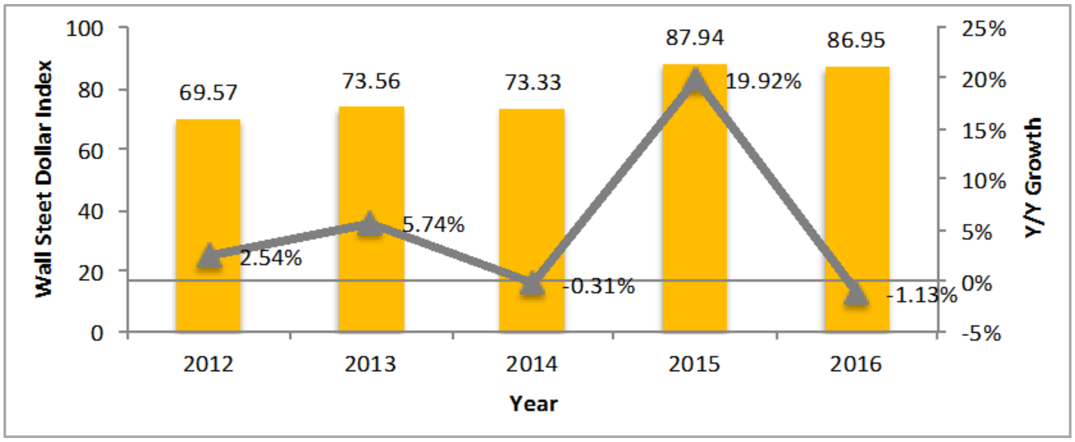
EL is looking to expand more into specialty stores including ULTA, Sephora, and Boots and Douglas. Fragrances and Hair Care have experienced substantial growth, 5.0% and 4.45% respectively, due to more exposure in specialty retailers. In particular, La Mer, Smashbox, Tom Ford, Aveda, and Bumble and bumble have seen substantial growth in these distribution channels.

EL strategically places its freestanding stores to locations where the prestige brands will attract the most consumers. Estee Lauder is not interested in every market, but in places where prestige beauty is in demand. To optimize sales, the stores are created with the culture of its consumers in mind. Estee Lauder plans to add more freestanding stores.

<u>Translation Exposure</u>

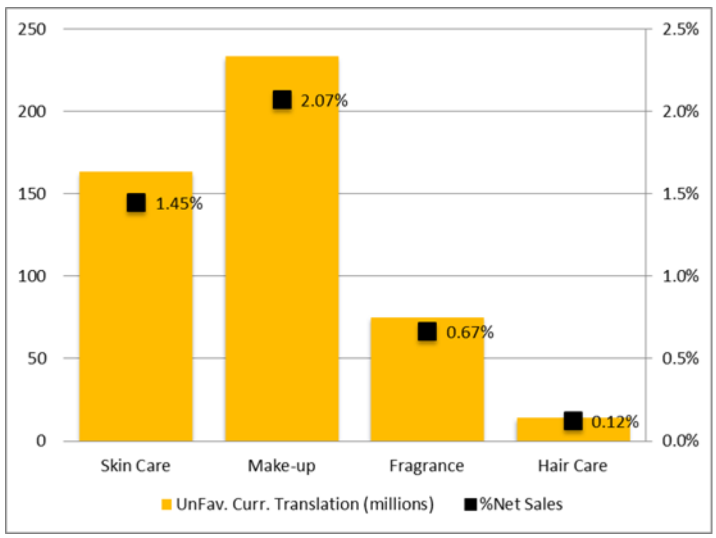
Because EL distributes in over 150 countries, the company inherently has currency translation risk. As discussed in the 10-K, EL translates all assets and liabilities of foreign subsidiaries and affiliates at the year-end rate of exchange, while the revenue and expenses are translated at weighted average rates of exchange for the given period. Current macroeconomic effects have strengthened the dollar and have adversely affected Estee Lauder. A strong dollar makes its products more expensive in foreign countries, which can potentially decrease sales and lowers the amount returned when foreign currencies are exchanged.

Figure 7: Wall Street Dollar Index



Source: Wall Street Journal

Figure 8: 2016 Unfavorable Currency Translation (UCT) and UCT as Percentage of Net Sales



Source: FactSet

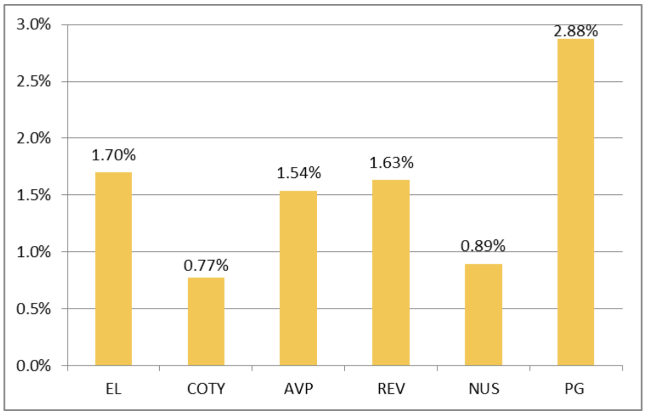
The pound and euro are now at a 31-year low and six-year low against the US dollar. In FY2015, countries such as Germany, Italy, and the Iberian Peninsula (Spain, Andorra, Portugal, small portions of France and British owned territories) saw a decline in sales of 2% due to the strong dollar. I believe the continued growing U.S. economy and rise in interest rates in the U.S. will lead to continued negative foreign currency translation effects. Dollar strength resulted in a $485 million loss ($163 from skin care, $233 from makeup, $75 from fragrance and $14 from hair care). I forecast low growth in net sales due to currency translation. I do believe, however, given a constant currency, net sales will continue to grow. Therefore, if the US dollar weakens against the Euro and Pound, this will be very positive for EL.

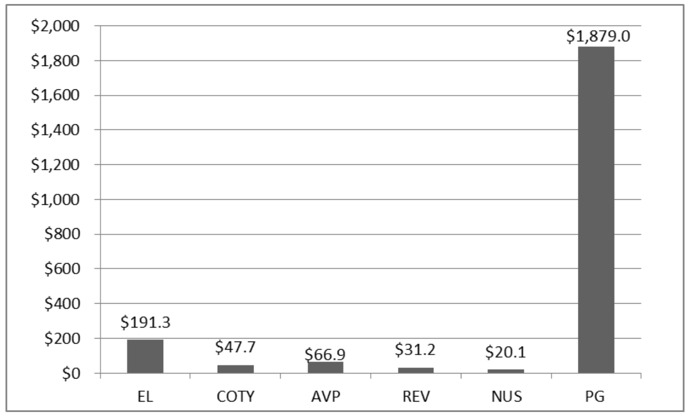
Acquisitions and New Products

EL must keep up to date with makeup trends and skin care formulas to stay competitive in the personal care product industry. New products produce growth and repeat consumer sales, which builds brand loyalty and prestige. EL introduces new products yearly in all of its brands. In FY2016, new product sales accounted for approximately one-quarter of total net sales. Shown in Figure 9, R&D is rising quicker than sales as the firm commits more to innovation.

The firm is also growing though acquisitions. In 2015, the firm acquired Editions de Parums Frederic Malle and GLAMGLOW, and in 2016, By Kilian. GLAMGLOW and RODIN olio lusso, categorized in skin care, added $108 million in net sales during fiscal 2016.

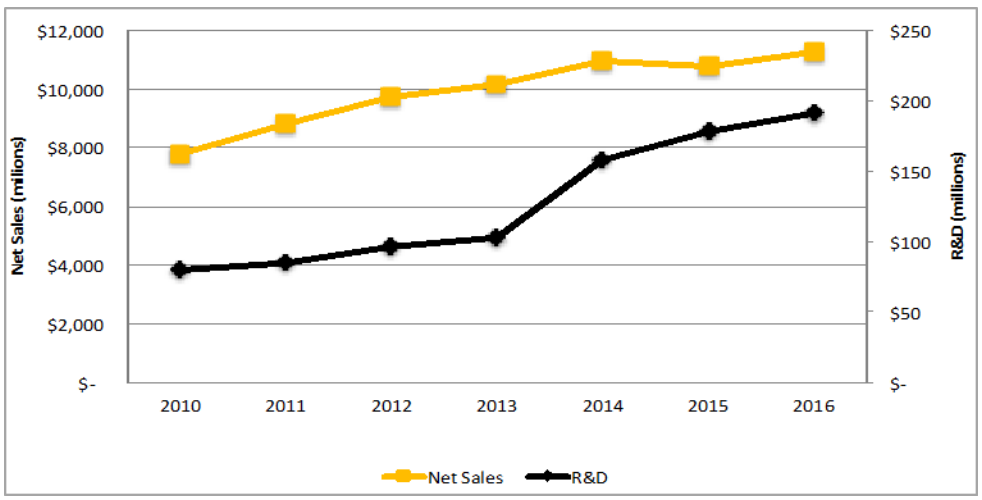
Figure 9: R&D Expenses as a Percent of Sales (left) Figure 10: R&D Expenses in Millions (right)





Source: FactSet

Figure 11: R&D Expenses and Net Sales



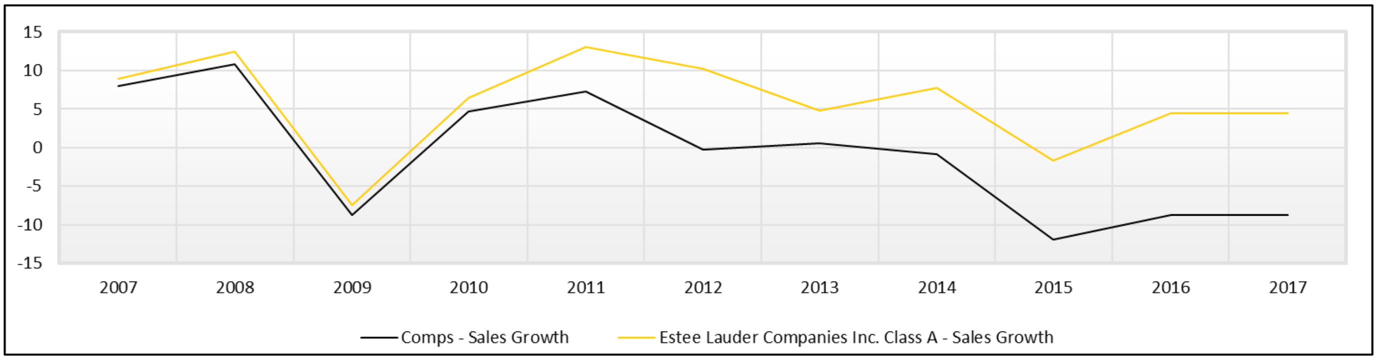
Source: FactSet

EL has a high R&D expense as a percent of sales, right behind PG.

<u>Competition</u>

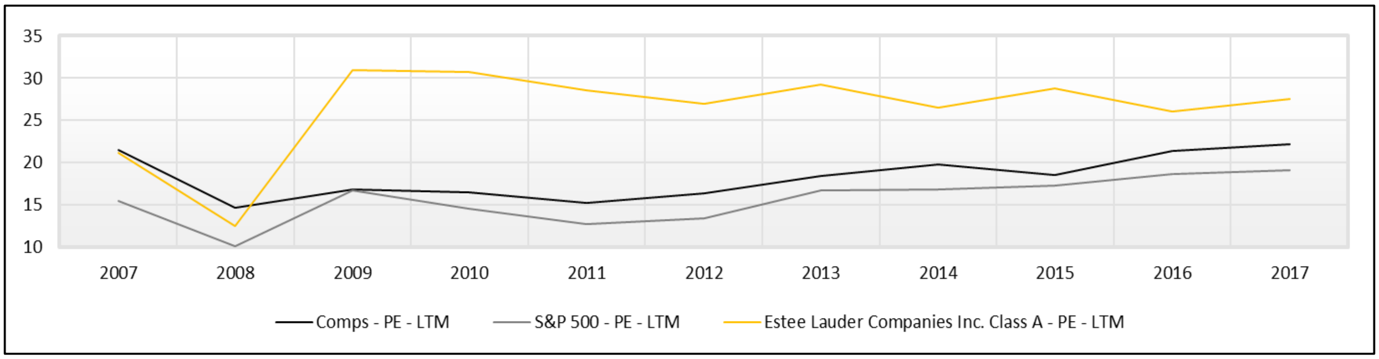
Estee Lauder has grown sales at about 7%, which is above the industry average. Competitors include big brand names such as Avon, Coty, Inter Parfums, Revlon, Nu Skin Enterprises, Procter & Gamble, and Shiseido. Personal care and beauty items are becoming increasingly popular among consumers with demand expected to increase between 3.5% and 4.5% globally over the next five years. The market for these products attracts consumers of all different types, which makes a company with a versatile portfolio of products successful. EL has maintained its competitive advantage by continuing to acquire new brands to expand, adjusting to consumer shopping preferences, and using social media to advertise. EL's above-average growth has also led it to have an above average P/E.

Figure 12: EL vs. Competitors – Sales



Source: FactSet

Figure 13: EL vs. Competitors vs. SP500 –PE-LTM

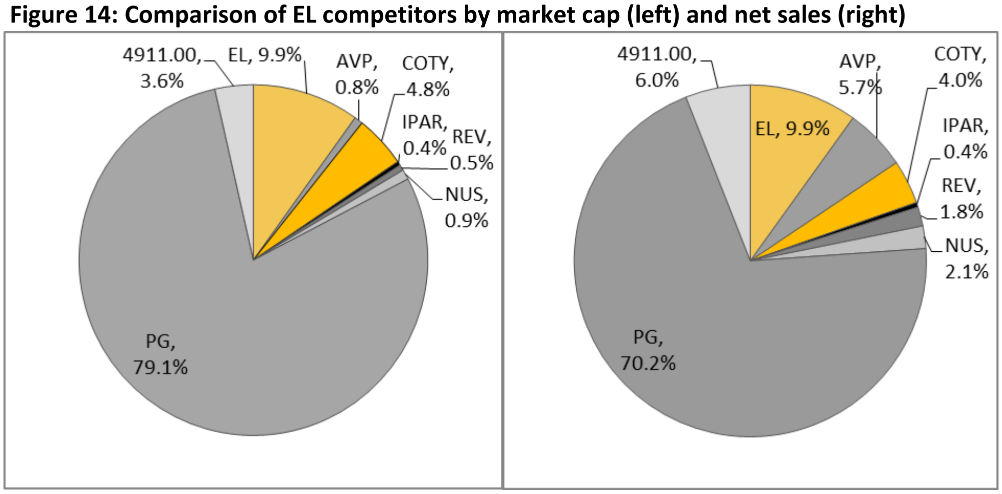


EL continues to outperform its industry and competitors.

Proctor and Gamble is by far the largest company in the household and personal care industry. Unlike EL, it has access to a larger consumer base because it distributes more types of products. The other brands are less versatile, focusing mainly on makeup, haircare, fragrance and/or skincare. Although personal care products are mostly interchangable, consumers often continue to buy their favorite products. Companies in the skin care industry must create quality products in order to build brand awareness and brand loyalty.

Companies in the Comps_EL composite include PG, AVP, COTY, NUS, REV, IPAR, 4911 (Shiseido), and EL.

Figure 14: Comparison of EL competitors by market cap (left) and net sales (right)



Source: FactSet

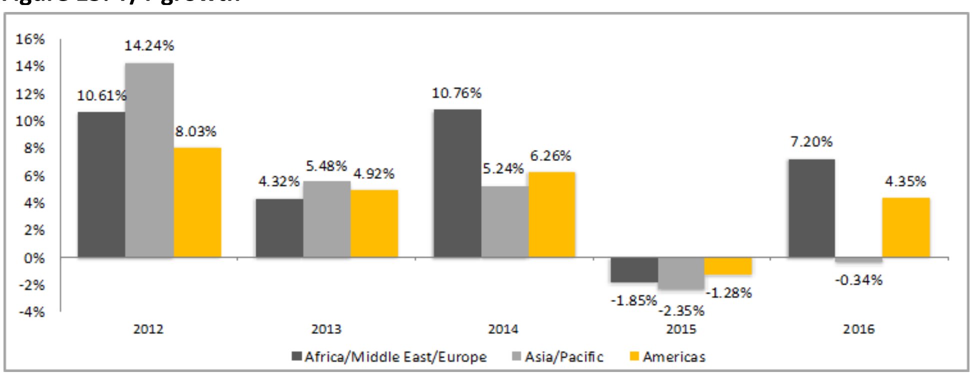
Initiatives

The Leading Beauty Forward (LBF) initative, instituted May 3, 2016, is a plan to optimize the following: corporate functions, supply chain operations, and region market support structures. It also will focus on discontinuing business pertaining to underperforming products, freestanding stores, and other inefficiencies. EL does not expect net benefits from this initiative until after FY2017.

2017Q1 will begin by expensing roughly $35 to $45 million to this process. By 2021, Leading Beauty Forward will cost anywhere between $500 and $600 million. Once FY2018 begins, the Leading Beauty Forward initiative should begin annualizing net benefits. These net benefits, at their maximum before 2021, will save EL between $200-$300 million annually. With the estimated EL's tax rate of 28% and number of shares at roughly 350 million, this cost translates to adding a value of $0.50/share. With these savings, EL plans to reinvest or distribute this savings to its shareholders.

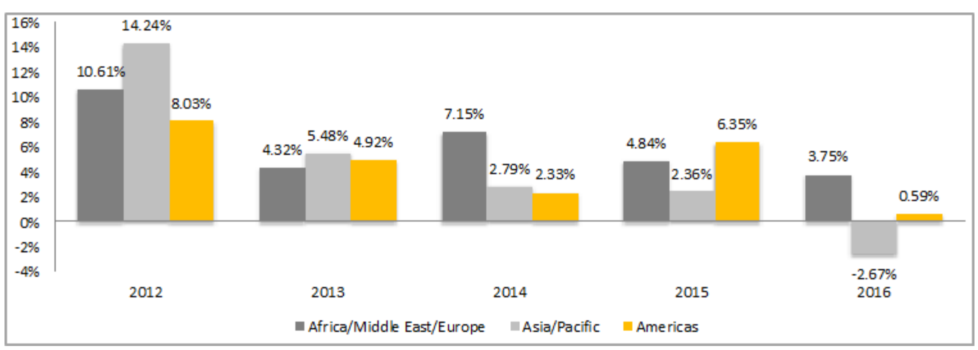
In the past, EL has had other initiatives to cut back costs, grow net sales, and improve the company structure. These initiatives include the Global Technology Infrastructure (GTI) restructuring and the Strategic Modernization Initiative (SMI). Net sales in fiscal year 2015 was negatively effected due to the impact of accelerated orders in 2014 due to SMI rollout. Therefore, FY2014 net sales were overestimated, FY2015 net sales were underestimated, and net sales were overestimated in FY2016.

Figure 15: Y/Y growth



Source: FactSet

Figure 16: Y/Y growth adjusted for SMI rollout

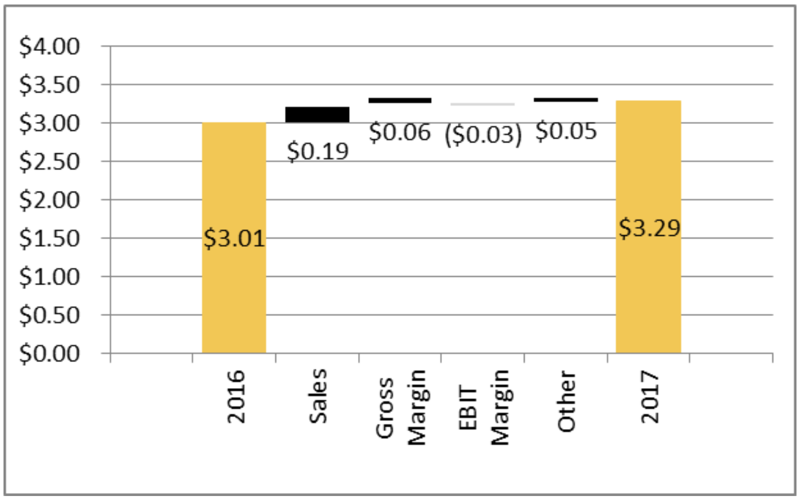


Source: FactSet

Financial Analysis

I expect the EPS for Estee Lauder to be $3.29 for the FY2017. I expect Estee Lauder to achieve a $0.19 positive impact on EPS from sales growth of 6.1%, slightly higher than consensus, to $11.9B. Sales growth will be driven by acquisitions of new brands, expanding EL's market exposure and creating opportunities to introduce newly acquired brands into emerging markets. I expect direct costs to remain relatively similar, allowing the growth in sales to ensure a growth in gross margin, positively impacting EPS by $0.06. Share buybacks will offset higher interest and lead to a $0.05 increase in EPS, while the EBIT margin will suffer slightly, from higher R&D as a percent of sales dragging EPS down by $0.03.

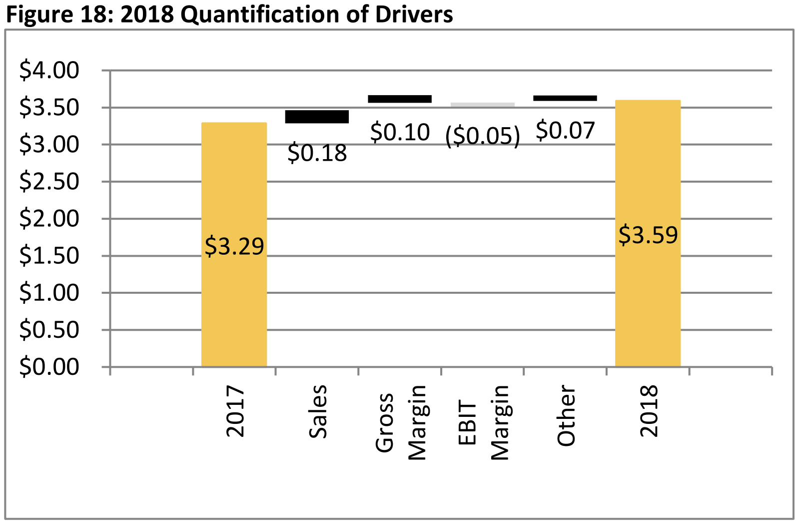
Figure 17: 2017 Quantification of Drivers



Source: FactSet

I anticipate FY2018 EPS will grow $0.30 to $3.59. Again, I expect an increase in sales due to newly acquired companies as well as expansion into new markets for both the older and newer brands. I also believe there will be an increase in sales from EL's ability to anticipate consumer demands and create products in line with trends. The effect on EPS from the sales growth will be $0.18, and a higher gross margin will positively affects EPS by $0.10. Share buybacks again, more than offset higher interest expense and add $0.07 to EPS. Higher marketing costs and R&D limits expansion and hurts EPS by $0.05.

Figure 18: 2018 Quantification of Drivers



Source: FactSet

My sales estimate for 2017 is slightly higher than consensus. I believe the makeup segment will see 7.2% growth, largely due to the acquistions of Too Faced and Becca. I believe EL will continue in strong sales growth in 2018, although my outlook is slightly bearish in comparison to consensus. EL's management believes they can produce 6-8% growth in 2017, so I am also bearish verses management. I believe my estimation is more reasonable rather than the high end 8.0% due to economic conditions.

EL's management expects to achieve 6-8% growth in FY2017.

Figure 19: Estimated Revenues vs. Consensus

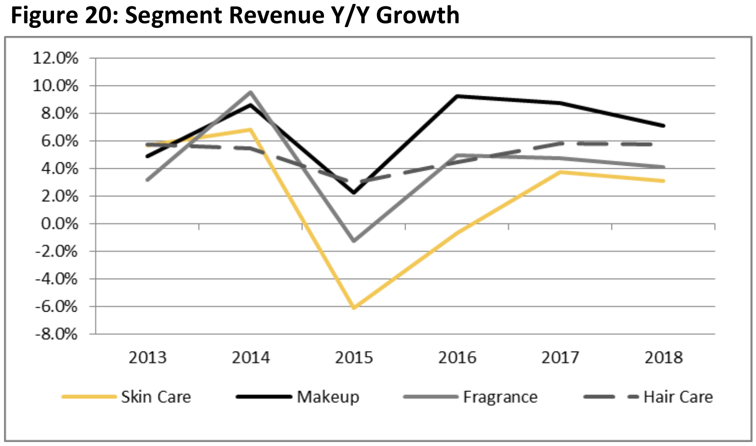
	FY 2017 E	FY 2018E
Revenue - Estimated	$11,944	$12,551
Y/Y growth	6.1%	5.1%
Revenue - Consensus	$11,877	$12,626
Y/Y growth	5.5%	6.3%
EPS - Estimate	$3.29	$3.59
Y/Y growth	9.3%	8.8%
EPS - Consensus	3.30	$3.82
Y/Y growth	9.6%	15.8%

Source: Factset, IMCP

Revenues

Estee Lauder continues to lead the personal care and household products industry in sales growth. I expect EL will continue to focus on sales in the makeup category. I believe Estee Lauder will achieve makeup sales growth of 8.7% and 7.1% in 2017 and 2018, respectively. The company will achieve this growth through expansion of its products in new markets, particularly emerging markets, and continue acquisitions as the company sees fit. The acquisitions of TooFaced and Becca will increase sales in the makeup segment of EL. Department store decline in foot traffic is a threat to growth and EL plans to adjust accordingly. This decline in traffic has affected sales in M●A●C, Estee Lauder, and Clinique, mostly taking place in the skin care segment. EL will maintain its competitiveness by deploying and retracting freestanding stores, as well as by creating effective strategies for E&M commerce. I expect a decline in freestanding MAC stores, while other brands such as Smashbox will expand. I also expect the skin care segment to recover due to expansion in specialty retail with growth of 3.7% and 3.1% in 2017 and 2018, respectively.

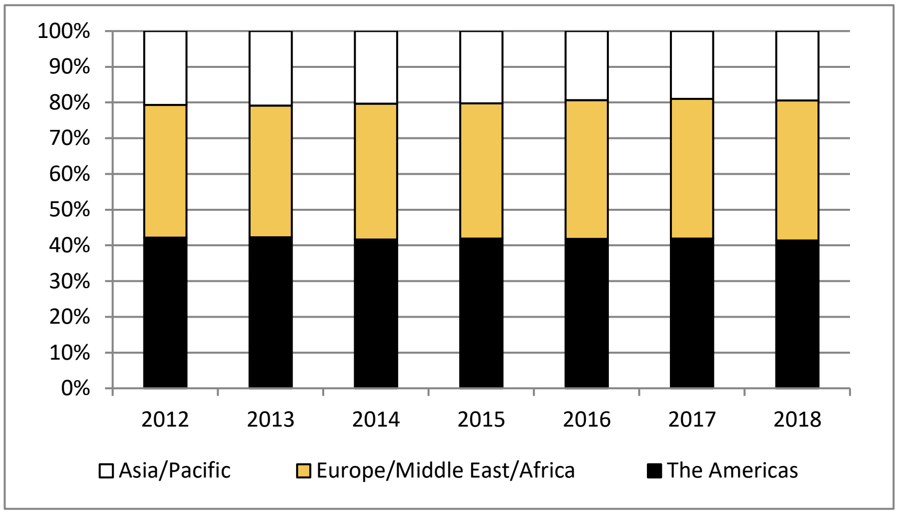
Figure 20: Segment Revenue Y/Y Growth



Source: FactSet

Much of Estee Lauder's sales are obtained from outside the US; therefore, it is essential outside economies remain strong for EL to continue growth. I anticipate sales outside the US to remain difficult to maintain due to geopolitical and economic issues continuing in Europe, the Middle East and Asia. Although there are concerns in these areas, travel retail is expected to grow and EL is expanding travel retail exposure; therefore, I anticipate that Europe and the Middle East will capture a slightly larger proportion of EL's total revenue.

Figure 21: Percentage of Total Sales by Region



Source: FactSet

As the dollar strengthens against other currencies, costs to open stores abroad have decreased. Although this has its advantages, prices of products from the EL brands will be viewed as expensive and could deter consumers from choosing the brand's products. I expect this effect will be most prominent in Asia.

<u>Operating Expenses and Drivers of Growth</u>

Operating expenses consist of research and development, selling, general and administrative expenses, and shipping and handling. I expect Estee Lauder to continue utilizing and exploring strategies to minimize these costs. EL has been successful and consistently diminishing the costs of SG&A and shipping and handling relative to the total operating expenses. I expect this trend to continue because EL holds brands that focus on digital and social media advertisement, which is much less expensive than print and television and therefore increases sales margins.

EL R&D costs have consistently risen the past five years. The Leading Beauty Forward (LBF) initiative was created to leverage EL's cost structure and free resources to invest in future growth, furthering go-to-market capabilities and margin progress. I believe these expenses will continue to rise as they have in the past until 2021, when benefits of LBF are expected to take place. LBF will also be responsible for a net reduction of 900-1,200 positions, 2.5% of EL workforce globally including elimination of positions, retraining, and redeployment of certain employees. I expect SG&A expenses to decrease while these changes take place.

EL redistributes many of its brands through different means and shifts depending on the performance in specific channels, brands, and regions. EL plans to close several freestanding stores which will result in inventory write-offs and a reduction of workforce. The company also plans to exit certain brands from mid-tier department stores, redirecting them through different channels to improve profitability and margins. Other consequences of these actions will be a number of product returns, accelerated depreciation, and termination of contracts.

Figure 22: Operating Expenses

All Values in Millions	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17	Jul-18
Sales	$ 9,714	$ 10,182	$ 10,969	$ 10,780	$ 11,262	$ 11,944	$ 12,551
Growth		*4.82%*	*7.73%*	*-1.72%*	*4.47%*	*6.05%*	*5.08%*
Direct costs	1,996	2,026	2,158	2,101	2,181	2,281	2,347
Gross Profit	$ 7,718	$ 8,156	$ 8,811	$ 8,680	$ 9,081	$ 9,662	$ 10,204
Gross Margin		*80.10%*	*80.32%*	*80.51%*	*80.63%*	*80.90%*	*81.30%*
Operating Expeses							
R&D	$ 97	$ 104	$ 158	$ 178	$ 191	$ 206	$ 233
SG&A	2,656	2,798	2,840	2,772	2,821	2,915	2,947
Shipping&Handling	312	338	374	364	363	366	373
Other	3,321	3,344	3,594	3,732	4,065	4,421	4,780
Total Operating Expenses	$ 6,385	$ 6,584	$ 6,966	$ 7,045	$ 7,440	$ 7,907	$ 8,334
Growth		*3.11%*	*5.81%*	*1.14%*	*5.60%*	*6.28%*	*5.40%*
EBIT (operating income)	$ 1,333	$ 1,572	$ 1,845	$ 1,635	$ 1,642	$ 1,756	$ 1,870
EBIT Margin		*15.44%*	*16.82%*	*15.17%*	*14.58%*	*14.70%*	*14.90%*
Growth analysis	**Jun-12**	**Jun-13**	**Jun-14**	**Jun-15**	**Jun-16**	**Jun-17**	**Jul-18**
R&D		7.36%	52.41%	12.79%	7.41%	7.52%	13.45%
SG&A		5.36%	1.50%	-2.41%	1.78%	3.33%	1.11%
Shipping&Handling		8.16%	10.57%	-2.68%	-0.28%	0.83%	1.98%
Other		0.71%	7.48%	3.82%	8.93%	8.75%	8.14%
Same Size analysis	**Jun-12**	**Jun-13**	**Jun-14**	**Jun-15**	**Jun-16**	**Jun-17**	**Jul-18**
R&D	1.51%	1.57%	2.27%	2.53%	2.57%	2.60%	2.80%
SG&A	41.59%	42.50%	40.77%	39.34%	37.91%	36.86%	35.36%
Shipping&Handling	4.89%	5.13%	5.36%	5.16%	4.87%	4.62%	4.47%
Other	52.00%	50.79%	51.60%	52.97%	54.64%	55.91%	57.36%

Source: FactSet

EL's operating margin is large for its industry, but has been falling the past few years.

Inventory

Compared to its competitors, EL manages its inventory poorly, with an average inventory turnover over the past 6 years of 1.88 and average days in inventory of 194. The figures below were calculated as COGS/average inventory over a span of 6 years. Costs of keeping inventory impact expenses, yet EL has not managed to adjust inventory to consumer demand. In fact, EL's inventory turnover has plummeted from 2.11 in 2009, to 1.76 in 2016.[1] I am not aware of any attempt by EL to more effectively control inventory and believe this cost will continue to negatively impact operating expenses.

Figure 23: Inventory

	Avg inventory turnover	Avg days in inventory
LAUDER (ESTEE) COS INC -CL A	1.88	194
AVON PRODUCTS	3.58	102
COTY INC	3.28	111
INTER PARFUMS INC	1.79	204
REVLON INC -CL A	4.04	90
NU SKIN ENTERPRISES -CL A	2.22	164
PROCTER & GAMBLE CO	6.06	60
SHISEIDO CO LTD	2.24	163
Average	3.14	136

Source: FactSet, GuruFocus.com

[1] See Appendix 9 for EL inventory turnover by year bar graph.

Return on Equity

Estee Lauder has a high return on equity in comparison to its competitors. I expect it to increase to 38.06% by fiscal year 2018 as profit margin (margins due to initiatives) and leverage rises (debt is rising and equity falls due to share buybacks).

Figure 24: 5-Stage DuPont

5-Stage DuPont ROE	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17	Jul-18
EBIT / sales	15.4%	16.8%	15.2%	14.6%	14.7%	14.9%
Sales / avg assets	1.48	1.46	1.34	1.29	1.26	1.27
EBT / EBIT	95.3%	96.3%	95.5%	94.7%	93.8%	93.3%
Net income /EBT	68.1%	67.8%	69.8%	71.7%	71.8%	71.8%
ROA	14.8%	16.0%	13.5%	12.8%	12.5%	12.7%
Avg assets / avg equity	2.27	2.09	2.14	2.41	2.70	3.00
ROE	33.7%	33.6%	28.9%	30.8%	33.8%	38.1%

Source: FactSet

Free Cash Flow

EL continues to produce positive FCFF. FCFF will rise substantially in 2017 as the firm slows long-term asset growth to $300 million from $950 million the year before and as NOPAT rises 7%. Continued moderate capital growth and NOPAT pushes FCFF to above $1 billion in 2018. Share purchases are about $900 million and dividends are over $400 million, so the firm needs to raise debt to distribute this cash. Historically, in 2015 FCFF fell due to a small drop in sales, associated NOPAT, and because EL purchased short and long term investment with available cash, significantly decreasing the cash account.

Figure 25: Free Cash Flow without Cash and Debt

Free Cash Flow (without cash and debt)	2012	2013	2014	2015	2016	2017E	2018E
NOPAT	$ 913	$ 1,099	$ 1,255	$ 1,145	$ 1,183	$ 1,265	$ 1,348
Growth		20.3%	14.3%	-8.8%	3.3%	7.0%	6.5%
NWC	$ 601	$ 885	$ 1,158	$ 559	$ 493	$ 523	$ 549
Net fixed assets	$ 2,738	$ 2,848	$ 3,044	$ 4,043	$ 4,998	$ 5,301	$ 5,570
Total net operating capital	$ 3,339	$ 3,733	$ 4,201	$ 4,602	$ 5,491	$ 5,823	$ 6,119
Growth		11.8%	12.5%	9.5%	19.3%	6.1%	5.1%
- Change in NWC		$ 285	$ 273	$ (599)	$ (66)	$ 30	$ 27
- Change in NFA		$ 110	$ 196	$ 1,000	$ 955	$ 302	$ 269
FCFF		$ 704	$ 787	$ 745	$ 294	$ 933	$ 1,052
Growth			11.8%	-5.4%	-60.6%	217.5%	12.7%
- After-tax interest expense	$ 42	$ 52	$ 46	$ 52	$ 62	$ 79	$ 91
FCFE		$ 652	$ 741	$ 693	$ 232	$ 855	$ 961
Growth			13.6%	-6.5%	-66.6%	268.8%	12.5%
FCFF per share		1.82	2.04	1.96	0.79	2.59	3.01
Growth			12.2%	-3.6%	-59.6%	226.6%	16.2%
FCFE per share		1.68	1.92	1.83	0.63	2.38	2.75
Growth			14.0%	-4.8%	-65.7%	279.4%	15.9%

Source: FactSet

Valuation

EL was valued using multiples and a 3-stage discounting cash flow model. Based on earnings multiples, the stock is overpriced in comparison to its peers and is worth $78. Relative valuation shows EL to be overvalued based on fundamentals versus those of its peers in the household and personal care products industry. Price to book valuation yielded a price of $61. A detailed DCF analysis values EL at $82 in opposition of the other valuation methods used. I place more weight on DCF in relation to the other valuation methods because it considers EL's buyback program and improving operations. With a 20% weight on the earnings multiple valuation and relative valuation, and a 60% weight on the DCF, I conclude that EL is valued at $78.

Trading History

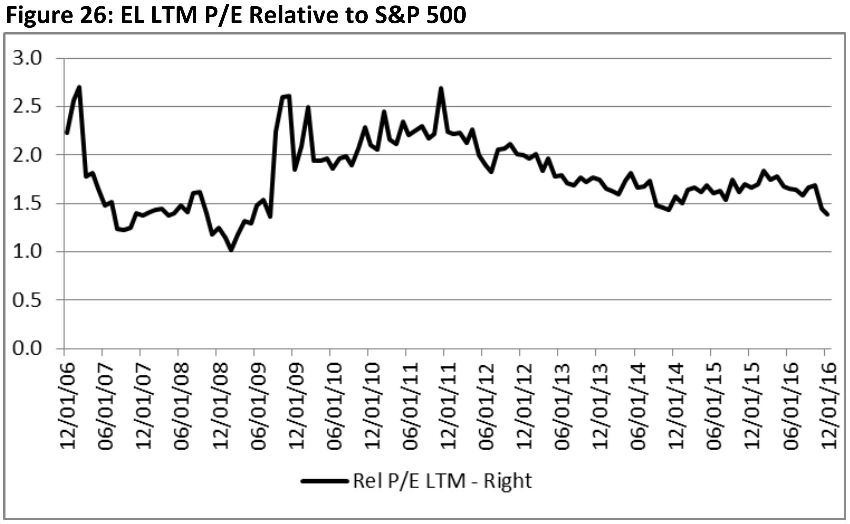
EL's price dropped to $77.26 from the year high at $97.48. EL dropped 8.1% and quickly recovered due to the Brexit vote in June, then continued in a negative trend, substantially dropping 9.3% Oct 31-Nov 4 due to missed revenue expectations. Over the past ten years, Estee Lauder's P/E has traded at a higher P/E relative to the S&P 500, but it has been decreasing relatively to S&P 500 for the past 5 years. EL's current NTM P/E is at 22.1 which is less than its five year average of 23.9. I believe EL's P/E will continue to decrease over time.

Assuming the firm maintains a 22.1 NTM P/E at the end of 2017, it should trade at $79.34

- Price=P/E x EPS = 22.1 x $3.59 = $79.34

The target price for 2017 using the NTM P/E multiple is $79.34. I expect sales to grow moderately and margins to expand due to completion of initiatives in coming years, and these benefits will not be realized by 2018, so this value could be low.

Figure 26: EL LTM P/E Relative to S&P 500



Source: FactSet

Relative Valuation[2]

Estee Lauder TTM P/E is 26.4, above the industry average P/E multiple of 19.3, excluding an outlier P/E (COTY). Due to Estee Lauder's historical above average growth, investors are willing to pay higher multiple for EL's earnings. I expect this to decrease in the future years as growth will be

[2] See Appendix 5 for Competitors Table

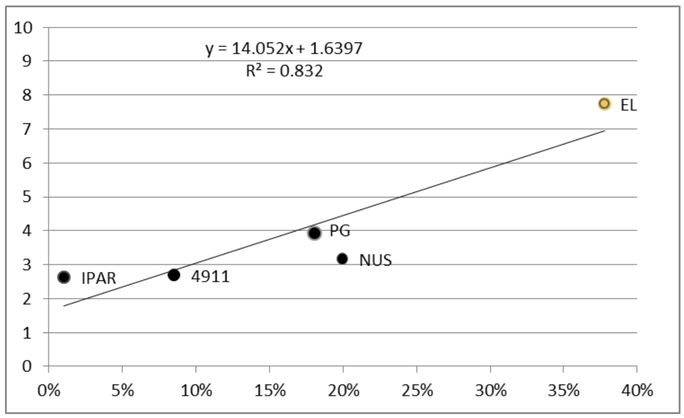
difficult to maintain at past rates (5-yr EPS growth rate: $49.24%). EL also has P/B value of 7.74 which is over double the peer average of 2.15 (excluding COTY) and a P/S multiple of 2.5, which is 25% higher than its peer group average of 2.02.

A more thorough analysis of P/B and NTM ROE is shown in figure 27. The calculated R-squared of the regression indicates that over 83.2% of a sampled firm's P/B is explained by its 2016 NTM ROE. Note that Revlon, Avon and Coty all have NTM ROE and P/B values that are extreme outliers and therefore have been removed from the graph. EL has the largest P/B value and NTM ROE, which somewhat justifies the P/B, but the company is still overvalued.

- Estimated P/B = Estimated 2017 ROE (38%) x 14.052 + 1.6397 = 6.98
- Target Price = Estimated P/B (6.98) x 2017E BVPS ($9.48) = $66.17

The target price for 2017 is $66.17 using this metric.[3]

Figure 27: NTM ROE v. P/B



Source: FactSet

Figure 28: Composite relative valuation, % of range

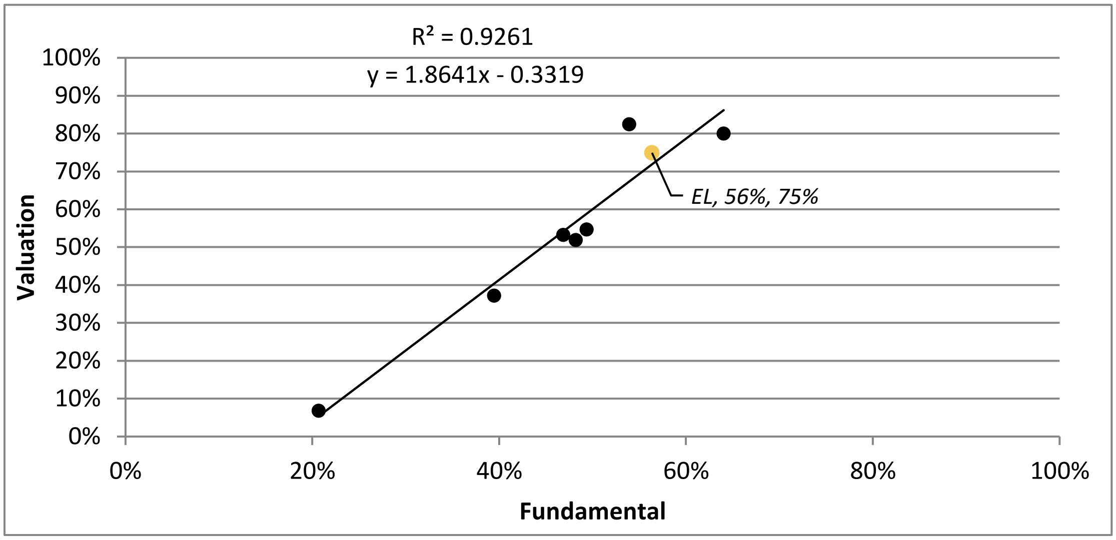
		Fundamentals					Valuation					
	Weight	4.0%	9.0%	15.0%	47%	25.0%	13.0%	7%	50%	30%		
Ticker	Name	2016 Earning Growth	1/(LTD/ Equity)	1/ Payout	2016 NPM	Sales Growth STM	P/E TTM	P/B	P/S	EV/ EBIT	Weighted Fund	Weighted Value
EL	LAUDER (ESTEE) COS INC -CL A	1%	31%	52%	44%	100%	68%	100%	73%	76%	56%	75%
AVP	AVON PRODUCTS	100%	-6%	52%	4%	30%	-68%	-37%	11%	42%	21%	7%
COTY	COTY INC	3%	1%	4%	100%	65%	16%	32%	91%	100%	64%	80%
IPAR	INTER PARFUMS INC	1%	100%	37%	28%	86%	85%	34%	58%	41%	49%	55%
REV	REVLON INC -CL A	0%	-3%	52%	52%	65%	100%	-36%	56%	45%	48%	52%
NUS	NU SKIN ENTERPRISES -CL A	0%	38%	37%	30%	65%	50%	41%	34%	36%	39%	37%
PG	PROCTER & GAMBLE CO	-1%	48%	29%	64%	61%	60%	51%	100%	70%	54%	82%
4911	SHISEIDO CO LTD	0%	91%	100%	16%	65%	52%	41%	40%	78%	47%	53%

Source: FactSet

For a final comparison, I created a composite ranking of several valuation and fundamental metrics. Since the variables have different scales, each was converted to a percentile before calculating the composite score. Weightings of 4% 2016 earnings growth, 9% 1/(LTD/Equity), 15% 1/Payout, 47% 2016 NPM and 25% STM sales growth were compared to a composite of 13% TTM P/E, 7% P/B, 50% P/S and 30% EV/EBIT. The regression line had an R-squared of 0.92. One can see that EL is above the line, so it is considered slightly expensive based on its fundamentals.

[3] See Appendix 7 for NTM ROE and P/B table

Figure 29: Composite Valuation



Source: FactSet

Discounted Cash Flow Analysis[4]

A three stage discounted cash flow model was also used to value EL.

For the purpose of this analysis, the company's cost of equity was calculated to be 6.99% using the Capital Asset Pricing Model. The underlying assumptions used in calculating this rate are as follows:

- The risk free rate, as represented by the ten year Treasury bond yield, is 2.44%.
- A ten year beta of 0.75 will be used because Estee Lauder is more stable than the market. The peer beta average is 0.74, excluding an outlier (Avon).
- A long term market rate of return of 8.5% was assumed, since historically, the market has generated an annual return of about 8.5%.

Given the above assumptions, the cost of equity is 6.99% (2.44 + 0.75 (8.5 – 2.44)).

Stage One - The model's first stage simply discounts fiscal years 2017 and 2018 free cash flow to equity (FCFE). These per share cash flows are forecasted to be $2.38 and $2.75, respectively. Discounting these cash flows, using the cost of equity calculated above, results in a value of $4.63 per share. Thus, stage one of this discounted cash flow analysis contributes $4.63 ($2.22+$2.41) to value.

Figure 30: FCFE and discounted FCFE for 2017-2023

	2017	2018	2019	2020	2021	2022	2023
FCFE	$ 2.38	$ 2.75	$ 3.14	$ 3.51	$ 3.09	$ 3.75	$ 4.24
Discounted FCFE	$2.22	$2.41	$2.56	$2.68	$2.20	$2.50	$2.64

Source: FactSet

Stage Two - Stage two of the model focuses on fiscal years 2019 to 2023. During this period, FCFE is calculated based on revenue growth, NOPAT margin, and capital growth assumptions. The resulting cash flows are then discounted using the company's 6.99% cost of equity. I expect growth in sales to

[4] See Appendix 9 for in-depth 3-stage DCF table

decline in 2019-2020 due to continued difficult economic conditions, with the strength of the dollar and geopolitical issues continuing in many nations. In 2021, I expect growth to rise to 7.0% due to benefits of initiatives, expansion of brands, possible acquisitions, and development of new product. I expect EL to continue decreasing shares through share buybacks of roughly 2.0% per year. As expenses fall from EL initiative, I anticipate a growing profit margin, leading NOPAT/S to increase to 11.1% by 2023 from 10.75% in 2018. I expect net working capital and net fixed assets to rise with sales.

Added together, the 2019-2023 discounted cash flows total $12.58.

Figure 31: EPS for 2017-2023

	2017	2018	2019	2020	2021	2022	2023
EPS	$ 3.29	$ 3.59	$ 3.85	$ 4.08	$ 4.48	$ 4.84	$ 5.17
Growth		*9.2%*	*7.3%*	*5.9%*	*10.0%*	*7.9%*	*6.9%*

Source: FactSet

Stage Three – Net income for the years 2017 – 2023 is calculated based upon the same margin and growth assumptions used to determine FCFE in stage two. EPS is expected to grow from $3.29 in 2017 to $5.17 in 2023.

Stage three of the model requires an assumption regarding the company's terminal price-to-earnings ratio. For this analysis, it is generally assumed that as a company grows larger and matures, its P/E ratio will converge near to the historical average of the S&P 500. Therefore, a P/E ratio of 20 is assumed at the end of EL's terminal year. I believe this multiple is reasonable because EL has been a high growth company for the past 10 years, rarely seeing much downturn. Also, the average P/E among EL's peers is 27 (excluding Avon, an outlier) which is strong, but as the economy is growing I expect company's P/E and the industry P/E to decrease overall. Also, I believe EL's sales growth will slow, resulting in a lower P/E value in year 7 than the TTM P/E of 26.4.

Given the assumed terminal earnings per share of $5.17 and a price to earnings ratio of 20, a terminal value of $103.4 per share is calculated. Using the 6.99% cost of equity, this number is discounted back to a present value of $64.45.

Total Present Value – given the above assumptions and utilizing a three stage discounted cash flow model, an intrinsic value of $81.66 is calculated (4.63 + 12.58 + 64.66). Given EL's current price of $77.26, this model indicates that the stock is slightly undervalued.

Scenario Analysis

Estee Lauder is difficult to value with certainty because customers can change purchase location preferences, new products may be developed and gain share, and discretionary income changes with the economy. Also, acquisitions have risk and there is pressure to create profitable and go-to-market ventures for each different brand. EL's ability to globally manufacture and market each brand successfully depends on great execution of their plans and stable economic and political conditions of each country. The following discussion uses the DCF framework above to determine the value under bull and bear case scenarios.

Sales Growth (Base Case: 6.1% and 5.1% in 2017 and 2018 respectively):

I expect a **bull case** scenario to result in sales growth of 8.0% and 8.4% in 2017 and 2018, respectively. I anticipate sales to dramatically escalate in skin care, a segment Estee Lauder has been struggling to grow. I believe it is possible for this growth because EL has accepted that high-end and mid-tier department store distribution customers are declining and is dramatically adjusting distribution channels for affected brands. EL is largely increasing its presence in specialty multi-retailers, which customers prefer as a place where they can find new products and all their favorite personal care products in one spot, easing the customer experience.

I expect a **bear case** scenario to result in sales growth of 4.0% and 4.1% in 2017 and 2018, respectively. I don't believe EL will miss out on the opportunity to grow makeup due to its acquisitions of TooFaced and BECCA in 2016. MAC has had difficulty in growing revenue, but EL is taking action to correct the profitability of MAC by discontinuing certain freestanding stores and allocating savings to distribute products through different channels. In this scenario, I expect sales in skin care to continue to slow, and EL would not be successful expanding travel retail and specialty retail.

Bear Case: 5% chance

Bull Case: 10% chance

Figure 32: Scenario Analysis

	2017E		2018E	
	Bull Case	Bear Case	Bull Case	Bear Case
Sales	$12,167	$11,708	$13,191	$12,189
Growth	*8.0%*	*4.0%*	*8.4%*	*4.1%*
Segments				
Skin Care	4,713	4,491	4,996	4,545
Growth	*6.0%*	*1.0%*	*6.0%*	*1.2%*
Makeup	5,173	5,032	5,742	5,389
Growth	*10.0%*	*7.0%*	*11.0%*	*7.1%*
Fragrance	1,606	1,531	1,726	1,577
Growth	*8.0%*	*3.0%*	*7.5%*	*3.0%*
Hair Care	599	580	646	602
Growth	*8.0%*	*4.6%*	*8.0%*	*3.8%*
Other	77	75	81	77
Growth	*6.0%*	*3.0%*	*5.0%*	*2.5%*

Source: FactSet

Gross Margins (Base Case: 80.9% and 81.3% in 2017 and 2018, respectively):

I expect in a **bull case** scenario that gross margins will be 81.0% and 81.5% for 2017 and 2018, respectively. I believe these are reasonable estimates because margins have improved over the last few years and are close to the base case. In a bull case scenario, they will be able to profit more by reducing direct costs and will have less need for discounting products to compete.

I expect in a **bear case** scenario that gross margins will be 80.5% and 80.6% for 2017 and 2018, respectively. I believe gross margins will be similar to values of prior years and that direct costs will not increase to the point of threatening the margin. Further, this scenario anticipates more pressure on prices by consumer choices of substitute brands. Recall that Chinese customers are less likely to trade up to EL's brands than in the past.

Operating Efficiency (Base Case: EBIT margin of 14.7% and 14.9% in 2017 and 2018, respectively): I believe operating efficiency should remain relatively near the base case, as EL remains focused on implementing its initiatives to improve operations, profitability and margins.

In a **bull case** scenario, I expect the EBIT margin to be 15.5% and 16.0% for 2017 and 2018, respectively. This is an extra 0.7% and 0.9% improvement on top of my bull gross margin scenarios for 2017 and 2018, respectively. These are reasonable estimates because operating margins continue to be a priority of EL's initiatives. Although EL has struggled to improve its EBIT margin, I believe achieving a 15.5% operating margin is possible if R&D costs per sales decrease. Also, EL has consistently decreased SG&A and shipping and handling expenses relative to sales and I anticipate this is something they will continue to achieve.

In a **bear case** scenario, I expect the EBIT margin to be 14.2% and 14.0% for 2017 and 2018, respectively. These are reasonable estimates because operating margins have decreased the past few years, and in a bear case, I believe this trend will continue. Costs for forgoing initiatives could have been underestimate and R&D costs could increase to create new products.

Valuation[5]:

I expect EL's valuation to fall between the base and bull case.

In a **bull case** scenario, DCF analysis yields a value of $108.71 in 2017. This DCF case assumes that buybacks will reduce 3% of shares every year and growth will be, on average, 6% per year in stage 2. Due to past performance, I believe this scenario has a 10% chance of happening. I also adjusted the terminal P/E to 22 from 20 in the base case scenario. I believe this scenario is more likely than the bear scenario. EL's initiatives and movements of brands to different channels will likely be successful.

In a **bear case** scenario, DCF analysis implies a value of $60.82. This DCF case assumes that buybacks will be smaller at 0.5% of shares. I also lowered the terminal P/E to 17 and projected an average sales growth of 4.0%. I believe this scenario is very unlikely and the valuation is too low to be considered seriously. I believe this scenario has a 5% chance of taking place.

Business Risks

Some of the following risks can be found in the 10-k of Estee Lauder (FY2016). I chose risks I found most noteworthy and important to discuss, due to being either very prominent or showing the most potential downfall if the risk were to occur.

Populism Movement in Europe
As votes continue to take place in the nations of Europe, threats to the fallout of ECB become more serious. As EL participates largely in operations among many of these countries, the company is likely to be affected. Operations could become more expensive as more currencies emerge, possibly heightening the currency exchange rate risk EL faces already.

Possible Trade War
Currently, much is being discussed politically in the US to re-establish production and manufacturing domestically. EL runs its operations worldwide which will expose it to regulations, if any, are made during the next presidential term. I expect it will be important to view the taxes and tariffs that will affect businesses such as EL to proficiently evaluate their financial health.

Highly Competitive Industry
The Personal care product industry is highly competitive, with bargaining power highly with the consumer. Companies that wish to succeed must keep up with trends to maintain their profit margin incase competition drives prices down. The ability of Estee Lauder to compete depends on the continued strength of its brands, the ability to attract and retain key talent and other personnel, the efficiency of its manufacturing facilities and distribution network,

[5] *View Appendix 6&7 for more in-depth Base-Bull-Bear case views of 3 stage DCF and 2017-2023 EPS*

and the ability to maintain and protect the intellectual property and the rights used in the business *(EL Company Filings, 10-k, pg 14).*

Anticipation and Response to Market Trends
To remain profitable, Estee Lauder must anticipate market trends and react in a timely and cost-effective manner. They must maintain and adapt their "High-Touch" services while consumer preferences in shopping platform changes to a more digitalized forum. This is significantly more challenging due to the increased use of digital and social media where the speed of consumer opinions is rapidly shared *(EL Company Filings, 10-k, pg 14).*

Acquisition Risk
Although acquisitions bring many benefits to the company, there are some costs that must be considered. These include: difficulties in integrating acquired operations or products, including the loss of key employees from, or customers of, acquired businesses; diversion of management's attention from the existing businesses; adverse effects on existing business relationships with suppliers and customers; adverse impacts of margin and product cost structures different from those of EL's current mix of business; and risk of entering distribution channels, categories or markets in which they have limited or no prior experience *(EL Company Filings, 10-k, pg 15).*

General Economic Downturn
Estee Lauder's profits, although considered consumer staples and relatively stable, tend to decline when recessionary periods occur. With lower disposable income, consumers lean toward substitutes that are cheaper. If the economic downturn were to cause liquidation of a major retailer, where EL sells a substantial number of products, the firm may incur additional costs *(EL Company Filings, 10-k, pg 15).*

Foreign Operation Risk
The majority of 2016 net sales and operating income were generated outside the US. With foreign operations, come risks that include: fluctuations in foreign currency exchange rates and the relative costs of operations, prices, and cost of inventory in different places; foreign laws, regulations and policies, including restrictions on trade, import and export license requirements, and tariffs and taxes, as well as United States laws and regulations relating to foreign trade, operations and investment; lack of well-established or reliable legal and administrative systems in certain countries; and adverse weather conditions, currency exchange controls, and social, economic and geopolitical conditions, such as terrorist attacks, war or other military actions *(EL Company Filings, 10-k, pg 17).*

Recommendation Disclaimers

I recommend EL as a sell and a value of $78 through multiple valuation techniques to the best of my ability. After careful consideration of values such as terminal P/E, sales growth, and industry beta I used my discretion to best imply what I believe the market will dictate for Estee Lauder's future. Although I have completed thorough research of the company and its industry, it is not possible to process information that is not made known for investors or to predict future political issues, economic downturns, natural disasters, or other unpredictable events. This is one of the reasons I have provided bull, base, and bear scenarios.

My recommendation of a sell could be incorrect as EL management is strong and the firm has opportunity for growth. Buying EL at its current price is a viable option. Although I expect a lower P/E moving forward, EL has a high P/E in comparison to its peers and could continue in this trend. This could mean EL's terminal value would be higher and therefore a buy today may be a good deal.

One should also consider the bear case scenario. If movement into the specialty retail, travel retail, and freestanding store distribution channels are slow, EL could lose out on much of the market share and sales opportunity. This would worsen inventory conditions and heighten costs throughout the business.

Appendix 1: Sales Forecast 2017 & 2018

Sales	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17	Jun-18
Items							
Sales	$9,716	$10,183	$10,979	$10,780	$11,262	11,944	12,551
Growth		*4.8%*	*7.8%*	*-1.8%*	*4.5%*	*6.1%*	*5.1%*
Skin Care	4,225	4,465	4,770	4,479	4,446	4,612	4,755
Growth		*5.7%*	*6.8%*	*-6.1%*	*-0.7%*	*3.7%*	*3.1%*
% of sales	*43.5%*	*43.8%*	*43.4%*	*41.5%*	*39.5%*	*38.6%*	*37.9%*
Makeup	3,697	3,877	4,210	4,305	4,703	5,113	5,476
Growth		*4.9%*	*8.6%*	*2.2%*	*9.2%*	*8.7%*	*7.1%*
% of sales	*38.0%*	*38.1%*	*38.3%*	*39.9%*	*41.8%*	*42.8%*	*43.6%*
Fragrance	1,271	1,311	1,435	1,416	1,487	1,557	1,621
Growth		*3.1%*	*9.5%*	*-1.3%*	*5.0%*	*4.7%*	*4.1%*
% of sales	*13.1%*	*12.9%*	*13.1%*	*13.1%*	*13.2%*	*13.0%*	*6.0%*
Hair Care	462	489	516	531	554	586	620
Growth		*5.7%*	*5.5%*	*2.9%*	*4.4%*	*5.8%*	*5.7%*
% of sales	*4.8%*	*4.8%*	*4.7%*	*4.9%*	*4.9%*	*4.9%*	*4.9%*
Other	60	41	48	50	73	76	80
Growth		*-31.5%*	*16.5%*	*4.2%*	*10.2%*	*5.0%*	*5.0%*
% of sales	*0.6%*	*0.4%*	*0.4%*	*0.5%*	*0.6%*	*0.6%*	*0.6%*
Total	100.0%	100.0%	99.9%	99.8%	100.0%	100.0%	100.0%
The Americas	4,101	4,303	4,572	4,514	4,710	5,007	5,199
Growth		*4.9%*	*6.3%*	*-1.3%*	*4.4%*	*6.3%*	*3.8%*
% of sales	*42.2%*	*42.3%*	*41.6%*	*41.9%*	*41.8%*	*41.9%*	*41.4%*
Europe/Middle East/Africa	3,603	3,759	4,164	4,068	4,381	4,670	4,920
Growth		*4.3%*	*10.8%*	*-2.3%*	*7.7%*	*6.6%*	*5.4%*
% of sales	*37.1%*	*36.9%*	*37.9%*	*37.7%*	*38.9%*	*39.1%*	*39.2%*
Asia/Pacific	2,011	2,122	2,233	2,180	2,173	2,268	2,434
Growth		*5.5%*	*5.2%*	*-2.4%*	*-0.3%*	*4.4%*	*7.3%*
% of sales	*20.7%*	*20.8%*	*20.3%*	*20.2%*	*19.3%*	*19.0%*	*19.4%*

Appendix 2: Income Statement

	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17	Jul-18
Income Statement							
Sales	$9,714	$10,182	$10,969	$10,780	$11,262	$11,944	$12,551
Direct costs	1,996	2,026	2,158	2,101	2,181	2,281	2,347
Gross Margin	7,718	8,156	8,811	8,680	9,081	9,662	10,204
SG&A, R&D, and other	6,385	6,584	6,966	7,045	7,440	7,907	8,334
EBIT	1,333	1,572	1,845	1,635	1,642	1,756	1,870
Interest	61	74	68	74	86	109	126
EBT	1,272	1,498	1,777	1,561	1,555	1,647	1,744
Taxes	401	451	568	467	434	460	487
Income	871	1,047	1,209	1,093	1,121	1,187	1,257
Other	14	27	5	5	6	5	5
Net income	857	1,020	1,204	1,089	1,115	1,182	1,252
Basic Shares	389	388	386	379	370	360	349
EPS	$2.20	$2.63	$3.12	$2.87	$3.01	$3.29	$3.59
DPS	$0.52	$1.08	$0.78	$0.92	$1.14	$1.31	$1.55

Appendix 3: Balance Sheet

	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17	Jul-18
Balance Sheet 1							
Cash	1,348	1,496	1,629	1,021	914	904	807
Operating assets ex cash	2,507	2,802	3,196	2,659	2,842	3,014	3,167
Operating assets	3,855	4,297	4,825	3,680	3,756	3,918	3,974
Operating liabilities	$1,907	$1,916	$2,038	2,100	2,349	2,491	2,618
NOWC	1,948	2,381	2,787	1,580	1,407	1,427	1,356
NOWC ex cash (NWC)	601	885	1,158	559	493	523	549
NFA	2,738	2,848	3,044	4,043	4,998	5,301	5,570
Invested capital	*$4,686*	*$5,229*	*$5,831*	*$5,623*	*$6,405*	*$6,727*	*$6,926*
Marketable securities	-	-	-	504	469	469	469
Total assets	*$6,593*	*$7,145*	*$7,869*	*$8,227*	*$9,223*	*$9,688*	*$10,013*
Short-term and long-term debt	$1,288	$1,344	$1,343	$1,625	$2,242	$2,642	$2,992
Other liabilities	651	583	618	848	1,046	1,144	1,243
Equity	2,748	3,302	3,869	3,654	3,587	3,411	3,161
Total supplied capital	*$4,686*	*$5,229*	*$5,831*	*$6,127*	*$6,874*	*$7,197*	*$7,395*
Total liabilities and equity	*$6,593*	*$7,145*	*$7,869*	*$8,227*	*$9,223*	*$9,688*	*$10,013*

Appendix 4: Balance Sheet II

Balance Sheet (in millions)					
Items	2012	2013	2014	2015	2016
Assets					
Current Assets					
Cash and cash equivalents	1,348	1,496	1,629	1,021	914
Short-term investments	0	0	0	504	469
Accounts receivables, net	1,060	1,172	1,379	1,175	1,258
Inventroy and promotional merchandise, net	984	1,114	1,294	1,216	1,263
Prepaid expenses and ther current assets	464	516	523	268	320
Total current assets	3,855	4,297	4,825	4,184	4,225
Property, Plant and Equipment, net	1,232	1,351	1,503	1,409	1,583
Other Assets					
Long-term investments	0	0	0	420	1,108
Goodwill	883	882	893	1,145	1,228
Other intangible assets, net	190	170	157	327	345
Other assets	433	446	491	661	735
Total other assets	1,506	1,497	1,541	2,553	3,415
Total Assets	6,593	7,145	7,869	8,146	9,223
Liabilities and Equity					
Current Liabilities					
Current debt	219	18	18	30	332
Accounts payable	494	482	525	635	717
Accrued income taxes	97	0	0	0	0
Other accrued liabilities	1,316	1,435	1,514	1,465	1,632
Total current liabilities	2,126	1,935	2,057	2,130	2,681
Noncurrent Liabilities					
Long-term debt	1,069	1,326	1,325	1,595	1,910
Accrued income taxes	106	0	0	0	0
Other noncurrent laiabilities	544	583	618	848	1,046
Total noncurrent liabilities	1,720	1,909	1,943	2,443	2,956
Common Stock	6	6	6	6	6
Paid in capital	2,006	2,290	2,563	2,872	3,161
Retained Earnings	4,765	5,364	6,266	7,004	7,693
Accumulated other comprehensive loss	(213)	(158)	(100)	(382)	(545)
Less: Treasury stock	(3,830)	(4,215)	(4,879)	(5,857)	(6,743)
Noncontrolling interes	14	15	15	11	15
Total stockholders equity	2,748	3,302	3,869	3,654	3,587
Total liabilities and shareholder equity	6,593	7,145	7,869	8,227	9,223

Appendix 5: Competitors

		Current	Market	Price Change						Earnings Growth								LT Debt/	S&P	LTM Dividend	
Ticker	Name	Price	Value	1 day	1 Mo	3 Mo	6 Mo	52 Wk	YTD	LTG	NTM	2015	2016	2017	2018	Pst 5yr	Beta	Equity	Rating	Yield	Payout
EL	LAUDER (ESTEE) COS INC -CL A	$77.27	$28,315	0.1	(1.7)	(11.1)	(13.9)	(13.6)	(12.3)	11.4	19.1%	-7.2%	13.1%	6.6%	11.7%		0.72	52.2%	A	1.60%	41.0%
AVP	AVON PRODUCTS	$5.14	$2,249	(0.6)	(5.9)	(6.9)	34.9	20.9	26.9		-254.7%	-98.7%	1200.0%	169.2%	322.9%		1.99	-282.2%	B-	1.12%	
COTY	COTY INC	$18.41	$13,740	(0.4)	(5.8)	(20.2)	(28.4)	(28.9)	(28.2)	0.4	870.6%	22.2%	38.4%	-32.1%	19.4%		0.32	1678.2%		2.81%	525.0%
IPAR	INTER PARFUMS INC	$33.00	$1,026	(0.3)	(5.6)	6.0	16.1	40.2	38.5		22.9%	3.2%	12.2%	13.6%	12.8%	2.2%	1.47	15.9%	B+	1.68%	58.0%
REV	REVLON INC -CL A	$29.20	$1,533	0.5	2.5	(19.2)	(6.5)	3.2	4.9			110.4%	-2.5%	-100.0%		-29.9%	0.41	-476.4%	B-	0.00%	0.0%
NUS	NU SKIN ENTERPRISES -CL A	$48.48	$2,640	0.0	(9.6)	(23.4)	10.2	25.8	27.9	7.6	29.4%	-32.3%	4.3%	9.9%	7.8%	1.3%	0.99	41.7%	A-	2.72%	57.3%
PG	PROCTER & GAMBLE CO	$84.35	$225,720	0.3	1.8	(4.4)	0.5	5.0	6.2	7.7	9.6%	-4.7%	-8.7%	5.4%	7.8%		0.52	33.0%	A	3.24%	74.0%
4.91E+03	SHISEIDO CO LTD	$25.44	$10,150	(0.8)	1.4	10.1	14.2	19.4	17.1	22.4	-73.3%	12.9%	-2.9%	1.5%	24.6%	-2.9%	0.74	17.5%		1.03%	21.2%
Average			$35,672	(0.1)	(2.9)	(8.6)	3.4	9.0	10.2	9.9	89.1%	0.7%	156.7%	9.3%	58.1%	-7.3%	0.90	135.0%		1.77%	110.9%
Median			$6,395	(0.1)	(3.6)	(9.0)	5.3	12.2	11.7	7.7	19.1%	-0.8%	8.3%	6.0%	12.8%	-0.8%	0.73	25.3%		1.64%	57.3%
SPX	S&P 500 INDEX	$2,249		(0.0)	2.0	4.6	8.6	8.2	10.0			7.6%	1.0%	0.7%	11.7%						

		2016		P/E							2016	2016			EV/	P/CF	P/CF	Sales Growth			Book
Ticker	Website	ROE	P/B	2014	2015	2016	TTM	NTM	2017	2017E	NPM	P/S	OM	ROIC	EBIT	Current	5-yr	NTM	STM	Pst 5yr	Equity
EL	http://www.elcompanies.com	32.1%	7.74	25.3	27.3	24.1	26.4	22.1	22.7	20.3	10.4%	2.51	16.2%	20.8%	19.3			6.9%	6.2%	5.0%	$9.98
AVP	http://www.avoncompany.com	-7.2%	-2.85	6.9	514.0	39.5	-26.5	17.1	14.7	3.5	1.0%	0.39	6.2%	-41.1%	10.6	7.5	7.1	16.5%	1.9%	-10.7%	-$1.80
COTY	http://www.coty.com	183.6%		22.7	18.6	13.4		19.0	19.8	16.6	23.5%	3.16	11.4%	4.0%	25.5			98.6%		1.2%	$0.75
IPAR	http://www.interparfumsinc.com	8.8%	2.64	34.7	33.7	30.0	33.0	26.9	26.4	23.4	6.7%	2.01	13.0%	7.4%	10.4	21.0	17.6	7.6%	5.4%	0.4%	$12.49
REV	http://www.revlon.com	-18.6%	-2.76	30.4	14.5	14.8	38.9						12.1%	4.9%	11.5					7.7%	-$10.59
NUS	http://www.nuskinenterprises.com	19.1%	3.17	11.7	17.3	16.5	19.6	15.2	15.1	14.0	7.1%	1.18	11.8%	12.5%	9.0			0.5%		7.9%	$15.31
PG	http://www.pg.com	17.2%	3.94	20.0	21.0	23.0	23.4	21.4	21.8	20.2	15.0%	3.46	22.3%	12.6%	17.8	18.4		0.9%	3.8%	-4.6%	$21.39
4911.00	http://www.shiseidogroup.jp	8.4%	3.14	41.0	36.3	37.4	20.4	76.2	36.9	29.6	3.7%	1.40	6.3%	6.5%	19.8	14.1	12.0	-7.8%		9.6%	$8.10
Average		30.4%	2.15	24.1	85.3	24.9	19.3	28.3	22.5	18.2	9.6%	2.02	12.4%	3.5%	15.5	15.3	12.2	17.6%	4.3%	2.1%	
Median		13.0%	3.14	24.0	24.1	23.6	23.4	21.4	21.8	20.2	7.1%	2.01	11.9%	7.0%	14.6	16.3	12.0	6.9%	4.6%	3.1%	
spx	S&P 500 INDEX			20.7	19.3	19.1			18.9	16.9											

Appendix 6: Base-Bear-Bull Case EPS

Base Case	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
EPS	$ 3.29	$ 3.59	$ 3.85	$ 4.08	$ 4.48	$ 4.84	$ 5.17
Growth		*9.2%*	*7.3%*	*5.9%*	*10.0%*	*7.9%*	*6.9%*
Bear Case	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
EPS	$ 3.14	$ 3.29	$ 3.52	$ 3.71	$ 3.91	$ 4.11	$ 4.33
Growth		*4.8%*	*6.9%*	*5.3%*	*5.3%*	*5.3%*	*5.2%*
Bull Case	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
EPS	$ 3.55	$ 3.83	$ 4.38	$ 4.74	$ 5.14	$ 5.57	$ 6.04
Growth		*7.8%*	*14.3%*	*8.4%*	*8.4%*	*8.4%*	*8.4%*

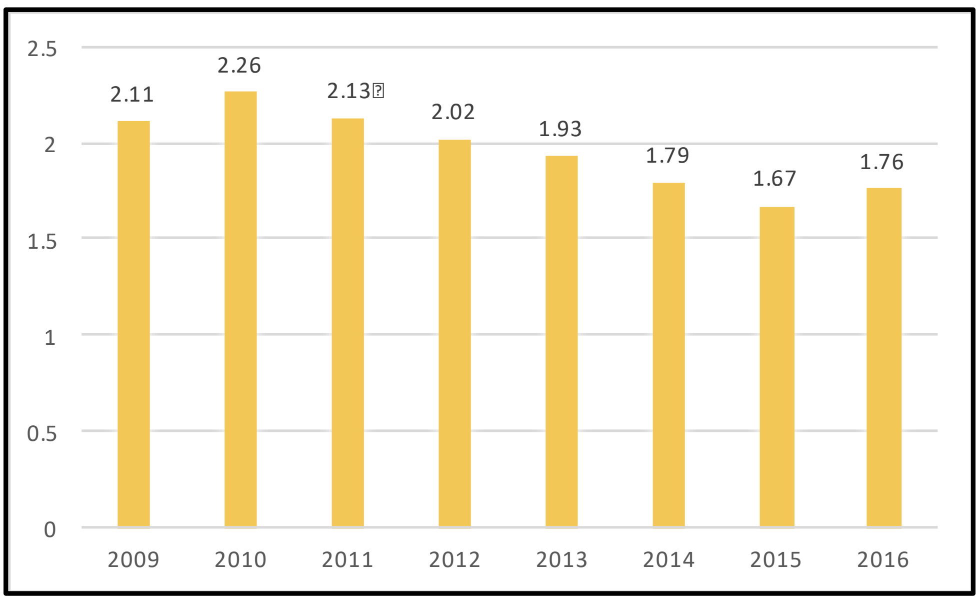
Appendix 7: NTM ROE v P/B Values

	NTM NI	2016 Equity	NTM Equity	Avg Equity	NTM ROE	P/B-Today
EL	$ 1,263	$ 3,576	$ 3,114	$ 3,345	37.76%	7.7
NUS	$ 149	$ 826	$ 667	$ 747	19.96%	3.2
IPAR	$ 33	$ 2,808	$ 3,563	$ 3,186	1.05%	2.6
PG	$ 10,533	$ 57,983	$ 58,602	$ 58,293	18.07%	3.9
4911	$ 271	$ 2,808	$ 3,563	$ 3,186	8.51%	2.7

Appendix 8: Base-Bear-Bull DCF Valuation

BASE CASE		**Summary**	
	First stage	$4.63	Present value of first 2 year cash flow
	Second stage	$12.58	Present value of year 3-7 cash flow
	Third stage	$64.45	Present value of terminal value P/E
	Value (P/E)	**$81.66**	= value at beg of fiscal yr 2017
BEAR CASE		**Summary**	
	First stage	$4.67	Present value of first 2 year cash flow
	Second stage	$11.16	Present value of year 3-7 cash flow
	Third stage	$44.98	Present value of terminal value P/E
	Value (P/E)	**$60.82**	= value at beg of fiscal yr 2017
BULL CASE		**Summary**	
	First stage	$8.55	Present value of first 2 year cash flow
	Second stage	$16.54	Present value of year 3-7 cash flow
	Third stage	$83.63	Present value of terminal value P/E
	Value (P/E)	**$108.71**	= value at beg of fiscal yr 2017

Appendix 9: EL Inventory Turnover by Year



Appendix 10: 3-Stage DCF Model

	Year						
	1	2	3	4	5	6	7
First Stage			**Second Stage**				
Cash flows	2017	2018	2019	2020	2021	2022	2023
Sales Growth	*6.1%*	*5.1%*	*4.0%*	*3.0%*	*7.0%*	*5.0%*	*4.0%*
NOPAT / S	*10.6%*	*10.7%*	*10.8%*	*10.9%*	*11.0%*	*11.0%*	*11.1%*
S / NWC	*22.86*	*22.86*	*22.86*	*22.86*	*22.86*	*22.86*	*22.86*
S / NFA (EOY)	*2.25*	*2.25*	*2.25*	*2.25*	*2.25*	*2.25*	*2.25*
S / IC (EOY)	*2.05*	*2.05*	*2.05*	*2.05*	*2.05*	*2.05*	*2.05*
ROIC (EOY)	*21.7%*	*22.0%*	*22.2%*	*22.3%*	*22.5%*	*22.6%*	*22.8%*
ROIC (BOY)		*23.1%*	*23.1%*	*23.0%*	*24.0%*	*23.7%*	*23.7%*
Share Growth		*-3.0%*	*-2.0%*	*-2.0%*	*-2.0%*	*-2.0%*	*-2.0%*
Sales	$11,944	$12,551	$13,053	$13,445	$14,386	$15,105	$15,709
NOPAT	$1,265	$1,348	$1,411	$1,463	$1,576	$1,666	$1,744
Growth		*6.5%*	*4.7%*	*3.7%*	*7.7%*	*5.7%*	*4.7%*
- Change in NWC	30	27	22	17	41	31	26
NWC EOY	*523*	*549*	*571*	*588*	*629*	*661*	*687*
Growth NWC		*5.1%*	*4.0%*	*3.0%*	*7.0%*	*5.0%*	*4.0%*
- Chg NFA	302	269	223	174	418	319	268
NFA EOY	*5,301*	*5,570*	*5,793*	*5,967*	*6,384*	*6,704*	*6,972*
Growth NFA		*5.1%*	*4.0%*	*3.0%*	*7.0%*	*5.0%*	*4.0%*
Total inv in op cap	332	296	245	191	459	351	295
Total net op cap	5823	6119	6364	6555	7014	7364	7659
FCFF	$933	$1,052	$1,166	$1,272	$1,117	$1,315	$1,449
% of sales	*7.8%*	*8.4%*	*8.9%*	*9.5%*	*7.8%*	*8.7%*	*9.2%*
Growth		*12.7%*	*10.9%*	*9.1%*	*-12.2%*	*17.7%*	*10.2%*
- Interest (1-tax rate)	79	91	94	97	104	109	113
Growth		*15.4%*	*4.0%*	*3.0%*	*7.0%*	*5.0%*	*4.0%*
FCFE w/o debt	$855	$961	$1,072	$1,175	$1,013	$1,206	$1,336
% of sales	*7.2%*	*7.7%*	*8.2%*	*8.7%*	*7.0%*	*8.0%*	*8.5%*
Growth		*12.5%*	*11.6%*	*9.6%*	*-13.8%*	*19.0%*	*10.8%*
/ No Shares	359.7	348.9	341.9	335.1	328.3	321.8	315.3
FCFE	$2.38	$2.75	$3.14	$3.51	$3.09	$3.75	$4.24
Growth		*15.9%*	*13.8%*	*11.9%*	*-12.0%*	*21.4%*	*13.0%*
* Discount factor	0.93	0.87	0.82	0.76	0.71	0.67	0.62
Discounted FCFE	$2.22	$2.41	$2.56	$2.68	$2.20	$2.50	$2.64
Third Stage							
Terminal value P/E							
Net income	$1,182	$1,252	$1,317	$1,366	$1,472	$1,557	$1,630
% of sales	*9.9%*	*10.0%*	*10.1%*	*10.2%*	*10.2%*	*10.3%*	*10.4%*
EPS	$3.29	$3.59	$3.85	$4.08	$4.48	$4.84	$5.17
Growth		*9.2%*	*7.3%*	*5.9%*	*10.0%*	*7.9%*	*6.9%*
Terminal P/E							20.00
* Terminal EPS							$5.17
Terminal value							$103.40
* Discount factor							0.62
Discounted terminal value							$64.45

Summary

First stage	$4.63	Present value of first 2 year cash flow
Second stage	$12.58	Present value of year 3-7 cash flow
Third stage	$64.45	Present value of terminal value P/E
Value (P/E)	**$81.66**	= value at beg of fiscal yr 2017

Appendix 11: Ratios

Ratios	Jun-12	Jun-13	Jun-14	Jun-15	Jun-16	Jun-17	Jul-18
Profitability							
Gross margin	79.5%	80.1%	80.3%	80.5%	80.6%	80.9%	81.3%
Operating (EBIT) margin	13.7%	15.4%	16.8%	15.2%	14.6%	14.7%	14.9%
Net profit margin	8.8%	10.0%	11.0%	10.1%	9.9%	9.9%	10.0%
Activity							
NFA (gross) turnover		3.65	3.72	3.04	2.49	2.32	2.31
Total asset turnover		1.48	1.46	1.34	1.29	1.26	1.27
Liquidity							
Op asset / op liab	2.02	2.24	2.37	1.75	1.60	1.57	1.52
NOWC Percent of sales		21.3%	23.6%	20.3%	13.3%	11.9%	11.1%
Solvency							
Debt to assets	19.5%	18.8%	17.1%	19.8%	24.3%	27.3%	29.9%
Debt to equity	46.9%	40.7%	34.7%	44.5%	62.5%	77.4%	94.6%
Other liab to assets	9.9%	8.2%	7.9%	10.3%	11.3%	11.8%	12.4%
Total debt to assets	29.4%	27.0%	24.9%	30.1%	35.6%	39.1%	42.3%
Total liabilities to assets	58.3%	53.8%	50.8%	55.6%	61.1%	64.8%	68.4%
Debt to EBIT	0.97	0.86	0.73	0.99	1.37	1.50	1.60
EBIT/interest	21.81	21.27	27.13	22.00	19.02	16.11	14.87
Debt to total net op capital	27.5%	25.7%	23.0%	28.9%	35.0%	39.3%	43.2%
ROIC							
NOPAT to sales		10.8%	11.4%	10.6%	10.5%	10.6%	10.7%
Sales to IC		2.05	1.98	1.88	1.87	1.82	1.84
Total		22.2%	22.7%	20.0%	19.7%	19.3%	19.7%
Total using EOY IC	19.5%	21.0%	21.5%	20.4%	18.5%	18.8%	19.5%
ROE							
5-stage							
EBIT / sales		15.4%	16.8%	15.2%	14.6%	14.7%	14.9%
Sales / avg assets		1.48	1.46	1.34	1.29	1.26	1.27
EBT / EBIT		95.3%	96.3%	95.5%	94.7%	93.8%	93.3%
Net income /EBT		68.1%	67.8%	69.8%	71.7%	71.8%	71.8%
ROA		14.8%	16.0%	13.5%	12.8%	12.5%	12.7%
Avg assets / avg equity		2.27	2.09	2.14	2.41	2.70	3.00
ROE		33.7%	33.6%	28.9%	30.8%	33.8%	38.1%
3-stage							
Net income / sales		10.0%	11.0%	10.1%	9.9%	9.9%	10.0%
Sales / avg assets		1.48	1.46	1.34	1.29	1.26	1.27
ROA		14.8%	16.0%	13.5%	12.8%	12.5%	12.7%
Avg assets / avg equity		2.27	2.09	2.14	2.41	2.70	3.00
ROE		33.7%	33.6%	28.9%	30.8%	33.8%	38.1%
Payout Ratio		41.1%	25.1%	32.1%	37.9%	39.8%	43.1%
Retention Ratio		58.9%	74.9%	67.9%	62.1%	60.2%	56.9%
Sustainable Growth Rate		19.9%	25.2%	19.6%	19.1%	20.3%	21.7%

Appendix 12: SWOT Analysis

Strengths	Weaknesses
Brand Recognition	Inventory Turnover
Relatively Large Growth Ability	Limited Distribution
Marketing Techniques	Decreasing Operating Margin
Opportunities	**Threats**
Transition to Freestanding Stores	Currency Translation
Brand Acquisition	Intense Competition
Emerging Market Expansion	Decreasing Foot Traffic

Appendix 13: Porter's 5 Forces

Threat of New Entrants: Low

To enter the industry, a company must have a quality product that will penetrate the market. To create this product, the company must have significant means to both research, develop, manufacture and market the product. The cost is very high. Economies of scale are required to effectively participate in this market; the more products sold, the higher the profit margin. Without customer loyalty, it is difficult to enter the market. Personal care products are not required to be FDA-approved, unless they are used to affect the body (antiperspirants, SPF products, dandruff products). They are however, regulated by the FDA.

Threat of Substitutes: High

Personal care products are similar to one another and there are as many other manufactures, there is a high threat of substitutions. The only thing that separates products from one another is customer experience. Innovative products are essential to win over customers.

Supplier Power: High

Estee Lauder uses a variety of direct and indirect suppliers for their products. Some of EL's products rely on a single or limited number of suppliers. EL is aware that changing financial conditions of their suppliers will affect their ability to bring products to market.

Buyer Power: High

With so many competitors, consumers can influence prices because they can shop around for similar quality for a lower price, or for sales or discounts.

Intensity of Competition: High

Competition is intense. This is partly what gives consumers power over prices. There are plenty of substitutes and each company continues to research and develop innovative products that will catch the attention of consumers. Most competitors market through social media.