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Research Paper: Estee Lauder Companies Inc.

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Company Business Background

The Estee Lauder Companies Inc. is one of the leading companies in upscale beauty products. Estee Lauder Companies Inc. is the only company exclusively focused on high-end prestige beauty and skin care products. These products range from Make-up, Fragrances over Moisturizers, Toners, Oilers, Face masks to hair care products, such as shampoo and conditioner. With over 25 different brands, Estee Lauder has a very diverse portfolio.

The company`s products are sold in over 120 countries around the globe. Many of these are under well-known names and brands such as Estee Lauder, MAC, Bobbi Brown, DKNY, Michael Kors, Smashbox, Clinique, and many more are included in the Estee Lauder Companies

Inc. The products are sold in many different ways. First, original stores for each brand, such as the MAC store. Second, department stores also distribute many of Estee Lauder's products, Macy's for example. Other options are also shops on cruise ships, in airports, in-flight or duty free shops, or e-commerce websites.

The Estee Lauder Companies Inc. was founded in 1946 in New York City by Estee Lauder and her husband Joseph Lauder. The company became public in November 1995 and raised about \$450 million through the IPO. Due to secondary offers, over the next couple years, lowered the family's holding in the firm to 65% of the common stock and 93% of the voting stock (International Directory of Company Histories).

By launching different cosmetics lines, such as Aramis and Clinique, and various acquisitions, like MAC and Bobbi Brown, the company has a high market share in the beauty industry of 38% (CSIMarket). All these different make-up lines and companies under the Estee Lauder umbrella, gives the company a diversity that almost no other beauty company has. One of the people responsible for creating this diversity is the current executive chairman and chairman of the board of directors Leonard A. Lauder. He is the grandson of Estee and Joseph Lauder. He joined the company in 1986, from when he was working his way up into the Board of Directors. He was responsible for creating the 'Origins' brand, and devised the store-in-store concept. In 2003, he became Chief Operating Officer and was trusted with the company's global operations and nine specialty brands, as well as the retail business. Between 2004 and 2009 he was Chief Executive Officer. He strengthened the portfolio of his grandparents' company and expanded its international presence, especially by investing in the Internet business. In 2009, he became Executive Chairman and Chairman of the Board of Directors. Overall, he was responsible for a lot of Estee Lauder's previous success and diversity in its portfolio (Estee Lauder).

The current CEO is Fabrizio Freda. Before he became CEO at Estee Lauder, he was active at Procter&Gamble for over 20 years, where he was responsible for various segments, such as marketing, operating and key strategies (Morningstar).

This diversity is a key to the success. All products, under the Estee Lauder umbrella, are present in all age-groups. MAC and Smashbox are mostly used by customers between 18 -34, Bobbi Brown users are normally between 35-54, while Estee Lauder customers are generally over 55 years old. This shows that they have all age groups covered and are not depended on one specific group (Mohsenian, Doctor and Fitzgerald).

The stock of Estee Lauder (EL) was traded on December 2th on the New York Stock Exchange for \$75.84 (Yahoo Finance). In the fiscal year 2016 Estee Lauder Companies had net sales of \$11.26 billion. Net earnings in 2016 attributed to Estee Lauder Companies Inc. are \$1.1 billion. Included in these numbers are adjustments for restructuring activities of \$134.7 million related to Company`s Global Technology Infrastructure (Lauder, Estee). In the last five years, Estee Launders net sales have gradually increased from \$9.71 billion in 2012 to \$11.26 billion in 2016.

Stock Valuation

To be able to evaluate Estee Lauder`s stock, the Capital Asset Pricing model as well as the Dividend Growth Model are being used.

At the moment, Estee Lauder`s beta is 0.73. The risk -free rate, also called T-Bill rate, is at 0.33 (kRF) for the US. The last number that is needed to be able to calculate the CAPM is the expected rate of return. Because it is impossible to know what the expected return of the market is exactly, this number is generally taken from the return of the last years of the S&P 500. The

following number is from the arithmetic average within the timeframe from 1966 to 2015. The annual return on Investments for the S&P500 was 11.01% (kM).

Therefore,

$$\text{Expected Return on Stock} = k_{RF} + \beta(k_M - k_{RF})$$

$$E(r) = 0.33 + 0.73(11.01 - 0.33)$$

$$E(r) = 8.13$$

This means the expected return for the Estee Lauder stock is 8.13%.

Using the Dividend Growth Model to evaluate how their stock is progressing how the company has been able to pay dividends to their shareholders; different numbers are needed.

The current dividend yield and their growth rate will be needed to calculate the dividend growth. These numbers are given on finance.yahoo.com. The current dividend yield for Estee Lauder Companies Inc. is 1.79%, the growth rate is taken from the 52 -week change, which is -12.81%.

$$E(r) = 1.79\% + (-12.81\%)$$

$$E(r) = -11.02\%$$

The dividend growth model shows that the stock of Estee Lauder will probably decrease in the future.

Dividend History

During the last five years, Estee Lauder Companies Inc. increased their dividends paid almost every year. In fiscal year ended June 2011 they paid their shareholders \$0.38 per share,

while in FY ended 06/2012 it increased to \$0.53. The next year the increase is even more. A total of \$1.08 per share is issued to the shareholders. Something very surprising happened in 2014 though. The company apparently had to decrease their dividends by \$0.3 to \$0.78 per share. The next year it increased a little bit again, but only by \$0.14 to \$0.92. Only during the last fiscal year, it got to the highest dividend in the last five years; \$1.14.

Recent beta and Interpretation

The beta coefficient presents the risk in a particular risky asset relative to that in an average risky asset (Stephen A. Ross). The beta coefficient is generally called beta and is represented by the greek letter β . An average asset with a beta of 1.0 has a relative risk of itself. The higher the beta, normally means the higher the expected return. The more risk someone is willing to take, the more that person will get out of it, if everything goes well. Estee Lauder's stock has a current beta of 0.73, which makes it less risky than an average asset. This means that the expected return is also not as great as some other stocks, such as Abercrombie&Fitch, which has a beta of 2.74.

Company Stock Price Performance

Estee Lauder's stock price has been decreasing during the last year. On December 5th, Estee Lauder trades for \$77.46, this is shown on finance.yahoo.com. One year before the stock price was \$85.25. This means that their price decreased by \$7.79. The 1 year return is calculated by subtracting the 2015 stock price from the current stock price and dividing that number by the 2015 stock price. In the equation form this is

$$(\$77.46 - \$85.25) / \$85.25 = -0.914.$$

This shows that the stock price went down by -0.914.

The five-year return is calculated the same way, only that the stock price is taken from 2011.

$$(\$77.46 - \$57.93) / \$57.93 = 0.337$$

That shows that since 2011 Estee Lauder has been performing well and their stock price performance has been increasing.

Comparison to competitor

Estee Lauder has many competitors. Examples for these are Avon Products Inc., Colgate-Palmolive Company, and The Proctor and Gamble Company. The only company out of those three that has been growing in the last five years is *The Proctor and Gamble Company*. Their stock performance shows this. All the following number are taken from Finance.Yahoo.com, the current stock price is from December 9, 2016; the stock price from one year ago is from January 1, 2016; and the stock price from five years ago is from January 1, 2012.

$$1 \text{ Year: } (\$84.37 - \$81.69) / \$81.69 = 0.033$$

$$5 \text{ Year: } (\$84.37 - \$63.04) / \$63.04 = 0.34$$

Although, the return slowed down a little bit over the years, the stock price steadily increased in the past five years.

Avon Products Inc.'s stock price has been increasing in the past year, but has been greatly decreasing the past five years.

$$1 \text{ Year: } (\$5.57 - \$3.39) / \$3.39 = 0.64$$

$$5 \text{ Year: } (\$5.57 - \$17.77) / \$17.77 = -0.68$$

Avon Products Inc. has been doing bad in the past years, but are slowly working themselves back up. Their one year stock return gives evidence for this.

Colgate-Palmolive Company is the direct opposite of Avon Products Inc. Their one year return is negative while their five-year return is positive.

$$1 \text{ Year: } (\$66.29 - \$67.53) / \$67.53 = -0.02$$

$$5 \text{ Year: } (\$66.29 - \$45.36) / \$45.36 = 0.46$$

These returns show that only one company, *The Procter and Gamble Company*, has been successful in the last five years. Both *Colgate-Palmolive Company* and *The Estee Lauder Companies Inc.* have had a negative stock return in the last year, while having a positive return for the past five years. *Avon Products Inc.* jumps out of this pattern. They have had a negative stock return for the last five years, but a positive for the most recent year. Even though their stock price is lower than Estee Lauder's, relatively Avon has been doing better.

Recent News

On December 7th, 2016, Estee Lauder Companies Inc. signed the White House Equal Pay Pledge that supports the endeavor of promoting equality of women and men in the work force. This shows the commitment of Estee Lauder for this cause. Since the founding of the company by a woman in the 20s, this has always been a very important aspect.

The product line Aveda received a new Senior Vice President/General Manager for the North American Region on December 2nd 2016. Barbara De Laere oversees to increase the market share of Aveda. Applied Marketing, Retail, Field Sales and Education, as well as social media and digital brand marketing are reporting to her (Estee Lauder Companies). That way the brand can strengthen their winning strategy across America and can engage more consumer. Ms.

De Laere has experience in this department, as she already worked for L`Oreal for 16 years in many different international senior leadership positions. The day after this announcement on the stock market, the 5th of December, Estee Lauder`s stock price increased by \$1.32. Since then the stock price has been steadily increasing (Yahoo Finance!). Although Aveda is only one portion of the company, this change might be one of many reasons for the rising overall stock price.

Another reason for the climbing stock price on the 5th of December is the acquisition of BECCA Cosmetics on this day. With this acquisition, Estee Lauder increases their presence to more parts of the world. BECCA Cosmetics just expanded to Southeast Asia, Europe, and the Middle East by being represented by Sephora. Estee Lauder Companies write on their website that they “see terrific growth opportunities for BECCA as it expands globally and continues to cultivate its online and digital expertise” (Estee Lauder Companies). In the long run, this benefits the umbrella company just as well.

The press release on November 2nd, 2016, reported about first quarter ended of Fiscal year 2017 financials. The net sales increase by 1% to \$2.87 billion compared to the prior-year quarter. Although net sales increased, net earnings decreased by \$15 million, due to restructuring and other charges. The sales grew just to the expectations of the President and CEO Fabrizio Freda (Estee Lauder Companies). Especially, the small- and mid-sized brands are contributing to the increase in sales. This goes hand in hand with the acquisition of BECCA Cosmetics, as that company falls under this category.

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Kilian, Clinique, Editions De Parfums Frédéric Malle, GLAMGLOW, Jo Malone London, Le Labo, M·A·C, Prescriptives, RODIN Olio Lusso, Smashbox and Tom Ford Beauty. In Addition, Mr. Demsey Leads the Company's Center of Excellence for Creative, Continuing T. "Executive Officers." – *The Estée Lauder Companies Inc.* Estee Lauder, n.d. Web. 07 Nov. 2016. <https://www.elcompanies.com/investors/corporate-governance/executive-officers#executive-officers-william-p-lauder>

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