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# Weak U.S. Sales and Declining Margins Continue To Strain Revlon's Business

October 29th, 2013 by Trefis Team



30.89 Trefis

35.44 Market

-12.83% Downside

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[Revlon](#) (NYSE:REV) reported its Q3 FY13 results on October 24. Revenues continued to slide down impacted by adverse currency fluctuations. Excluding these currency fluctuations, growth in constant dollar revenues decelerated from 4.8% in Q3 FY12 to 1.1% this quarter. Lower volume sales of color cosmetic products in the U.S., specifically the *Almay* brand, is the primary reason for the slowdown in constant dollar revenues. Additionally, a sequential dip in gross and operating margins added to the top line growth concerns for the company while net income stood at \$0.18 per share. The NYSE listed stock took a 5.6% hit on its price after the release of its results as it missed both top line and bottom line estimates of \$342.3 million and \$0.44 per share.

### Q3 FY13 Recap

Total revenues for the quarter stand at \$339 million, compared to \$350 million in the previous quarter and \$347 million in the September quarter in 2012. Although reported revenues decreased sequentially, Revlon reports an increase in constant dollar revenues from higher volume sales over the previous quarter. Gross margins depreciated by approximately 1% due to an increase in cost of sales, which was a consequence of increased promotional expenses, offsetting cost benefits from better supply chain and manufacturing practices.

Operating margins in the quarter saw an improvement over September 2012 to reach 12.3%, but declined from the 16.9% observed during Q2 FY13. September 2012 was the first quarter of implementation of Revlon's restructuring program, and this resulted in a steep decline in operating margins to 5.5% due to an increase in restructuring expenses. Margins, however, bounced back to 21% the next quarter, benefited by an increase in the holiday season revenues and significant cost reductions. We expect margins to increase in the following December quarter as sales tend to outpace any increase in costs during the holiday season.

Although the refinancing of debt concluded in February 2013 led to a temporary delay in interest obligations, Revlon's sizable debt burden is the reason for its high interest expenses. Interest expense for FY13 amounted to approximately 43% of operating profit earned, compared to 30% the previous year. Going forward, we expect that interest expenses as a percentage of operating profits would stand at 40%, if not go higher, due to the \$700 million in additional debt from the Colomer acquisition.

### [See Our Full Analysis for Revlon Stock](#)

### Weak U.S. Sales' Volumes, Slow Product Adaptation Result In Tepid Top Line Performance in 2013

Revlon generates approximately 56% of its revenues from the U.S. alone. Reported revenues from the U.S. market stood at approximately \$186 million and were down 3.2% y-o-y for the quarter. Continued weak performance of the *Almay* brand along with lower sales from *Revlon* weighed down on higher sales from the *Colorsilk* brand, contributing to this decline. Sales for the *Almay* brand have declined for the fifth quarter in a row, and Revlon's efforts in improving the brand's position don't seem to be gaining traction in sales. As part of its renovation plan for *Almay*, the company expanded its offerings in the eye make-up removal range and re-entered the lip category with newer products. [1]

Additionally, product adaptations to changing consumer trends seem weak from Revlon in comparison to its competitors. In 2013, nail polishes and BB creams were the main drivers of the U.S. cosmetics market.

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[2] Consistent to the market trend, Revlon has seen growth in its only BB cream product, *PhotoReady BB Cream*, and nail polish offerings. Revlon re-launched two of its biggest nail franchises in the U.S. market in Q4 FY12, along with the release of new products such as *Nail Art* and *Brilliant Strength Enamel*. However, these launches were only completed in Q4 FY12. [3] In comparison, competitors such as [L'Oréal](#) (PINK:LRLCY) increased offerings in these niche segments as early as November 2011 in response to consumer demand. [4] We believe that the decline in volume growth of products might be a result of slow adaptation of products, resulting in a slowdown in constant currency revenues in 2013.

**International Sales Gain Traction From Global Economic Stabilization**

Sales from international geographies in Q3 FY13 were \$153.6 million, compared to \$146 million in Q2 FY13 and \$155 million in Q3 FY12. In constant dollar terms, all of the international regions that Revlon operates in showed positive y-o-y growth rates due to the recovery in European markets and strong demand in Asia and Latin America. Sales from Asia-Pacific region, the largest segment after the U.S. for Revlon, gained 4.8% from a year ago compared to a y-o-y growth rate of 0.9% in Q2 FY13. Similarly, the EMEA and Latin America & Canada geographic segments posted decent y-o-y-growth rates of 13.9% and 2% in Q3 FY13 compared to 3.6% and (-5.1%) during Q2 FY13.

With 60% of TCG's revenues arising from international markets, we believe the acquisition could significantly boost Revlon's top line. Additionally, we should see further revival in consumer spending due to the strengthening European economy along with the high demand for beauty products in growth markets of Latin America and Asia Pacific, contributing to a turnaround in Revlon's declining international market sales.

**Revlon** Interactive Slideshow

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30.89  
Trefis

Net Debt  
54.1%

DIVISION	% of STOCK PRICE
<a href="#">Color Cosmetics</a>	51.7%
<a href="#">Hair Color</a>	27.9%
<a href="#">Skin Care</a>	12.0%
<a href="#">Antiperspirants, Deodorants &amp; Fragrances</a>	8.5%
<b>TOTAL</b>	<b>100%</b>

Trefis Analysts estimate a price of \$30.89 for Revlon's stock, about 13% lower than the current market price. \* Color Cosmetics constitute 52% of the Trefis price estimate for Revlon's stock. \* Hair... [More](#)

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We have reduced our price estimate from \$24.58 to [\\$24.16 for Revlon](#) to reflect the recent Q3 earnings.

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Notes:

1. [Revlon's CEO Discusses Q3 2013 Results – Earnings Call Transcript](#), Seeking Alpha, October 2013 [↔]
2. [Nail polish and BB creams star performers for US color cosmetic market](#), cosmeticsdesign.com, August 2013 [↔]
3. [\(\(Revlon's CEO Discusses Q4 2012 Results – Earnings Call Transcript](#), Seeking Alpha, February 2013 [↔]
4. [BB CREAM BY GARNIER](#), L'Oréal Newsroom, November 2011 [↔]

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