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LB.N - L Brands Inc Virtual Investor Meeting for Bath & Body Works

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## PRESENTATION

**Amie Preston** *- L Brands, Inc. - Chief IR Officer*

Good morning, everyone, and welcome to 2021 Bath & Body Works 2021 Investor Day. I'm Amie Preston, SVP of Investor Relations, and I'd like to thank you all for joining us today.

Before we get started, I need to remind you that any forward-looking statements today are subject to the safe harbor statement found in our SEC filings. After our presentation this morning, we will conduct a question and the answer session. We will not be commenting on guidance for the back half of the year today as our earnings call is coming up in a few weeks. Thanks. And with that, it's my pleasure to turn it over to Andrew Meslow, CEO of L Brands and Bath & Body Works.

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**Andrew M. Meslow** *- L Brands, Inc. - CEO & Director*

Good morning, everyone, and thank you for joining us today. In May, we announced our plans to separate Bath & Body Works and Victoria's Secret into 2 independent publicly traded companies. Today is an important milestone achievement for both companies as we share more information on our go-forward plans as stand-alone companies. I am excited and proud to be speaking to you this morning with some of my colleagues about the Bath & Body Works business.

Let's look at our agenda. This is a material that we will be covering today. Before providing more information regarding the business and our future opportunities, let's take a moment to introduce our speakers this morning. I will lead us off with a discussion about who Bath & Body Works is and why we believe we are so well positioned to continue to deliver industry-leading growth and profitability as we begin our journey as a stand-alone public company.

I'll then turn it over to our Brand President, Julie Rosen, who will discuss our products and our product strategy. Chief Operating Officer, Chris Cramer, will then detail how we drive value through our supply chain and how our investments in digital, in-store and international serve as major growth drivers for the business. CFO, Wendy Arlin, will then conclude our presentation with a discussion of our financials and our long-term growth opportunities. Following Wendy's presentation, there will be a Q&A session. With that, let's dive right in.

Our next slide shows our purpose, and I think it's always important to remind ourselves of our purpose. While I will not read all of this aloud to you, I will say that in Bath & Body Works, we are empowered by our mission to make the world a brighter happier place through the power of fragrance. We are passionate about creating and sharing the world's best fragrances across all of our different product categories. Our whole team is also committed to creating a diverse, equitable and inclusive culture that is focused on delivering outstanding customer and associate experiences. These are the ideas that Bath & Body Works was founded on, and they are at the heart of everything that we do.

This next slide, we have tried to summarize the key ideas that we believe make Bath & Body Works a compelling investment opportunity. In short, Bath & Body Works is a leading bath, body and home fragrance brand and retailer with leadership positions across all of our key product categories. We have a highly loyal, active and growing customer base. We have a unique blended business model that emphasizes both newness and use up replenishment and it performs well across all of our channels and geographies. We have a track record of consistent, strong financial performance, and we have an experienced leadership team.

While the business has delivered exceptional recent results, Bath & Body Works, we believe, is poised to capitalize on the substantial growth opportunities that still lie ahead, and we are well positioned to deliver continued strong profitability go forward.

I know I speak on behalf of the entire team when I say that I'm excited to spend this morning digging into our investment thesis and the compelling opportunity that Bath & Body Works presents.

So let's take a look at Bath & Body Works at a glance. As an overview of our company, despite the significant challenges that the pandemic has posed to all businesses, we were able to deliver record results in 2020, ranking as the #1 specialty home fragrance and fragrance body care retailer across all of America with $6.4 billion in net sales. Over the last 5 years, we have delivered a compound average revenue growth rate of 11% and an average operating income rate of over 24%.

We also delivered strong performance across all channels with a diversified footprint across mall stores, off-mall stores and digital. Specific to digital, we continue to see tremendous growth and momentum out of our Bath & Body Works online business with now over 30% of our sales last year coming through our digital platforms.

Let's take a look at our team. This slide highlights our senior leaders and shows that they all bring deep and broad experience and expertise, including significant leadership experience at other major retailers and world-class organizations. Each of us is focused on leveraging our unique abilities and experiences to create value for all BBW stakeholders. As mentioned earlier, today, you will hear from Julie, Chris, Wendy and myself.

As shown on the slide, Chris and I have each been with Bath & Body Works for over 16 years, and we have had experiences that have taken us through multiple functional leadership roles in addition to broad general management opportunities. Wendy has been with L Brands for 16 years, leading corporate finance functions and was recently announced as the new Chief Financial Officer for Bath & Body Works.

Julie is one of our newer leaders, having joined us in the back half of 2020, and she brings a wealth of merchandising, product development and creative experiences from her time leading those functions at Gap and at Ascena. As shown, the remainder of the team also has a very strong mix of individuals who have been with L Brands for many years as well as a healthy dose of those who are newer to the company and bring new and fresh perspectives and experiences.

Let's shift now to some more specifics of our Bath & Body Works business. As you hopefully know, we operate across 3 main product categories. For fiscal 2020, our home fragrance business accounted for roughly 40% of sales. Our body care and fragrance business represented approximately 35% of sales and soaps and sanitizers accounted for about 20% of sales, up from our history of more low to mid-teens. The other roughly 5% of the business comes from accessories and gift sets.

While we do expect some normalization in category mix as we emerge from the pandemic time frame, especially in soaps and sanitizers. We continue to see meaningful opportunities for further long-term growth across all of these categories.

Let's turn now to our channels. As mentioned earlier, we delivered strong performance across each of our 4 main channels: our mall stores, our digital business, our off-mall stores and our international franchises. Mall, digital and off-mall each accounted for roughly 1/3 of our 2020 sales. As a reminder, our digital channel is highly profitable and has shown approximately 99% of our in-mall and 100% of our off-mall stores are cash flow positive.

Chris will describe in more detail later in the presentation our future plans in terms of continuing to manage our exposure in malls while also continuing to expand the number of our very successful off-mall locations.

We also believe that we have multiple opportunities available for substantial international growth in both existing and new geographies as all of our franchise partners are pleased with our performance around the world and are excited to help us continue to expand our footprint.

Let's turn to our position in the markets. As shown, we are a market leader across our key product categories, and in home fragrance and soaps and sanitizers, we have a 22% and 21% market share, respectively. Importantly, we continue to believe that we are in the right markets as each one has experienced strong historical growth and is projected for further future growth. While we have strong market share already, given the massive addressable markets across all of our categories, there remains significant room for further growth in our existing product lines.

We also see potential opportunities for expansion in large and growing markets that Bath & Body Works doesn't compete in today, including in the clean, natural organic space within our existing categories as well as potential near in white space categories such as skin care, hair care and other home categories.

The next slide further underscores our market leadership. Within fragrance, body care and home fragrance, we have the #1 brand across multiple categories. As shown, these include fine fragrance mist, body lotion, body cream, candles, electric diffusers, liquid handsoap and hand sanitizers. Important to note that we also have numerous other key items that hold top 3 positions in their respective categories, and we see the opportunity for further growth in each of these items as well as for further expansion to more key items over time.

This next slide shows our uniquely differentiated position versus our competition. Our position at the crossroads of best-in-class vertical retailers and consumer product companies differentiates Bath & Body Works from our peers and provides a significant competitive advantage. Importantly, we control all of our channels of distribution, ensuring that the quality and consistency of the interaction between our product and the customer is maintained at a very high level.

As a vertical business, we develop and create all of our own products, ensuring that our quality is outstanding and that our items are special enough to be given as gifts but are also affordable enough to be used every day. That everyday use drives frequent trips for replenishment of our used-up products generally every 4 to 8 weeks. We are also committed to maximizing our flow of newness in fragrances and innovation in product forms to also help drive frequency of trips.

We built continuity and capacity into our supply chain and match customer demands for our products, giving us the ability to command higher prices and margin rates while selling less at clearance prices. We balance our discipline in expense and inventory management with a focus on innovation and an ability to rapidly respond to customer trends.

With that, let's take a few minutes and look at our customer in more detail. Bath & Body Works serves more than 55 million customers each year with broad brand recognition among adult women and men. After a brief decline in customership in the first half of 2020 due to the closure of all of our stores for approximately 90 days, we have seen strong customer growth across all channels and are now back to growing on a trailing 12-month basis. We are proud to be the #1 consumer product brand for Gen Z. And as shown, we have very healthy customer engagement metrics that have continued to improve over time.

To that point, on the next slide, customer longevity is critically important to driving value. We create emotional connections with our customers that drive them to return to our website and our stores multiple times per year and purchase multiple products on each trip. As shown, we have grown customer retention rates nearly every year for the last 5 years, with the exception in 2020 driven by the previously mentioned store closures. This level of retention rate outpaces industry benchmarks.

Next slide shows the customer spend has also continued to increase over time. We have successfully done this by implementing initiatives and product collections that encourage customers to shop across categories and across channels. As shown, 60% of our customers shop across multiple of our key categories. And when they do so, they spend 3.5x more than the customer who only purchases a single category. Dual channel customers spend nearly 140% more than an average customer.

By continuing to elevate our online experience, while keeping our in-store experience memorable and fresh, we have more than doubled the percent of customers who shop across multiple channels over the last 4 years. That said, our dual channel customers still only represent about 18% of our total customer base, so we have plenty more room for growth here, especially as we continue to invest in omnichannel capabilities over the next few years.

The next slide speaks about our customer loyalty program. Another way that we have grown customer spend is through our My Bath & Body Works customer loyalty app. Across the 4 markets where we have been piloting this program, we have seen approximately 30% more spend per loyalty member versus non-loyalty members. We are further expanding the loyalty program into 2 additional markets this fall with an upgraded platform and assuming continued success, we are planning for a full U.S. launch for 2022.

Now it's important to note that our product offering and assortment strategy is key to driving continued customer loyalty and increases in customer spend. I am pleased, therefore, to hand over the presentation at this time to Julie Rosen, who will take us through that portion of our agenda. Julie, over to you.

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**Julie B. Rosen** - *Bath & Body Works, LLC - President*

Thank you, Andrew. Good morning, everyone. I'm Julie Rosen. I'm the President of Bath & Body Works, and I'm thrilled to be here with you today to talk about our brand and our product.

We are going to start with our product pillars. At Bath & Body Works, our product pillars align with our values and drive every decision that we make. Our first pillar is we are fragrance first. This pillar encompasses everything we do here at BBW and embodies our mission to make the world a brighter, happier place through the power of fragrance. At BBW, we believe that fragrance is transportive. It's mood-enhancing. It makes us happy, empowered and it makes us relaxed. Smell is actually the sense that is most connected to our memories.

Moving to our next pillar. BBW is an inclusive brand, whose more than 55 million customers reflect America's diverse demographics, and we are very proud of that. We're focusing on delivering products that honor and celebrate the diversity and the values of our brand. Our associate inclusion resource groups play a role in realizing this objective by reviewing product launches with us and even proposing launches that they think that we should do. We use these groups to ensure that our products celebrate our country and our customers' diversity.

As a leader in the beauty and home fragrance markets, we look to mass to size the price and prestige to inspire our execution. This results in our products having a high degree of giftability and customers are proud to use and gift Bath & Body Works products. We travel the world regularly to seek global ideas to apply to our brand.

Our portfolio comprises market-leading forms and fragrances. As you heard Andrew say before, 7 of our forms occupy the #1 market share. 6 of our fragrances alone do almost $100 million, which is collectively about $1 billion in sales. In addition to our year-round offerings, we also offer seasonal fragrances that are off top volume drivers and our customers come back excited season after season to look for their favorites.

Our products are designed to be used daily and replenished frequently. So we are laser-focused on consistent quality across all of our products to drive repeated use. Repeat drives trips. And when they visit us at our stores, our associates are very effective at conversion. We leverage promotions to inspire customers to try our products and build loyalty.

We know fashion and newness leads the way and leveraging our unique position at the crossroads of consumer products and fashion, we use this fashion model for personal care and for home. This unique model encourages newness across our products, which in turn drives trips and repeat customers. Our fashion trend inspired products build brand relevance and differentiate us from our competition. To ensure that we're always on the cutting edge, we utilized informed merchants and designers and we partner with a dedicated team focused solely on trend, fashion and emerging concepts.

Another critical pillar for us is the use of storytelling, and I think we do this better than any other brand out there. We tell stories through fragrance, packaging and all customer touch points. in our stores and online, we highlight themes that excite customers and allow them to reminisce and to even be transported. Our new product introductions and in-store experiences will continue to focus on bringing happiness and fun to our customers. Given giftability is a key component of our strategy. Seasons and holidays are a main pillar of our business. Our customers embrace the seasons and the holidays, and they love celebrating with friends and family, and we do too. We strive to foster 365 as a key initiative to encourage customers to celebrate daily. Outside of daily celebrations, we see particular strength in our business during Christmas and Mother's Day.

And our last product pillar, which is incredibly important to all of us, is that we are focusing on being cleaner and greener. Sustainability and making an impact in the communities in which we work and live continues to be a huge focus for our teams. This extends to our products, where we're focused on developing clean and eco-friendly products for our customers and the planet.

Over the last few years, we've introduced recycled plastics across categories to migrate our entire portfolio of plastic. And we are going to continue with the execution of our Good For You, Good for the Earth initiative. We have a unique operating platform here. It enables responsiveness to the ever-changing desires of our customers. We have 4 key components: learn, launch, read and react. We're focused on learning from our customers' commerce patterns and from our stores. We then take these insights and make actionable informed decisions to launch new products.

This includes a regular flow of new products as well as a rigorous testing agenda. We're constantly looking to analyze our business across all of our channels. We continually read our daily sales and store reports to see how our products are performing and how we can drive improvements across the business.

This really leads to our last and most important component, which is reacting. Over the years, we've taken proactive decisions following our analysis of the business. This includes the creation of beauty park, the utilization of our promotional calendar and our maniacal focus on rapid response and replenishment.

Our product strategy is guided by our product pillars and our operating principles. To start, we keep our top selling forms in growth mode with a constant flow of new launches. And you can see that depicted here with our famous 3-Wick Candle. We have a core assortment that we sell year round that you can see on the top, which our most loyal customers love. And then we constantly launch new products throughout the year, including around the holidays and during the seasons. And this ensures that we really meet the desires of all of our customers and build loyalty.

We also continue to upgrade the formulas of our products. And by doing so, we meet our customers' changing desires and priorities for skin and beauty evolve, while making greener more efficient products this slide shows our famous shea body butter cream from 2009 to the planned launch in 2022 of our ultimate hydration and clean body launch. During this span between 2009 and 2022, not only have we continued to optimize the formula of our best-selling body butter, but we've also improved the product's packaging and expanded the variety of creams that we have in our stores.

Building on that packaging theme that I just mentioned, you can see here the evolution of the packaging of our famous fragrance Japanese cherry blossom. By constantly evolving our packaging and keeping it fresh, we continue to satisfy our existing customers with the product that they've come to love, and hopefully, we are attracting new customers with new cutting-edge designs. We believe this is a key component that keeps our product constantly retaining their #1 market share positions.

And finally, we are focused on gaining market share in new and emerging categories and forms across our products. For an example of this in action, you can see at the top of the slide, our spray sanitizer. Right after the onset of the COVID-19 pandemic, we launched our first line of spray sanitizers. Our speed to market is -- for this product ensured that we became the brand of choice for many customers. Had we been -- to bring this form to -- from concept to customer, we might not have been the brand of choice.

You can see in the next line that we're launching bar soaps in the fall of '21, and then we're focused on developing green and clean products that we tested in spring of '21, and you will see in spring of '22. So there's a lot we're doing in our product to keep it relevant and keep it fresh. And with that, I'm going to hand it over to Chris.

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**Chris Cramer** - *Bath & Body Works, LLC - COO*

All right. Thanks, Julie, and good morning, everyone. I'm Chris Cramer, Chief Operating Officer here at Bath & Body Works. And I'm excited to tell you more about our supply chain and then take a deeper dive into our 3 channels of business.

Bath & Body Works is supported by an agile supply chain. We place quality and innovation at the core of our sourcing strategy, investing in strong technical R&D and innovation capabilities to drive the robust product development that Julie just discussed. We also regularly invest with our partners in production capacity and capabilities to support the business growth and product line enhancements that you just heard about. We leverage internal product design and development teams, fragrance R&D partners, external and seasoned manufacturing partners and a mix of internal and external capability for logistics and fulfillment. Taken together, this strategy helps ensure we can quickly respond to shifting consumer trends while being disciplined in expense and inventory management. We partner with suppliers that share our focus on sustainability and also being financially and socially responsible.

Now digging a little deeper into the supply chain and underscoring our industry-leading speed in product development. We launched over 6,000 new SKUs each year across channels, including more than 250 new fragrances annually, supporting the flow of newness throughout the year that our customer desires. We also have significant chase capabilities as roughly half of our production occurs via the speed replenishment model with our fastest reorder times in the 3- to 5-week range. This level of speed is supported by our long-term supplier relationships as we have 50 strategic vendor relationships, many of which span more than 15 years of working together in partnership.

Our long-standing vertically integrated beauty park manufacturing vendors also play a significant role in supporting our supply chain as roughly 60% of our finished goods and 30% of our components are produced at that critical location. In total, over 80% of our products are sourced in the United States, and we have multi-sourced product and raw materials, ensuring that we can ramp production quickly as needed.

In addition to continued investment in our product supply chain, we also invest consistently in our logistics network to support our stores and digital business. We currently have 3 company-owned distribution centers to support our U.S. and international stores. We also now have 5 third-party, permanent direct channel fulfillment centers in the United States, having opened our fifth here in June. And we also plan to have 5 to 6 third-party pop-up facilities to aid in these -- with these fulfillment center hubs in supporting our needs at peak.

As another sign of our continued investment in this space, we're building a new 1 million square foot fulfillment center in the Columbus area to support our direct business. We expect this fulfillment center to drive initial benefits in fall 2022 and to be at full capacity by fall 2023.

Now let's turn to a deeper look at our digital business. Digital is at the forefront of our company growth strategy. Our digital channel is highly profitable, and we have a track record of driving consistent growth. We have grown our direct sales via digital from $450 million in 2016 to $2 billion in 2020. The direct sales penetration has more than doubled in the same period, rising from 12% in 2016 to over 30% last year. Like most retailers, we saw a significant uptick in digital sales during the pandemic. Direct sales via digital more than doubled last year and we saw a more than 70% increase in digital customers. Customer engagement with our digital initiatives gives us confidence that many of our new digital customers will continue to shop with us online into the future.

To ensure that, we continue to enhance the experience with new or upgraded capabilities like our continued rollout of Buy Online Pick Up in Store, which is now currently offered in over 500 store locations; our revamped buy online return in store initiative. We've also launched Shop In App capability for our loyalty members, and we have auto replenishment capability currently in development for future launch.

Supporting these investments was an upgrade in our order management system and, as alluded to, continued investments in our app. And as digital demand continues to increase, we will need to expand our fulfillment capacity. As noted, we're continuing to invest significantly in that space.

We're leveraging our digital strengths and capabilities to drive customer engagement across multiple digital platforms. Our e-mail file has now reached over 30 million e-mail addresses. We also have a robust digital marketing presence across multiple channels, including social media, display advertising and search properties. Last year, we had over 5.5 digital marketing impressions. We will continue to refine our approach in channels that we engage with to stay relevant with our customers and keep Bath & Body Works top of mind as our customer engages with our brand and explores and expands on their shopping experience.

We now serve more than 15 million digital customers for the brand and are committed to continually improving and adding to our digital and omnichannel experiences. Key focus areas as we move forward will continue to be bringing more graphics, video and content online and further improving the ease of navigation and engagement with our website. We use and will continue to use real-time customer feedback to improve the online experience. As mentioned earlier, we're also expanding fulfillment options to serve our customer.

As an example, we expect to ultimately provide Buy Online Pick Up In Store capability in approximately 700 to 800 of our stores. We're also continuing to build new international dot-com sites on top of the more than 20 that we offer today to reach our international customers in as many ways as we possibly can.

Now let's turn a bit to our real estate store portfolio. At the heart of our brand and business is the store experience. It has always been the core of the business, and we believe the store is the best experience of the brand, driven by our passionate sales force, the ability to try our products in store and the nostalgia and emotion we create through seasonal storytelling and product newness throughout the year.

As Andrew referenced earlier, we have a diversified physical store portfolio across all mall types. Of our 1,752 stores, 45% are in off-mall locations, 10% are in A malls and 17% are in B malls. Our continued off-mall expansion limits our exposure to vulnerable mall locations, and our leases overall provide protection on occupancy and co-tenancy provisions.

Perhaps most critically, 99% of our stores are cash flow positive, underscoring our strong physical store economics regardless of venue. We proactively manage our real estate to enhance profitability. Over the last 5 years, we've opened 188 new stores primarily in either top mall or off-mall venues while closing 124 stores primarily in lower tier venues. This management of the fleet, along with the strength of our product offering and in-store experience, has allowed us to grow our sales per selling square foot significantly over the last 5 years from $831 per selling square foot to $916 per selling square foot despite having stores closed for a significant portion of the second quarter last year. And we've also done this while increasing our digital sales by $1.5 billion, as you saw over the same time period.

We expect the mix of locations of our stores to continue to shift with off-mall penetration approaching 50%, but our sales and profit remained strong across venues. By year-end, we expect our mix of off-mall stores to rise to 47%, coming primarily from a reduction in D malls and up roughly 8 points as a percent of stores since 2016 with favorable economics from the shift, given the stronger economics in off-mall stores versus those of D mall stores.

We have lower remaining lease terms in C and D malls, which is helping to facilitate this transition as well. As our mix of real estate venue has shifted profitability has consistently remained strong. With our 4-wall return on sales over 30% in all venues, the exception being high rent A malls, where our return on sales is still a very strong 25%.

Over the last several years, we've also had a design evolution for our stores as we've implemented the White Barn Remodel program. About half of our stores are currently in this design type. Results have been strong. Stores remodeled to the White Barn model have seen an average increase in sales and traffic of more than 15% in year 1 following the remodel. We expect to remodel roughly half of our remaining stores in this design over the next 2 to 4 years.

With our belief that stores are the core of our business and the strong performance we've seen across physical stores over the last several years, we will continue to support a strong physical fleet of stores with the following plans and expectations. We expect to see low single-digit annual increases in North American square footage with off-mall penetration increasing and driving the square footage increase due to the nature of being able to acquire more square footage in off-mall locations more readily.

We plan to open new stores in emerging non-mall venues and close stores in nonviable declining malls similar to the approach that we've seen over the last several years. We plan to remodel 100 to 150 stores per year in the new White Barn format. And we expect to add capabilities to our store experience like expanding our Buy Online Pickup In Store capability as we previously discussed and also testing new capabilities like ship from store.

Finally, before I pass the presentation over to Wendy, I'll cover our international business. Internationally, Bath & Body Works operates in a partnership-based model with a small number of strong partners around the world. This partnership has been very productive, resulting in retail sales last year of over $450 million. Highlights of the partnership are -- partnerships are Bath & Body Works owns the assortment, pricing architecture, promotions, store designs and has real estate approval, were paid on a royalty basis. Our partners bring expertise in local real estate, people and practices, and we also have local associates on the ground to ensure standardized coaching and training as we open stores, get into markets and operate the business.

We've been a top-tier performer for our partners, and they are committed to incremental expansion around the world. We've been measured in our approach to international expansion but now have a broad international presence with stores in the Middle East, Asia, South America and Mexico and Australia. We ended 2020 with nearly 290 international store locations, and we operated in 35 countries. As I mentioned earlier, we have experienced teams that are helping to deliver this international experience to our customers, and this experienced team averages 16 years with the business and over 6,000 global associates.

While our international business leverages the product pipeline of our North American business, the portfolio is catered to taste in specific regions. Launch timing is different than in North America, and fragrance and collection emphasis will vary to meet our customers' tastes in specific regions. Our customer feedback also tells us that the international customer has a high value perception of the brand and its giftability both core equities and helping to support the business and drive it forward.

Like the North American business, the international business has seen a steady increase in sales over the last 10 years. Over this time period, international sales have risen from under $5 million at retail to over $450 million. At the same time, we've increased from 6 stores to roughly ending the year last year with 290.

Given our prior experience in the international business, we believe that this can drive significant growth for Bath & Body Works into the future. We expect to see store growth and digital expansion with highlights including 15-plus percent targeted store growth per year, high teens to low 20s retail revenue growth, and we also expect to expand into new markets, especially Europe, where we're lightly penetrated today. In short, we believe there is a strong opportunity and we are in a position to realize material international growth in the business.

And with that, I'll turn it over to Wendy.

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**Wendy Arlin** - *L Brands, Inc. - Senior VP of Finance & Controller*

Good morning, everyone. My name is Wendy Arlin, newly appointed Chief Financial Officer of Bath & Body Works. I'm very excited to be here. Today, I will be talking about 2 things: First, we'll spend a few minutes reviewing the historical financial performance of Bath & Body Works; secondly, we'll spend a few minutes looking at our go-forward growth opportunities for Bath & Body Works as a stand-alone company.

So as Andrew, Julie and Chris have all touched on this morning, Bath & Body Works has a very strong track record of performance. For 2020, we were very pleased to build off a solid 2019. We delivered sales of $6.4 billion; direct sales of $2 billion, which is notably growing as compared to only 2 years ago at $724 million. We grew operating income to over $1.8 billion, and we also grew comparable sales by 45%. Although 2020 did benefit from demand for soaps and sanitizers categories, I do think it's important to note that all of our categories contributed to our performance in 2020. All performed well and all contributed to our growth.

Additionally, I also think it's important to note that this has continued into 2021. We don't have 2021 on the page, but if you look at 2021 through Q1 on a trailing 12-month basis, we are now over $7 billion in top line sales. So very exciting and a very strong recent track record.

In terms of a longer track record, the next slide shows sales over the last 10 years. So I think the headline with this slide is in the title. Two words are key: consistent and growth. The consistency, you can see; and the growth, you can see this business has been fantastic in terms of growth and performance over the last 10 years.

In addition to sales, operating income is also extremely important. And so we've been able to grow operating income, along with the consistent sales growth over the last 10 years. And we've been able to do it profitably. So if you look at the pink line, that represents our operating income as a percentage of sales. We started this period in 2010 coming off the 2008 and 2009 time frame at 18.1%. And through the continued innovation and listening to our customer and improved assortment that you heard about earlier, we were able to expand our profit rate into the 20s for most of the last 10 years.

Now most recently, in 2020, we did report a rate of 28.5%. That is very high. As I share our growth algorithm for the future in the next couple of slides, you'll see, over the next 3 to 5 years, we do expect that rate to normalize back to the low to mid-20s. as we continue to invest in the business and also see things return to a more steady and historical level. So we do expect that to go back into the low to mid 20s. But we're very, very pleased with the growth, and we're very, very pleased with the profit rate of this business.

On the next slide, we talk about, well, how do we do that? One may look at the consistency and the growth and wonder what enables this business to be able to deliver that. And I would tell you that it's our speed that you heard about earlier. This business is very nimble and very quick and we're constantly reading the business and we're able to quickly react and correct and redeliver positive performance. So in the middle of the chart, you can see in Q4 of 2013, we had a quarter that didn't meet our expectations. That key holiday quarter was only a flat comp. But the business leaders were able to read, think about the assortment, think about what our customer wants, and we quickly corrected and continue to deliver growth.

So we've been delivering historical quarterly comps that are positive since 2014. We do have 2020 on this table. It's in the lower right-hand corner. I didn't put it on the graph. As you can see, in 2020, the numbers would skew our table a little bit, but we did -- we're very pleased with growth as we roll through 2020, including growth of 123% in Q2 of last year and 56% in Q3 of last year.

So the next slide translates this great performance into what we see as great opportunity. So the top part of the slide are summaries of the historical revenue growth and EBIT margin from the pages we just reviewed. And what we've done is we've compared our performance to a best-in-class basket of branded peers and a beauty peer basket. And you can see in both revenue growth and EBIT margin, we are outperforming these companies. But when you compare our historical L Brands multiples, to these same companies, you can see that it appears that there's opportunity for expansion, and we're very, very excited about that.

We believe that as we continue to deliver positive results in this business. We would like to see at the bottom of this chart continue to increase in terms of our enterprise value to EBITDA multiple. So very, very exciting opportunity to the management team.

In terms of looking forward on the next slide, we know to deliver the opportunity that we just saw on the previous slide, we need to continue to execute and we need to continue to grow this business. So as we think about where the growth is going to come from, we are focused on 4 key areas. Number one is we do believe that we can grow our existing categories. We are in a large total addressable market that's growing. And we believe we are well positioned to capitalize on that growing market, and we will continue to innovate. As you heard earlier, we are always focused on innovation. We're always thinking about new forms, new fragrances, additional products, and we do think that there is growth coming from our existing categories.

Secondly, as we do believe that there's a lot of white space out there where we can grow into new or adjacent categories, areas that the Bath & Body Works customer would love to see. Things that we're looking at include hair care, skin care, wellness, natural organics, et cetera. We think that those are areas with opportunity to meaningfully drive our future results.

Third, we are focused on the digital channel. You saw the recent results in that channel. We're pleased with the growth. In order to enable this growth, this is an area of future investment for us. We do know that to support the growth, we are going to have to continue to invest in capabilities to provide an excellent customer experience, and we are committed to doing so.

And then lastly, we do see meaningful opportunity for growth in the international business. We have a partner-run, franchise-based business right now, and it's -- we are in about 300 stores throughout the world outside of North America. And as such, we think that there's opportunity for additional stores. And whether it's in existing markets or new markets, we see that as a meaningful growth opportunity.

So on the next slide, we've translated that into a view of our path to $10 billion. So over the next 3 to 5 years, we are thinking about how can we grow this business to be a $10 billion business. And as we think about that, we see it being a balanced growth strategy. So fragrant body care and home fragrance, our 2 biggest categories, are important. But as you heard from earlier, we think that there's opportunity for packaging, formula innovation, fragrances, growth in adjacent forms. So both those categories, we see lots of areas where we can introduce newness to drive growth. Soaps and sanitizers, just given where we are in 2020, we don't see it as contributing as much as fragrant body care and home fragrance. That being said, we do see much opportunity for innovation and new forms that can drive growth. And then lastly, as I mentioned, we see some very key new categories that can help drive this business forward to $10 billion.

On the next slide, we looked at the same goal in terms of where our -- in terms of the channels and what the levels -- levers are by channel. We do expect growth out of our North American stores as you heard about earlier, we'll continue to roll out the White Barn format. Right now, it's only in about 50% of our fleet. We are planning a modest increase in overall selling square footage. We are moving more of our real estate mix into off-mall locations, resulting in that modest increase. And then lastly, we are focused on omnichannel and helping deliver growth through that experience with our customers.

Digital will continue to provide growth for this business. We are focused on expanding our experiences for our customers, increasing speed and convenience for our customers. And we're also looking at new marketing channels to continue to drive the digital business.

And then lastly, as I mentioned, international, although it's a small piece of the business today, that it represents a meaningful contributor to growth in the future. So whether that's in existing markets or new markets, we see that as contributing to our overall growth.

So on the next slide, we've summarized our financial targets. These are on a 3- to 5-year view. So we're looking at multiple years. As we look out multiple years, we see low to mid-single-digit comp growth. And we also, as I mentioned earlier, see low single-digit square footage growth. So that will contribute to the store's growth that was on the previous slide. As I mentioned, we also see meaningful opportunities in the direct channel. We see an opportunity to grow high single digits to mid-teens. And then lastly, international, we can see growth in the high teens to low 20s.

So adding that up, as we look at our multiple-year journey, we see a total sales growth model of mid- to high single digits, which will translate to operating income growth in the mid- to high single digits. In terms of rate, as I mentioned earlier, we do believe that the long-term view of this business will normalize to the low to mid-20s.

So one thing you don't see on this slide is earnings per share growth. I would share that we do expect our EPS growth to be higher than our operating income growth as we will benefit from accretion with respect to future share repurchases. So we do see that exceeding operating income growth.

On the next slide, we have a summary of our current views of our capital structure. So as we have proceeded with the spin, we've worked with advisers and our Board of Directors to develop a disciplined financial strategy and a view of our go-forward capital structure. We are committed to delivering value to our shareholders. That's important to both the management team and our Board of Directors. And through this work, we've identified a target leverage ratio. So right now, we are shooting for adjusted debt-to-EBITDAR leverage ratio in the mid-2x range. We have also, as part of that, committed to reducing debt by approximately $500 million. When we do that, that will put us very close to that mid-2x target range I just mentioned.

In terms of the dividend, we are committed to continuing our current annual dividend, which is at $0.60 per share. And then lastly, we recently announced last week that our Board of Directors has authorized a $1.5 billion share repurchase authorization. We did utilize some of that authorization last week in the offering that was published last week. So we have used a meaningful part of that, but we are committed to continuing to return value through execution of that authorization. And then lastly, we have updated our 2021 CapEx forecast. We are now looking at capital expenditures totaling $250 to $300 million.

So thank you. And with that, I'm going to turn it over to Andrew, who is going to conclude our prepared remarks.

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Thank you, Wendy. Let me close by returning to our investment opportunity slide. We hope after hearing from us today that you share our confidence that Bath & Body Works is poised to continue its record as one of the world's leading specialty retailers. With industry-leading sales and operating income growth, a proven ability to respond quickly to evolving customer tastes with our high-speed sourcing and logistics model, high brand awareness and a loyal and growing customer base and healthy growth opportunities in both stores and digital, domestic and international, Bath & Body Works is well positioned for the future. And as Wendy shared, with our track record, we believe there is also opportunity for valuation growth.

We are so excited to begin this new journey as an independent public company with our loyal shareholders and customers backing our success. With that, we'll now be happy to take your questions. Operator, I now turn it over to you. Thank you very much.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Jeff, I think we're ready for our first question.

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**Operator**

(Operator Instructions) Our first question comes from Simeon Siegel.

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**Simeon Avram Siegel** - *Nomura Securities Co. Ltd., Research Division - Former Executive Director & Senior Analyst*

Congrats on that's very exciting. Andrew, sorry if I missed it. Did you say what percent of sales was driven by new customers last year? And then the customer longevity table was really interesting and helpful. Can you speak to the why that drives that customer maturity curve? Is it growth over the years, increasing visits? Is it shift to higher-priced goods within the mix? Is it just as simple as people are using product more and that triggers faster replenishment? Any color there? And then just presumably no reason the new customers you earned last year should follow a multiyear trajectory, right?

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Great. Thank you, Simeon, for your questions. So the first part of your question, we did not share what portion of our growth was driven by new customers. And as a reminder, at the end of 2020, we actually had seen fewer customers in that year than we had in the prior year, again, really driven by that 90-plus day closure time frame in the first half of 2020. So when we think about what drove growth in 2020 from a sales standpoint, it was really around the customer engagement metrics. And so spend per customer, up pretty significantly year-over-year.

I'm going to go to the last part of your question, though, next in terms of the new customers that we did see, especially through the back half of 2020 and now through the first half of 2021 as stores are now lapping their closure time frame and are reopened and performing very strongly. It's early yet to read performance of new customers. But everything that we've seen so far is that they are performing at least on par with how our new customers have performed historically. So we're not seeing any difference in terms of the productivity or the behavior, if you will, of those new customers so far, caveat being it's a relatively short period of time.

Then I think the other part of your question was around that customer maturity profile that we showed, and your question was around what do we see as the real drivers of that? And what I would emphasize is that, that is really tied to the other aspects that I spoke about in terms of meaningful improvement over the last few years around cross-category engagement of our customers. And again, when we're able to get a customer to purchase not only, for example, in body care, if that's where they originally made purchases, but then moving on to home fragrance or soaps and sanitizers, not only do they become more valuable on an annual basis in terms of their spend as we showed, but it also drives their longer-term engagement with the business as well. And that is also similarly true if we're talking about things from a cross-channel standpoint.

And again, our hope is that we will be able to continue to drive meaningful improvements in both of those cross-category and cross-channel engagement metrics go forward. Hopefully, that helps. Thanks, Simeon.

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**Operator**

Our next question comes from Lorraine Hutchinson from Bank of America.

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**Lorraine Corrine Maikis Hutchinson** - *BofA Securities, Research Division - MD in Equity Research and Consumer Sector Head in Equity Research*

My first question is on the capital structure. Can you talk about the free cash flow conversion of the BBW business? It seems like the buyback could be a meaningful part of the story as the business grows. So I would love your comments on that.

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Thanks, Lorraine. Wendy, you want to take that?

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**Wendy Arlin** - *L Brands, Inc. - Senior VP of Finance & Controller*

Absolutely. So I would say as we look forward in terms of the use of our free cash flow, of course, as we talked about, we'll continue to invest. So we just updated our CapEx to be $250 million to $350 million. I would say, go forward, as we think about investing, you heard about our White Barn remodels, that will be a continued area of investment for us. We get great returns on those investments. We'll continue to invest in the digital channel. We want to enable the capabilities that Chris talked about. So that's important to us. And then as we go forward, we will invest in technology, both to keep the business fresh and current, but also to continue to separate the Victoria's Secret in the Bath & Body Works business. So as we think about CapEx in the future, we see that being probably in the $250 million to $350 million range go forward. I know that's a big range, but there's a lot of variables to that equation.

And then in terms of the rest of the cash, we're committed to a balanced approach. So we think about dividends, we think about share repurchase. As we work with our Board of Directors over the next several months, we'll continue to think about that. As a reminder, the fourth quarter for Bath

& Body Works is extremely important. It is our biggest quarter in terms of profit and capital -- and cash flow generation. And so as we get through the fourth quarter, we will reevaluate where we are in terms of our balanced approach with returning capital -- returning to shareholders, and we'll continue to relook at that after we see our performance in the fourth quarter. I hope that helps.

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**Lorraine Corrine Maikis Hutchinson** - *BofA Securities, Research Division - MD in Equity Research and Consumer Sector Head in Equity Research*

And then -- and secondly, on the loyalty program, can you discuss the cost associated with that, both for the rollout and the rewards and then what the expected sales lift might look like in '22 and beyond?

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Thanks, Lorraine. Chris, do you want to take that?

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**Chris Cramer** - *Bath & Body Works, LLC - COO*

Sure. In terms of the loyalty program, and I appreciate you asking that, Lorraine, we're very excited about the opportunity with the program. Some of the investments actually behind us as we've done some work replatforming the program to a new kind of foundational platform here in our this year. Go forward, the costs, we don't expect to be material from things like an expense standpoint in terms of perhaps some store training, associate training. The rewards themselves and the level of reward, that's part of the program that, frankly, we're still testing, still learning with.

We've had the benefit of significant pilot experience, which is helping to inform us as we look forward. But we will continue to try to manage the reward profile. We'll look at things like tiering. We'll look at things like additional options over time within the program, but we will keep an eye on margin rate as we roll out that loyalty program.

In terms of lift, what I would say around the loyalty program is we have seen, in the pilot, a significant lift in spend per customer for those customers that are in the program. And that lift is making us very optimistic about the potential opportunities of the program. And the increased customer engagement we see as that lift is also accompanied by incremental customer retention over time, which also, as you saw, is a very attractive situation for us as our customers build their relationship with us over time. Thank you. Hopefully, that helps.

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**Operator**

Our next question comes from Ike Boruchow.

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**Irwin Bernard Boruchow** - *Wells Fargo Securities, LLC, Research Division - MD and Senior Specialty Retail Analyst*

This is very, very helpful. Just a couple of clarification questions on the capital structure. So the mid-2s adjusted debt to EBITDA, I don't think that's a net debt to EBITDA. I guess, Wendy, could you talk about the expected -- how much cash you expect to have on the balance sheet for BBW at the end of this year? Maybe could you also say what the minimum cash balance that you would expect you would need to run the business over the next several years? And then I'm sorry, the last one is, could you possibly give us a rent number, either for last year or your expectation for this year for Bath & Body Works?

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**Wendy Arlin** - *L Brands, Inc. - Senior VP of Finance & Controller*

Okay. So let's start with cash. So I would say, as you know, this business is seasonal. So the way we think about minimum cash or where we want to end the year is we want to make sure that we have enough cash at the end of the year to cover our working capital build that happens in the second quarter and third quarter. So we buy inventory in Q2 and Q3 in advance of our very important holiday season. So we intend to have minimum cash available to support that going into that time frame.

For the last several years, we've generally targeted $900 million to $1 billion of cash for the combined Bath & Body Works and Victoria's Secret businesses. We expect the number, obviously, to be smaller with just Bath & Body Works. But however, given where we are, I mean, this business is obviously going through a tremendous amount of change, including a spin-off of a major part of our business, given that there's still a ton of uncertainty with respect to the macro environment, COVID is still out there, we do plan to be more conservative with our cash position. And so as we watch our fall performance, we'll continue to evaluate exactly where that minimum cash is at the end of the year.

And we'll also continue to evaluate, as I've talked about a little bit earlier, how to return value to shareholders and what that means in terms of dividend, share repurchase, et cetera. So I think that is the cash question.

In terms of rent, I actually don't have that number in front of me or have it committed to memory, but I would say that we expect our rent levels to be generally consistent with what they've been on our P&L. We see modest inflation. And then as we disclosed, we have low single-digit square footage increase as planned in terms of square footage. So that's what we would expect to go forward.

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**Operator**

Our next question comes from Kimberly Greenberger from Morgan Stanley.

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**Alexandra Ann Straton** - *Morgan Stanley, Research Division - Research Associate*

This is Alex Straton on for Kimberly Greenberger. A quick question is on 30% store return on sales, I think it was 25% in high-rent A malls. This is a super high number and very impressive. I just wanted to understand how this number was calculated?

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Thanks, Alex. Andrew, do you want to take that one?

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Yes. So Amie, maybe you can pull up the slide that I think Alex is referencing, Slide 47. I'm sorry, I'm having a hard time seeing it. But -- so answering your question, just as on how do we calculate 4-wall profit in general? Just want to make sure we're answering the right question?

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**Alexandra Ann Straton** - *Morgan Stanley, Research Division - Research Associate*

Yes. It is on Slide 47. You guys provided these return on sales metrics for the stores by mall type. I'm just trying to understand how that -- those values were calculated?

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Yes. That's a pretty traditional 4-wall view. What does that mean? It means that it's not burdened by other home office and corporate overhead expenses. So the average there ends up being in the low 30s relative to our total reported operating income rate for last year in the mid-28s. So the difference between those 4-wall numbers and our total would be those unallocated home office and corporate overhead pieces that we don't take down to the store level. Wendy, is there anything else you would want to add to that explanation?

**Wendy Arlin** - *L Brands, Inc. - Senior VP of Finance & Controller*

No, I think you covered it. That is the difference between that and the company profitability, company-wide.

**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

So does that get to your question, Alex?

**Alexandra Ann Straton** - *Morgan Stanley, Research Division - Research Associate*

It does.

**Operator**

Our next question comes from Matthew Boss from JPMorgan.

**Matthew Robert Boss** - *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

So maybe first, Andrew, on the top line. So if we break down the mid- to high single-digit total sales growth in the 3- to 5-year plan, not to get ahead of ourselves here, but is there any impediment, in your view, as we think about the 12% revenue growth that you've seen prepandemic? I think that was the CAGR 2017 to 2019 at 12%. And then as we think about market share, customer acquisition during the pandemic, I'm just questioning the mid- to high single digit relative to 12% revenue growth that you saw prepandemic, Just any way maybe to bridge the 2?

**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Great. Yes. Thank you, Matthew, for your question. So as part of that, and again, Wendy articulated it and maybe we want to go to that slide. I think it's Slide 66. Wendy articulated it appropriately that those are long-term growth targets. Meaning next 3 to 5 years, what we're clearly not wanting to imply at all within this is more short-term guidance because, as hopefully everyone remembers, really starting here in late Q2 through the back half of 2020, we're lapping unbelievably strong results, and that's embedded in the 12% CAGR that you're referencing, Matt.

I feel compelled to call out just how strong, for example, the third quarter of last year was where the 1-year sales growth, 2020 versus 2019, sales were up up 55% and operating income was up 136%. So again, we're not providing guidance now. We'll do that on our third quarter earnings call on August 19. But suffice it to say that we anticipate that we'll be challenged in the back half of the year to achieve the same type of results that we've seen in the first half of the year.

As we turn to this view, though, which is, again, more of a 3- to 5-year longer-term view, we absolutely believe that the numbers, as depicted here, which would take us to a growth rate from a total standpoint, that is a little bit slower than where we've been for, call it, either the last 3 years. Or even as Wendy showed on one of first slides, even over the last 10 years, our total sales growth has been in the high single to low double.

So we are being a little bit more conservative here, again, just based on how much growth has occurred over the last couple of years. Hopefully, that makes sense. And again, hopefully, it goes without saying that I and the rest of the management team are committed to trying to exceed the numbers that we're showing on this page but, again, meant to be shown from a modeling standpoint. Hopefully, that's helpful?

**Matthew Robert Boss** - *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

Yes, it is. And then just one follow-up on the margin front. I guess maybe is there a way to think about what inning you see overall pricing power? Or is there any impediment preventing further merchandise margin expansion, in your view?

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Yes. So I'll take that one as well. Yes, I think it's important to remind everybody that we saw tremendous growth in our margins and specifically our merchandise margins last year. So on the fourth quarter earnings call, when we were articulating what were the drivers of the year-over-year improvement in operating income of over 500 basis points, we articulated that about half of that came from merchandise margin improvements. And really, the driver of those merchandise margin improvements was our promotional strategy through the back half of last year. What we talked about is that we had higher ratios of full price selling, which for us really is everyday deal selling through the pandemic.

We've also been able to take up the top level of the deal that we sell those everyday deals through. We've also reduced our reliance on power promotions. We've been able to manage inventory very tightly, so we've had less clearance merchandise to go through. And importantly, we've also reduced the amount of shop-wide promotion discounting that we've done historically. So all of those factors drove the merchandise margin improvement for our last year back half. And good news is many of those things, we've also been able to continue here into the front half of 2021.

To your question on how to think about that long term, embedded in this view of mid to -- excuse me, of low to mid-20s on an operating income rate is an assumption that some of that merchandise margin improvement that I just articulated, we will have to give back. Some of that would obviously be driven by return to potentially more normal historical levels. of promotionality. But as a reminder, we are doing constant testing and using our read and react model that we've tried to articulate today to ensure that we only give back there what we need to give back.

And then the other piece that we, and I'm sure every other company out in the states is experiencing, some inflationary pressure. So there will be some costing input increases that will also have some dampening effect on our merchandise margin rates certainly for at least the short-term basis here of the next rolling 6 to 12 months. So that will be a contributor as well to why again, we assume that some of that merchandise margin improvement that we've seen, we will have to give back in this longer-term view. Hopefully, that helps.

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**Operator**

Our next question comes from Omar Saad from Evercore ISI.

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**Omar Regis Saad** - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

First question -- 2 quick questions. First question, the home fragrance business has experienced a really nice jump up in spend during the pandemic, a lot of people spending time at home, presumably burning candles and replenishing their candles. How do you think about -- or are there -- do you have any data so far, but how do you think about that kind of spend and that replenishment spend as people go back to work and back to school and are spending less time in their home? And are you going to be able to grow if there is a step-back as people adjust to life outside the home? And then I have one follow-up.

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Thanks, Omar. Julie, you want to take that one?

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**Julie B. Rosen** - *Bath & Body Works, LLC - President*

Yes. I mean the great news for us is that we are already, we're the market leader, had the #1 market share in candles. And yes, we saw to have exponential growth in the pandemic. But through the first quarter, we continue to see sales end units continuing to grow. So we believe that not only can we -- it will level off a bit, but we have opportunities within candles in that, we have one form in our 3-wick.

We think there's opportunities in other forms. We believe that there's other forms that are available in our single wick. And I think that we have just become so famous for this candle business. And yes, people might not be home as much, but I don't see the usage necessarily leveling off. The lines we had last Q4 for people waiting to get into our Candle Day was absolutely incredible, and we're looking forward to that again this year.

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**Omar Regis Saad** - *Evercore ISI Institutional Equities, Research Division - Senior MD and Head of Softlines, Luxury & Department Stores Team*

Got it. And then, Andrew, if you could maybe talk about the high market share, the high margins in home -- both the home fragrance and the soap and sanitizer business are really impressive. Maybe you could help us understand the importance of both the vertical nature of your businesses, kind of end to end from owning the consumer to a lot of the supply chain and then adding that to scale. Like is the defensibility of this business really built around that vertical business model you've built at scale?

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Yes. Thanks for the question, Omar. So Certainly, as I tried to articulate on a couple of our slides in terms of the unique nature of our business model, that combination of what you're asking about around the vertical nature of our business, combined with then our ability to control all of our channels of distribution, we think, is the 1-2 punch that allows us to continue to not only grow the overall business but, as you were asking about, continue to increase market share in each of the categories in which we play.

And I think Julie did a really good job of talking about what are all the pieces that fall into that vertical nature in terms of how detail-oriented we are around the product development process, how much time and effort we spend in looking at how we develop world-class fragrances, how we ensure that we're developing world-class formulas and that the quality of all of our products is world-class because, again, as both she and I reiterated, the importance of having a product that is good enough to give as a gift, and that you feel proud about giving as a gift and proud about using up every day, coupled with then that use-up and that replenishment nature is our secret sauce.

And so as you can imagine, we spend a lot of time looking at the competition, making sure that any advancements that are being made there that we are staying ahead and working to really ensure that our product and our fragrances offering and our packaging because, at the end of the day, nothing matters unless the customer picks it up and engages with the product based on the packaging, all of those elements have to be right. And so we're very, very pleased that we control all of those elements for every product that we sell, either in our store or online, and you can be sure that our commitment to that aspect of our business on a go-forward basis is as strong or stronger than ever. So hopefully, that helps.

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**Operator**

Our next question comes from Roxanne Meyer from MKM Partners.

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**Roxanne Felice Meyer** - *MKM Partners LLC, Research Division - MD & Senior Research Analyst for Specialty Retail*

Thanks for all of the very helpful and thorough information today. Two questions. First, innovation is obviously a very important part of everything you do. What percent of sales is driven by a repeat base of product or your core product versus what you would call a seasonal collection or newness? How has this breakdown changed over the last few years? And how has this differed by category?

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Thanks, Roxanne. And Andrew, you want to take that one?

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Yes, I'll start on that one, and then Julie, certainly feel free to jump in. But Roxanne, I think your question gets to the heart of the issue in and of itself, meaning that I think you're appropriately recognizing that our business does happen in about third in terms of we have a very, very strong, consistent core of our business. As Julie described, we have multiple fragrances that we've had in the portfolio for a long time that each do over $100 million a year. And so continuing to invest and make sure that those fragrances are getting appropriate restages from a packaging standpoint and formulation upgrades to keep them relevant and growing is a big piece.

The seasonal aspects that Julie about talked about in terms of favorites that come back in, whether it's at holiday, Christmas time or in the spring season, some of our tropical fragrances or in the fall timeframe around Halloween and around autumn, again, big pieces of the business. And then there's the consistent development of innovation and true new to the world that Julie described as well.

So the reality of how those different third of the business breakdown by category and by time frame, very pretty significantly. So in certain parts of the year, favorites and core are the most important. Specifically in the holiday time frame, those seasonal bring-backs and our core business is extremely important versus in other times of the year or in other categories. Newness is more important than in other times, core is more important. So without going into a whole lot more detail, that's how I would describe it, Roxanne. Julie, I don't know if there's any other color you would want to add on to my explanation there?

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**Julie B. Rosen** - *Bath & Body Works, LLC - President*

Yes. I mean I think that our business model is really predicated on life cycle management and change. It's the heart of what we do, and we're constantly ensuring that we're balancing core newness and seasonal. We charge our merchants with staying close to customer and understanding their changing desires and ensuring that we are constantly delivering their most loved fragrances.

And I think one of the things just to say to wrap up is just that we know that there's a tension between continually delivering these core fragrances that they've come to love as well as looking at innovation, and such, we actually have set up 2 different teams. So we have a core team that is constantly looking at reformulations and restages and ensuring that we continue to deliver exciting packaging on the fragrances that they have come to love.

And looking at their reformulations to assure that they maintain their best in capital class efficacy, but we also have a different team that's really looking at innovation and the future and true white space across our products and across our channels. So it is really that intersection of those 2 things that I think is also, as Andrew said, part of our secret sauce.

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**Roxanne Felice Meyer** - *MKM Partners LLC, Research Division - MD & Senior Research Analyst for Specialty Retail*

Great. And just one second question, a quick one. I know the majority of your products are sourced domestically, which obviously gives you a critical advantage in supply chain and ability to be nimble. Can you remind us which of your raw materials or components are sourced internationally? And where that exposure is? And also on the inflation side, where that's going to be manifesting itself most, in which raw materials?

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Thanks, Roxanne. Chris, do you want to take that one?

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**Chris Cramer** - *Bath & Body Works, LLC - COO*

Sure. Thanks, Roxanne. I'll try to hit that at a high level. Far East would be for the pieces that are sourced internationally. That is a general area. And what I would say in terms of things that you might expect some areas where we manufacture some things like wallflower, heaters or plug-in part of the unit. There's an element of that that's international.

And so some of the pressure that we're seeing, whether it's on an item like that or whether it's on some of the input costs is -- we're definitely experiencing some of that. Andrew alluded to some of the inflationary challenges that we're up against. I'd also say that items that are coming from the Far East also are part of what we have to manage around the port delays that -- on the West Coast that we're experiencing along with many other businesses. And so something that we have to really remain focused on as we're trying to drive and maximize the time period right in front of us.

I will say also consistent with the point that Andrew raised earlier about continuing to look at our promotions, the pricing and tickets, our ability to try to manage and offset those challenges is obviously something we're focused on every day through the testing that Andrew described.

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**Operator**

Our next question comes from Susan Anderson from B. Riley.

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**Susan Kay Anderson** - *B. Riley Securities, Inc., Research Division - Analyst*

I'm curious, I guess, just to follow up on Roxane's question a little bit. When you relaunched new products or launch a new line such as the green and clean, I'm curious how much of the sales just replace old product lines versus adding additional product sales? Or maybe you see new customers come into the brand because of the new product? And then also in terms of your move into beauty and skin care items, I saw in our store, you're testing some third-party beauty and skin products. I'm curious, are you planning to sell just third-party brands? Or will you eventually roll out your own brands?

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Thanks, Susan. We'll go to Julie for this question.

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**Julie B. Rosen** - *Bath & Body Works, LLC - President*

Yes. So the whole idea of this is not to launch new categories and just have them cannibalize other categories. So we hope that the customer we have wants to buy more, but we're also hoping to attract potentially -- a different maybe potentially younger customer with some of these new launches. When you think about the wellness and natural market, we have been doing a lot of studying on that market, and we know that, that is very important to a younger customer. So we're looking at how to increase our total customer count.

I think the second part of your question was about beauty and skin care and are we looking to bring it in ourselves? So as Andrew mentioned earlier in the presentation, the bath and body and beauty market is a $71 billion market. We only own 3% share. We don't play in $50 billion of that market. And skincare is a $17 billion market, which is one of those areas that we don't play; as well as hair care, which is a $12 billion market. So yes, you are seeing us test to see what our customers' appetite is, to understand, is she willing and could we sell these products?

And ultimately, we would either go and make these products ourselves and brand them ourselves, or if we think it's a better opportunity, we might partner with someone. So we are constantly out there testing just to really understand what the customers' appetite is, and then we will go back and figure out what is the best way to produce the product so that it maintains the level of efficacy that we demand in all of our products. I hope that helps.

**Operator**

Our next question comes from Jay Sole from UBS.

**Jay Daniel Sole** - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury*

Andrew, a lot of investors are wondering how the business can lap the strong growth of the last few quarters once the pandemic, hopefully, fully abates. I know we've touched on this in a couple of ways already. But can you give us a bit of a history lesson on what happened with the company's hand sanitizer business during the swine flu period of 10, 11 years ago? And then tell us how that experience might inform us how the business will react over the next couple of quarters and into fiscal '22?

**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Sure, Jay. Thanks for the question. Yes. So the swine flu epidemic was an interesting one. It was actually happened right around the time that we launched the hand sanitizer business for Bath & Body Works. It started off exclusively as these little 1-ounce guys pocketback hand sanitizers as we brand them. And it was a real charge from an explosive growth standpoint that occurred at that time that helped us take that business from a very, very small portion because as you can imagine, it's a low price item and got it really launched and off the ground, and a meaningful part of our business also helped us verify, validate that we were doing it appropriately because, in our language, we would say that our entrance into the hand sanitizer business was done in a "BBW way".

What does that mean? That means that you take a relatively sleepy commodity-like business, which is what hand sanitizer was 10, 11 years ago, and you bring the BBW elements to it of fragrance, first and foremost, but then fashion, as Julie talked about within her presentation; and then the third , which would be fun. We try to to make our stores and our websites fun and engaging places in something like hand sanitizer, which can be very -- thought of as very sterile and clinical, bringing those elements of fragrance, fashion and fun that really set that business off on a significant growth trajectory.

There was a slowdown after that big explosive growth around the swine flu time frame that you described, Jay. But then what I would say is it was able to meaningfully grow -- after a 1-year slowdown. Meaningfully grow every year thereafter through multiple restages and reformulations, similar to some of the things that Julie described in her presentation so that we were very well poised then when this pandemic hit to already have a well-established business in that area.

And then as Julie described, we were also able to use our very nimble active supply chain to bring additional forms to the market. So again, when the pandemic broke out, we had only that pocket back single item available. But within several months, we were then up and running with the spray sanitizers that Julie showed in her presentation as well as full-size sanitizers.

To the point of your question, do we expect that there will be some normalization in both soaps and sanitizers as we come, hopefully, fully out of the pandemic, similar to what we would have seen back as swine flu faded away? I think the obvious answer is, yes. There will be some slowdown. But that said, I would say a couple of things. One, I think that the nature of this pandemic has changed meaningfully everyone's behavior on a forward basis. So I would expect that both the soap and sanitizer business, even at a normalized level, will be at higher penetrations than they have been historically to our business. And two, the fact that we've been able to expand our forms to more in both sanitizers and, as Julie described, hopefully, taking that off now in soaps as well, I think, gives us an opportunity to even further grow what is already substantial market share in those categories.

So thanks for the question and for allowing me to take us on a little bit of a historical journey about our business. Hopefully, that's helpful.

**Jay Daniel Sole** - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Softlines & Luxury*

That was very helpful. That was great. If I could ask one more. This is a shorter question. What will be the effect on the company's EBIT margin as the international revenue grows faster than the rest of the business?

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Wendy do you want to?

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**Wendy Arlin** - *L Brands, Inc. - Senior VP of Finance & Controller*

Sure. I would say, generally, international in total has roughly consistent margin as the other 2 parts of the business. We've got -- as a reminder, we've got royalty in that number, but we also sell product to our franchise partners, which carries a lower rate. So as you look in the total, the international business doesn't have a material impact on the overall company's EBIT margin rate.

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Thanks, Jay. So I think we have time for one last question.

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**Operator**

Our final question comes from Mark Altschwager from Baird.

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**Sarah L. Goldberg** - *Robert W. Baird & Co. Incorporated, Research Division - Research Analyst*

This is Sarah Goldberg on for Mark. Thanks for making time for our question here. As you talked about, you've noted an impressive sales retention and lifetime value of customers. I was just wondering if you could give us any sense of the cost to acquire these customers, if it's different by channel? And then how that's trended over time?

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

Thanks, Sarah. Andrew?

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

I'm going to let Chris dive in on that, if you don't mind, Chris?

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**Chris Cramer** - *Bath & Body Works, LLC - COO*

No. That's fine. Cost per -- cost to acquire customers obviously can vary to some degree based on channel and in different time periods as costs of things like acquisition marketing varies at different points during the year. So rather than giving a specific number, I think what I would say is within that variation, what we do is we try to tailor our actions specifically to those time periods, map to channels and our activity to channels that are most profitable in certain time periods. And we've been able to consistently acquire customers across really many different channels and using many different vehicles.

Digital marketing activity tends to be our most productive set of channels, and that can be in the form of display advertising, or that can be in the form of social media-related advertising. Those tend to be our most effective in terms of targeted marketing activities. And we're able to do that with short-term profitability. So this -- generally, we've been able to find methodologies and models that allow us to both acquire customers in a relatively short period, have that be accretive to our profit as a result of driving, again, the testing that we use and the constant assessment of different marketing channels. Hopefully, that helped.

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**Amie Preston** - *L Brands, Inc. - Chief IR Officer*

That concludes our meeting today. Thank you for your interest in Bath & Body Works. Please join us back here at 12:30 for the VS and Co. Investor Meeting. Thanks, and have a great day.

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**Andrew M. Meslow** - *L Brands, Inc. - CEO & Director*

Thank you, everybody.

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**Chris Cramer** - *Bath & Body Works, LLC - COO*

Thank you.

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**Wendy Arlin** - *L Brands, Inc. - Senior VP of Finance & Controller*

Thank you.

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