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Coty Inc.'s Debt Ratings Affirmed; Recovery Rating On Senior Unsecured Debt Revised To '3' From '4'

March 12, 2021

NEW YORK (S&P Global Ratings) March 12, 2021--S&P Global Ratings today affirmed its ratings on Coty Inc.'s debt facilities, including its 'B' rating on the senior secured debt and its 'B-' rating on the senior unsecured debt. We revised the senior unsecured debt recovery rating to '3' from '4', indicating our expectation for meaningful (50%-70%; rounded estimate: 50%) recovery for lenders in the event of a payment default.

The rating actions result from our review of the impact of the company's sale of 60% stake in the Wella business to KKR and the inclusion of the company's equity interest in King Kylie LLC into the company's collateral package. As part of the 2020 covenant holiday negotiation, Coty agreed to include 100% of its equity interests in King Kylie as part of the collateral pool. Under the company's credit agreement, equity interests in all other joint ventures and any other non-wholly-owned subsidiary are recognized as excluded equity interests, and therefore not part of the collateral package.

In our analysis of the transactions, we no longer include the projected debt service costs and capital expenditures related to Wella in our default EBITDA proxy because of Coty's sale of majority stake in the business. We have also updated our analysis to reflect the inclusion of Coty's stake in King Kylie's business into Coty's security package for its lenders. We utilize a discrete asset valuation (DAV) approach to value Coty's remaining 40% stake in Wella and the company's equity interest in King Kylie. In evaluating the recovery prospects for debtholders, we have valued the company on a going-concern basis using a combination of EBITDA multiple valuation for its base business and DAV for the company's ownership stakes in Wella and King Kylie LLC.

The review does not affect our 'B-' long-term issuer credit rating or negative outlook on Coty. We continue to believe the company's credit measures will improve in the second half of fiscal 2021 (ending June 2021) including free operating cash flow generation turning positive due to better sales trends and cost reductions. Despite the anticipated improvement, we expect credit measures to remain weak as the company continues its restructuring and faces ongoing headwinds caused by the pandemic. We forecast leverage at about 10x in 2021 (about 8.5x excluding preferred stock) and EBITDA interest coverage at about 2x.

ISSUE RATINGS--RECOVERY ANALYSIS

Key analytical factors

The company's debt structure is composed of:

- A $2.75 billion revolving credit facility (with $456 million outstanding as of Dec. 31, 2020) maturing in April 2023;
- Term A facility with $1.9 billion outstanding as of Dec. 31, 2020, maturing in April 2023;

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- Term B facility with $1.5 billion outstanding as of Dec. 31, 2020, maturing in April 2025;
- 2023 senior unsecured euro notes with $676 million outstanding as of Dec. 31, 2020, maturing in April 2023;
- 2026 dollar notes with $550 million outstanding as of Dec. 31, 2020 maturing in April 2026; and
- 2026 euro notes with $307 million outstanding Dec. 31, 2020, maturing in April 2026.

Simulated default assumptions

- Our simulated default scenario contemplates a default in 2023, primarily due to missteps in executing its restructuring plan or due to a steep decline in demand for the company's products. We believe that in a distressed situation, funds from the company's operations would not be adequate to support the interest burden and cash needs for its operations.
- Coty Inc. is the borrower/issuer of all the debt. Coty BV is a co-borrower under the revolver. We continue to value the company on a going concern basis. The bank loans are guaranteed by the borrower and its direct and indirect wholly-owned domestic subsidiaries and secured by perfected first-priority security interest in substantially all assets of the borrower and each subsidiary guarantor, subject to certain exceptions, whether owned on the closing date or thereafter acquired. (All facilities are cross-guaranteed.) The unsecured notes are guaranteed direct and indirect wholly-owned domestic subsidiaries (U.S. and euro notes cross-guaranteed).
- The company has operations globally, with approximately 35% of its EBITDA generated in the U.S. and 65% overseas. The company's debt is incurred in the U.S. (with the exception of Coty BV being a co-borrower on the revolving credit facility), and each of the secured facilities are cross-guaranteed and cross-collateralized. In the event of an insolvency proceeding, the company would most likely file for bankruptcy protection under the auspices of the U.S. federal bankruptcy court system even though it has significant foreign operations, we do not assume any filings in foreign jurisdictions. The company could file for bankruptcy protection in foreign jurisdictions as well but in such a case, it would add complexity to the administration of the bankruptcy case and would incur additional bankruptcy-related costs, resulting in lower recovery prospects.
- We believe the company would be reorganized rather than liquidated under a default scenario, given Coty's portfolio of well-recognized brand names with strong market shares and its geographic diversity.
- We estimate $5.3 billion in gross recovery value at the time of default under our projected scenario. We base this on assumptions of the realization rates for Coty's ownership stakes in Wella and King Kylie as well as an assumption of an EBITDA multiple applied against the company's distressed emergence EBITDA under our hypothetical default scenario. Our analysis considers a 60% realization rate on the company's investments in Wella and King Kylie, resulting in a $1.3 billion combined DAV at default. We have valued the company's base business based on an enterprise value to gauge recovery and apply a 6.5x multiple on an assumed distressed emergence EBITDA of $645 million that results in an estimate gross recovery value of $4.2 billion. To determine net recovery value available for distribution to creditors, we reduced our estimate of total gross recovery value of $5.6 billion by 5% to account for estimated bankruptcy administrative expenses. This results in a total net recovery value of about $5.3 billion.

Calculation of EBITDA at emergence

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- Simulated year of default: 2023
- Total debt service assumptions (assumed default year interest plus amortization): $600 million
- Minimum capex assumptions: $118 million
- Operational adjustment: -10% ($72 million)
- EBITDA multiple: 6.5x

Simplified waterfall:

- Emergence EBITDA: $645.3 million
- Multiple: 6.5x
- Gross recovery value: $4.2 billion
- Gross asset value: $2.3 billion
- Realization rate: 60%
- DAV: $1.4 billion
- Total gross recovery value: $5.6 billion
- Net recovery value for waterfall after administrative expenses (5%): $5.3 billion
- Valuation split (obligor/nonobligors): 22%/57%/14%/7%
- Collateral for secured creditors: $3.3 billion
- First-lien claims: $5.6 billion
- Recovery expectation: 70%-90% (rounded estimate 80%)
- Collateral for unsecured creditors: $1.9 billion
- Unsecured claims: $3.8 billion
- Recovery expectation: 50%-70% (rounded estimate 50%)

Note: All debt amounts at default include six months accrued pre-petition interest.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013

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- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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