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Research Update:

Coty Inc. Upgraded To 'BB' From 'BB-'; Outlook Positive; Debt Rating Raised

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PRIMARY CREDIT ANALYST

Katherine Heng
New York
+ 1 (212) 438 2436
katherine.heng
@spglobal.com

SECONDARY CONTACT

Amanda C O'Neill
New York
+ (212) 438-5450
amanda.oneill
@spglobal.com

Rating Action Overview

- Coty Inc. continues to execute its growth and leverage reduction initiatives.
- We expect the company to use the net proceeds from the recent global offering of 33 million shares of common stock to reduce debt and that adjusted leverage will further improve to below 4x by the end of fiscal 2024 from 4.7x at the end of fiscal 2023 from both EBITDA growth and debt reduction.
- Therefore, we raised our issuer credit rating to 'BB' from 'BB-'. Concurrently, we raised the issue-level rating on Coty's senior secured debt to 'BB+' from 'BB' and on its senior unsecured debt to 'BB' from 'BB-'. The recovery ratings are unchanged at '2' and '3', respectively.
- The positive outlook reflects the potential for a higher rating over the next 12 months if Coty continues to execute its strategy and its products continue to resonate well with consumers, such that we have a more favorable view of the business, or the company demonstrates a more conservative financial policy and uses all proceeds from future asset sales including Wella for debt reduction, such that it sustains adjusted leverage below 3x.

Rating Action Rationale

The rating action reflects Coty's improved credit metrics from EBITDA growth as well as permanent debt reduction, and our expectation for leverage to further improve to below 4x by the end of fiscal 2024. Coty continues to prioritize debt reduction, repaying close to $200 million of debt in the last 12 months leading to leverage improving to 4.7x at of the end of fiscal 2023 from 5.4x at the end of fiscal 2022. The company recently announced a global offering of 33 million shares both on the New York Stock Exchange and Euronext Paris. We expect it to use the net proceeds to reduce debt. Coty recently completed the $2 billion revolver extension, pushing the maturity to 2028. The company also issued new seven-year U.S. dollar senior secured notes and five-year euro senior secured notes, and fully paid off its term loan B due in 2025.

Beauty demand remains robust with good momentum across the prestige and consumer segments, all regions, and key categories including fragrance, cosmetics, and body care. Prestige fragrance expanded in the low-teens percentages in fiscal 2023 due to the success of product innovation and growth in distribution in travel retail. Consumer beauty expanded 10% year over year in fiscal 2023, driven primarily by pricing. We expect strong momentum to continue in fiscal 2024, particularly in prestige fragrances, driven by product launches and pricing. Coty plans for an additional mid-single-digit percent price increase in the first quarter. We forecast modest EBITDA margin expansion, reflecting pricing and cost savings.

Therefore, we forecast adjusted leverage to further improve below 4x by the end of fiscal 2024. We also expect Coty to monetize Wella by the end of calendar 2025, which could permanently reduce debt close to $1 billion.

We expect Coty to resume dividends and share repurchases in fiscal 2024 as it reaches its mid- to long-term target leverage range of 2x-3.5x. This measure is based on management's calculations, which is roughly equivalent to about 2.7x-4.2x S&P Global Ratings-adjusted leverage. Coty is progressing toward its target, with company-defined leverage of 4.1x as of June 30, 2023, and continues to target leverage toward 3x exiting calendar 2023. Coty is focused on deleveraging to this target range before resuming distributions to shareholders or repurchasing shares. Therefore, we expect management to continue to prioritize debt reduction with free operating cash flow (FOCF) and asset sale proceeds until it hits the target range. With company-defined leverage approaching 3x in fiscal 2024, we expect dividends and share repurchases to return.

Coty continues to execute across all strategic growth initiatives. It has continued to deliver with brand repositioning, increased portfolio premiumization, product innovations across both prestige and consumer beauty, and developments in digital. Coty stabilized its consumer beauty business and implementing additional pricing to close pricing gaps versus its competition, particularly in consumer beauty. In prestige, it continues to expand the fragrance category and offer premium products, including the recent launch of Burberry Goddess, which resonates well with consumers. The fragrance market continues to expand at high-single-digit percents in both North America and Europe, above the historical low- to mid-single digits. The company also has plans to accelerate its skin care business, including Lancaster, Orveda, and Philosophy. Travel retail revenues are increasing about 30% year over year in fiscal 2023 and now represent 8% of Coty's sales. We expect continued global travel recovery to fuel ongoing momentum.

Outlook

The positive outlook reflects the potential for a higher rating over the next 12 months if Coty continues to execute its strategy and its products continue to resonate well with consumers, such that we have a more favorable view of the business, or the company demonstrates a more conservative financial policy and uses all proceeds from future asset sales including Wella for debt reduction, such that it sustains adjusted leverage below 3x.

Upside scenario

We could raise our ratings if the company:

- Sustains organic growth and establishes a record of retaining market share and sustaining its improved cost structure, leading to EBITDA margin improvement, such that we have a more favorable view of the business;

- Continues to execute its strategy of utilizing excess cash proceeds from asset sales, including Wella, for debt reduction; or
- Demonstrates conservative financial policies by not making large, debt-financed dividends or acquisitions, such that it sustains adjusted leverage below 3x.

Downside scenario

We could lower our ratings if growth momentum starts to slow and we expect adjusted leverage sustained above 4x, which could occur because of:

- A worsening macroeconomic environment, heightened competition, operational misstep, higher inflation, or consumer trade down, reducing demand for the company's products; or
- Coty pursues more aggressive financial policy with debt-funded share repurchases and acquisitions.

Company Description

Coty with its subsidiaries develops, manufactures, markets, and distributes fragrances, cosmetics, skin care, and body care products worldwide. JAB Holding Co. is Coty's largest shareholder, with a 53% ownership as of June 30.

Our Base-Case Scenario

- S&P Global Ratings economists expect U.S. GDP will expand 2.3% in calendar 2023 and 1.3% in calendar 2024, Europe GDP will increase 1% in calendar 2023 and 1.4% in calendar 2024, and China GDP will expand 4.8% in calendar 2023 and 4.4% in calendar 2024.
- Revenue increases at about a high-single-digit percentage in fiscal 2024, driven by strong momentum across the prestige and consumer beauty segments, all regions, and key categories including fragrance, cosmetics, and body care. We expect revenue growth to moderate slightly to the mid-single-digit percentages in fiscal 2025.
- We expect adjusted EBITDA margin to improve 50 basis points in fiscal 2024 on pricing actions, favorable mix, and cost saving initiative. We expect modest EBITDA margin expansion in fiscal 2025 due to operating leverage and cost savings.
- Capital expenditure (capex) of about $240 million annually over the next two years is mainly driven by maintenance capital spending requirements to support higher sales volumes.
- FOCF is about $560 million in fiscal 2024 and $580 million in fiscal 2025.
- Total dividends and share repurchases are about $200 million in fiscal 2024 after the company reaches its targeted leverage range.
- About $350 million proceeds come from the 33 million common stock offering, which it will use to reduce debt.

Table 1

Coty Inc.--Key Metrics*

	--Fiscal year ended June 30--			
Mil. $	2022a	2023a	2024f	2025f
Revenue	5,304.4	5,554.1	5,973.5	6,302.1
Revenue growth (%)	14.6	4.7	7.6	5.5
EBITDA	952.9	1,054.0	1,163.9	1,258.6
EBITDA margin (%)	18.0	19.0	19.5	20.0
FFO	531.5	739.4	800.7	911.6
FOCF	512.9	402.9	563.9	578.2
Debt	5,184.3	4,977.5	4,288.5	3,946.0
Debt to EBITDA (x)	5.4	4.7	3.7	3.1
FFO to debt (%)	10.3	14.9	18.7	23.1
EBITDA interest coverage (x)	3.7	3.7	4.0	4.6

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. FFO--Funds from operations. FOCF--Free operating cash flow.

Liquidity

We continue to assess Coty's liquidity as adequate, reflecting our forecast that its sources will exceed uses by more than 3x over the next 12 months and remain positive even if EBITDA declines 30%. We believe Coty has well established and solid relationships with its banks--demonstrated by securing large, committed credit facilities—and satisfactory standing in credit markets. However, we continue to believe the company will need to refinance following a high-impact, low-probability event such as severe market turbulence or a material decline in market share that erodes margin.

Principal liquidity sources:

- $247 million cash as of June 30;
- Availability of $1.85 billion under the revolving credit facility due in 2028, after using the proceeds from the euro senior notes to pay down its revolver balance; and
- Cash funds from operations of about $755 million over the next 12 months.

Principal liquidity uses:

- No near-term debt maturities;
- Capital spending of about $240 million over the next 12 months; and
- Seasonal peak-to-trough working capital of about $250 million.

Covenants

Coty's credit agreements contain a maximum 4x total net leverage ratio maintenance covenant requirement. It allows Coty to add back 36 months of forward cost savings and exclude restructuring costs. We expect Coty to remain in compliance with all applicable covenants under the ABL revolving credit agreement and term loan agreement for the respective periods over the next 12 months. We expect sufficient headroom over 20% over the next 12 months under our base-case forecast.

Issue Ratings - Recovery Analysis

Key analytical factors

The company's debt structure is composed of:

- $1.67 billion U.S. dollar/multicurrency revolving credit facility maturing July 11, 2028;
- €300 million revolver maturing July 11, 2028;
- $900 million senior secured notes, maturing in April 2026;
- €750 million senior secured notes, maturing in April 2026;
- $500 million senior secured notes, maturing in January 2029;
- $750 million senior secured notes, maturing in July 2030;
- €500 million senior secured notes, maturing in September 2028;
- 2026 senior unsecured dollar notes with $473 million outstanding as of June 30, maturing in April 2026;
- 2026 senior unsecured euro notes with $196 million outstanding as of June 30, maturing in April 2026; and
- Brazilian credit facilities with $31.9 million outstanding as of June 30.

Coty Inc. is the borrower/issuer of all the debt. Coty B.V. is a coborrower 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 by direct and indirect wholly owned domestic subsidiaries (U.S. and euro notes cross-guaranteed).

The company's debt is incurred in the U.S. (with the exception of Coty B.V. being a coborrower 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. Coty 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 incur additional bankruptcy-related costs, reducing recovery prospects.

We believe the company would reorganize rather than liquidate under a default scenario, given Coty's portfolio of well recognized brand names with strong market shares and geographic diversity.

We estimate about $5 billion in gross recovery value at default under our projected scenario. We base this on assumptions of the realization rates for Coty's ownership stakes in Wella and an assumption of an EBITDA multiple applied against Coty's distressed emergence EBITDA under our hypothetical default scenario. Our analysis considers a 60% realization rate on its investments in Wella, resulting in a $557.5 million discrete asset value (DAV) at default. We value the company's base business, which includes 51% ownership in Kylie, based on an enterprise value to gauge recovery and apply a 6.5x multiple on an assumed distressed emergence EBITDA of $681.8 million that results in an estimate gross recovery value of $4.4 billion. To determine net recovery value available for distribution to creditors, we reduce our estimate of total gross recovery value of about $5 billion by 5% to account for estimated bankruptcy administrative expenses. This results in a total net recovery value of about $4.7 billion.

Simulated default assumptions

Our simulated default scenario considers a default in 2028, primarily due to a steep decline in demand for Coty's products or any operational missteps. 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.

Calculation of EBITDA at emergence:

- Debt service: $348.2 million (default year interest plus amortization)
- Maintenance capex: $138.9 million
- Preliminary emergence EBITDA: $487 million
- Operational adjustment: $194.8 million (40% of preliminary emergence EBITDA)
- Emergence EBITDA: $681.8 million

Simplified waterfall

- Emergence EBITDA: $681.8 million
- Multiple: 6.5x
- Gross recovery value: $4.4 billion
- Gross asset value: $929 million
- Realization rate: 60%
- DAV: $557.5 million
- Total gross recovery value: $4.99 billion
- Net recovery value for waterfall after administrative expenses (5%): $4.74 billion
- Valuation split (obligor/nonobligors): 31.1%/57.7%/11.2%
- Collateral for secured creditors: $3.2 billion
- First-lien claims: $5.3 billion
- --Recovery expectation: 70%-90% (rounded estimate: 80%)
- Collateral for unsecured creditors: $1.48 billion
- Unsecured claims: $2.77 billion
- --Recovery expectation: 50%-70% (rounded estimate: 50%)

All debt amounts at default include six months accrued prepetition interest.

Ratings Score Snapshot

Issuer credit rating: BB/Positive/--

Business risk: Fair

- Industry risk: Low
- Country risk: Low
- Competitive position: Fair

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: bb

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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 | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded; Outlook Action

	To	From
Coty Inc.		
Issuer Credit Rating	BB/Positive/--	BB-/Stable/--
Issue-Level Ratings Raised; Recovery Ratings Unchanged		
Coty Inc.		
Senior Secured	BB+	BB
Recovery Rating	2(80%)	2(80%)
Senior Unsecured	BB	BB-
Recovery Rating	3(50%)	3(50%)

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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.