MOODY'S
INVESTORS SERVICE

# Rating Action: Moody's downgrades Coty's CFR to B2; outlook stable

**11 Jun 2019**

New York, June 11, 2019 -- Moody's Investors Service ("Moody's") downgraded Coty Inc.'s ("Coty") Corporate Family Rating ("CFR") to B2 from B1 and Probability of Default Rating to B2-PD from B1-PD. Moody's also downgraded the company's unsecured notes to Caa1 (LGD5) from B3 (LGD5). Concurrently, Moody's confirmed the ratings on Coty's first lien revolving credit facility and term loan at Ba3 (LGD2) and affirmed its Speculative Grade Liquidity Rating at SGL-4. The outlook is stable. This concludes the review that was initiated on February 13, 2019 when JAB Holding Company S.a.r.l ("JAB") announced its debt-financed partial tender offer for Coty shares.

The downgrade reflects that Moody's will include the $1.77 billion term loan debt used to finance JAB's tender offer to Coty's total enterprise debt, since its ultimate source of repayment are the cash flows generated by Coty along with any subsequent sales of Coty's shares. This raises Coty's enterprise debt to $9.5 billion and its enterprise debt to EBITDA by 1.0x turn to 7.0x. The debt was issued by Cottage Holdco B.V., which is an indirect subsidiary of JAB and the parent company of Coty. The debt is to be serviced through dividends paid by Coty to JAB and repaid following stock appreciation from the Coty shares. The debt at Cottage has no guarantees from JAB and is secured by 451 million shares of Coty. JAB is now a majority owner of Coty with 60% ownership.

Moody's also expects that Coty's credit metrics will remain weak over the next 12-18 months reflecting continued weakness in Coty's consumer beauty business and very slow progress at deleveraging. Moody's estimates that Coty's near-term leverage reduction will be hampered by low organic earnings growth. The company's profitability will be adversely affected by high promotional activity needed to support sales during the year. Coty is restructuring its operations to restore growth and improve operating performance. Coty has also had significant turnover in its senior management ranks. The company has a new chief executive officer and chief financial officer, which brings some level of uncertainty to the company's overall strategy.

The Ba3 rating on Coty's senior secured debt is two notch higher than the B2 CFR and reflects cushion provided by the company's junior debt. The junior debt includes Coty's unsecured notes as well as the Cottage term loan. The Cottage term loan is non-recourse to Coty.

The stable outlook reflects Moody's expectation that Coty's financial leverage will remain high over the next 12 -- 18 months, but will decline over time through a combination of earnings growth and debt repayment. The stable outlook also reflects Moody's view that it will take time for management to meaningfully improve operating performance in Coty's consumer beauty segment.

The following is a summary of Moody's rating actions:

Coty Inc.

Downgrades:

Corporate Family Rating to B2 from B1

Probability of Default to B2-PD from B1-PD

Guaranteed Unsecured Global Notes to Caa1 (LGD5) from B3 (LGD5)

Confirmations:

First Lien Senior Secured Bank Credit Facility at Ba3 (LGD2 from LGD3)

Affirmations:

Speculative Grade Liquidity Rating at SGL-4

The outlook is stable.

RATINGS RATIONALE

Coty's B2 CFR reflects the company's high enterprise debt to EBITDA financial leverage, estimated at about 7.0x. The high financial leverage is in part due to earnings weakness reflecting lackluster demand for the company's domestic consumer beauty products. The rating also reflects Moody's expectation that the company will generate weak free cash flow over the next several quarters due to its ongoing restructuring costs and dividends. Moody's recognizes Coty's concentration in fragrance and color cosmetics. This concentration creates exposure to discretionary consumer spending. It also requires continuous product and brand investment to minimize revenue volatility as these categories tend to be more fashion driven than other beauty products. Coty will remain more concentrated than its primary competitors in mature developed markets. This creates growth challenges and investment needs to more fully build its global distribution capabilities and brand presence. The ratings are supported by the company's large scale, its portfolio of well-recognized brands, and good product and geographic diversification. Moody's expects that Coty will generate modest revenue and organic earnings growth over the next year.

The SGL-4 Speculative Grade Liquidity Rating reflects Moody's view that Coty's liquidity is weak. Coty's ongoing restructuring actions will consume large amounts of cash and Moody's expects the company's free cash flow to remain negative in 2019. The company relies on a $3.25 billion secured revolving credit facility that had $814 million drawn as of March 31, 2019. Moody's expects the revolver to be used to fund the projected cash flow deficit and the company's dividend in 2019. The revolver is subject to a total net leverage financial covenant with step downs. As of March 31, 2019 the total net leverage covenant was at 4.98x with a 5.25x maximum. Moody's projects that the company will have weak headroom under the total net leverage covenant over the next 12 months.

Coty's ratings could be downgraded if the company is unable to return to positive free cash flow over the next 12-18 months. The ratings could also be downgraded if the company does not make meaningful progress in reducing enterprise debt to EBITDA (inclusive of the JAB term loan) below 6.5x. A downgrade could also occur if the company is unable to improve liquidity or pursues material debt funded acquisitions or shareholder returns.

Coty's ratings could be upgraded if the company stabilizes its operations and generates positive free cash flow. Coty would also need to reduce its financial leverage and bring enterprise debt to EBITDA (inclusive of the JAB term loan) below 5.5x before Moody's would consider an upgrade.

The principal methodology used in these ratings was Global Packaged Goods published in January 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Coty Inc. ("Coty"), a public company headquartered in New York, NY, is one of the leading manufacturers and marketers of fragrance, color cosmetics, and skin and body care products. The company's products are sold in over 150 countries. The company generates roughly $9.2 billion in annual revenues.

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