CREDIT OPINION
29 April 2020

Update

Rate this Research

RATINGS

Coty Inc.

Domicile	United States
Long Term Rating	Caa1
Type	LT Corporate Family Ratings
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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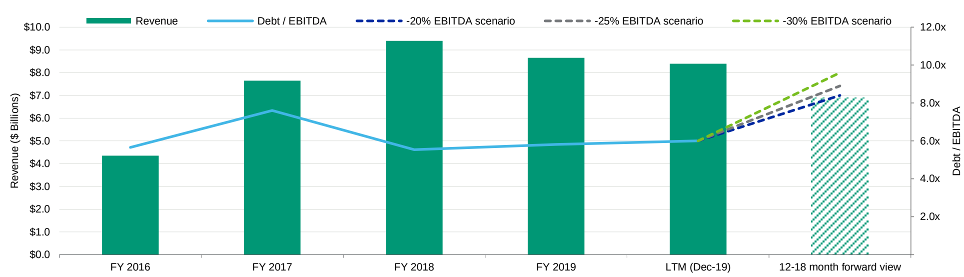
Coty Inc.

Update following CFR Downgrade to Caa1; outlook negative

Summary

Coty's credit profile (Caa1 negative) reflects revenue declines expected for the company's beauty products over the next few quarters driven by efforts to contain the coronavirus and pressure on discretionary consumer income, contributing to high debt to EBITDA financial leverage that we estimate will increase in excess of 6.5x in 2020. The credit profile also reflects our belief that the company will generate weak free cash flow over the next several quarters due to its ongoing restructuring costs and dividends. Coty's concentration in fragrance and color cosmetics creates exposure to discretionary consumer spending and 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 company's credit profile is supported by its large scale, its portfolio of well-recognized brands, and good product and geographic diversification.

Exhibit 1
Debt/EBITDA will increase as impact from coronavirus will weaken operating performance
Illustrative range



All figures and ratios are calculated using Moody's estimates and standard adjustments. Moody's Forecasts (f) or Projections (P) are Moody's opinion and do not represent the views of the issuer. Periods are Financial Year-End June unless indicated. LTM = Last Twelve Months.
Source: Moody's Financial Metrics™, Moody's Projections

Credit strengths

» Large scale and well-recognized brands in several beauty categories

» Strong public commitment to reducing net leverage to below 3.0x debt to EBITDA

Credit challenges

» High financial leverage and weak free cash flow

» Continued weak demand in the company's consumer beauty products

» Concentration in volatile fragrance and color cosmetics categories

» Need for constant innovation driven by portfolio composition

» Global diversification skewed towards slower growth mature developed markets

Rating outlook

The negative outlook reflects our belief that Coty faces high execution risk to improve operating performance and reduce financial leverage. This reflects the company's multi-step turnaround plan that includes the divestiture of its Professional and Hypermarcas businesses, proceeds of which are to be used to repay debt. The turnaround plan also includes the continued refocus of its Consumer Beauty business product mix away from low-value sales. We also recognize the challenges that Coty will face executing an operational turnaround given governmental mandates for social distancing that will keep department stores and specialty retail closed for an unknown period.

Factors that could lead to an upgrade

» Renewed revenue and earnings growth

» Significant reduction in financial leverage

» Generates comfortably positive free cash

Factors that could lead to a downgrade

» Inability to stabilize revenue and earnings or improve liquidity

» Ongoing weak or negative free cash flow over the next 12-18 months

» Financial leverage continues to increase

» Aggressive debt funded acquisitions or shareholder returns

Key indicators

Exhibit 2

Coty Inc.

US Millions	Jun-15	Jun-16	Jun-17	Jun-18	Jun-19	LTM (Dec-19)*	12-18 month forward view
Revenue	$4.4	$4.3	$7.7	$9.4	$8.6	$8.6	$5.9-$6.9
EBITA Margin %	13.5%	14.4%	8.9%	10.9%	11.4%	11.6%	10.0%-10.4%
Debt / EBITDA	3.8x	5.7x	7.6x	5.5x	5.8x	6.0x	9.6x-8.4x
RCF / Net Debt	19.5%	6.1%	-4.9%	4.3%	6.4%	6.3%	3.6%-5.0%
EBITA / Interest Expense	5.8x	4.4x	2.6x	2.9x	2.6x	2.7x	1.5x-1.8x

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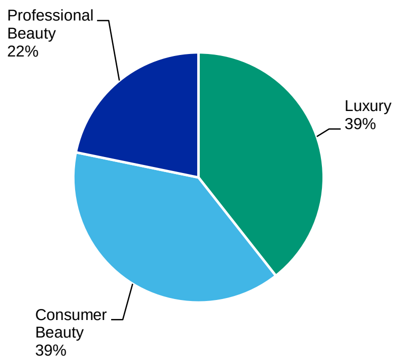
The projected credit metrics are based on a range of annual EBITDA declines, but there is significant uncertainty regarding the effect of the coronavirus on earnings performance. The midpoint of the projected leverage range is based on an approximate 25% EBITDA decline.
*Pro Forma for the acquisition of Kylie Cosmetics
Source: Moody's Financial Metrics™, Moody's Projections

Profile

Coty Inc., 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. Coty generates roughly $8.4 billion in annual revenues. Coty is 60% owned by a German based investment firm, JAB Holding Company S.a.r.l. (JAB), with the rest publicly traded.

Exhibit 3

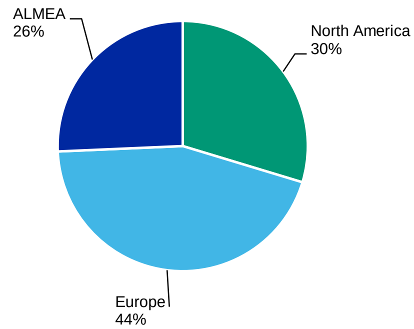
Revenue by segment
Twelve months ended December 31, 2019



Source: Company filings

Exhibit 4

Revenue by geography
Twelve months ended December 31, 2019



Note: ALMEA represents Asia, Latin America, the Middle East, Africa and Australia
Source: Company filings

Detailed credit considerations

High financial leverage

We expect Coty's debt to EBITDA will increase in excess of 6.5x in 2020 from 5.7x from the twelve months ending December 31, 2019. The company's financial leverage will increase due to significant declines in revenue and earnings from retail store closures and reduced demand for the company's products related to efforts to contain the coronavirus. The company estimates that 3rd quarter sales, ending March 31, 2020, will be down by 20% and we estimate that year-end sales ending June 30, 2020 will be down in excess of 15%. Lower demand for Coty's products reflects weaker than previously expected sales and earnings from its consumer beauty products (40% of sales) and from the company's luxury beauty and fragrance products (38% of sales). Demand will be adversely affected by ongoing competitive pressures, closures at department stores and specialty retailers, and governmental recommended social distancing reflecting efforts to contain the coronavirus. Efforts to contain the coronavirus are weakening economic growth globally and add further operating pressure to the company's credit profile.

Weak free cash flow

We expect Coty to generate negative free cash flow over the next year. Free cash flow will be adversely impacted by the company's declining sales and earnings. We estimate that the company will generate negative free cash flow in excess of $(85) million in the year ahead. We believe free cash flow will improve over time as retail stores reopen, and as the company stabilizes its operations and completes its restructuring program.

Ambitious global restructuring carries high execution risk

Coty's ongoing restructuring will carry high execution risks given the company's historical execution challenges. Execution risks reflect the company's multi-step turnaround plan that includes the divestiture of its Professional and Hypermarcus businesses, proceeds of which management says will be used to repay debt, as well as the turnaround of its Consumer Beauty business. The company will restructure its consumer beauty and fragrance businesses, which will include work force and product offering reductions. Coty will spend $600 million through 2023 on this turnaround plan, which is in addition to about $160 million of ongoing restructuring costs. Coty expects the restructuring program to generate about $200 million in annual cost savings, a meaningful improvement in operating margins to about 14% to 16% (as compared to about 11.1% today) and free cash flow of about $1.0 billion by 2023. These improvements are back ended, and given the company's track record, success remains uncertain.

Concentration in volatile fragrance and cosmetics categories

Coty will continue to face risks associated with its significant reliance on revenues from the fragrance and color cosmetics categories, which tend to be volatile and vulnerable to fashion risk. We expect more volatility in these categories than in other consumer packaged goods sectors. To generate growth, Coty will have to continually reinvest and launch successful new products given its exposure to fashion driven fragrance (especially, designer brands) and color cosmetic products. Succeeding in an industry with high fashion risk requires continual investment in product development and brand support to sustain market share.

Good geographic diversification, but skewed towards developed markets

Coty will have good presence in large key beauty markets, including the U.S., the U.K., Russia and Italy. However its geographic diversity is skewed toward developed markets. This puts the company at a growth disadvantage compared to peers with higher exposure to emerging markets. Around 74% of the company's revenues are generated from North America and Europe, presenting growth challenges in highly competitive markets. Only 26% of revenues are generated from developing markets including Asia, Latin America, the Middle East, Africa and Australia. That said the company has announced plans to focus on increasing sales from developing markets over time.

Large scale and well recognized brands in several categories

Coty will enjoy good scale relative to its peers in the beauty category. The company's mass consumer beauty products compete against those at Revlon (Caa3 negative; $2.4 billion in revenue). In contrast, some of Coty's luxury skin care and fragrance products compete against those at Estee Lauder (A1 stable; $15.9 billion). Scale benefits include leverage with suppliers and marketing efficiencies. Scale will also favorably affect the company's ability to obtain favorable terms with distributors, and create marketing efficiencies. The company's product portfolio enjoys good brand name recognition.

ESG considerations

The rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many sectors, regions and markets. The combined credit effects of these developments are unprecedented. The consumer products sector has been one of the sectors affected by the shock given its sensitivity to consumer demand and sentiment. More specifically, the weaknesses in Coty's credit profile, including its exposure to multiple affected countries have left it vulnerable to shifts in market sentiment in these unprecedented operating conditions and the company remains vulnerable to the outbreak continuing to spread. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

In terms of ESG considerations, the most important factor for Coty's ratings are governance considerations related to its financial policies and board independence. We view Coty's financial policies as aggressive given its appetite for debt financed acquisitions. In addition, the company's board of directors has limited independence given that four of the nine board members are related to JAB, Coty's 61% majority shareholder. The dividend is high given weak free cash flow, but JAB has agreed to receive dividends in shares for the third and fourth quarters ending in March and June 2020. The company is giving shareholders the option to received dividends in kind in the third and fourth quarter. JAB also repaid the approximate $2 billion loan it used to finance the share tender offer in 2019.

Liquidity analysis

The SGL-4 Speculative Grade Liquidity Rating reflects our view that Coty's liquidity is weak because of negative free cash flow, significant required term loan amortization, and potential need for a covenant amendment to avoid a violation or effective limits on the ability to utilize the revolver. Coty's ongoing restructuring actions will consume large amounts of cash (over $150 million). We expect the company to generate negative free cash flow of about $(85)-$(100) million in the year ahead following capital spending of about $444 and dividends of about $269 million. The company will rely on its $2.75 billion revolver expiring in 2023 to fund its working capital needs, projected free cash flow deficits and the $192.5 million annual term loan amortization. As of December 31, 2019, the company had about $2.1 billion available under its revolver. The credit agreement is subject to a maximum 5.25x total net leverage covenant that declines to 5.00x in March 2022. The ratio was raised to 5.95x in March 2020, in conjunction with the company's majority acquisition of Kylie Cosmetics, and will return to 5.25x in January 2021. We project that the company will have weak headroom under the total net leverage covenant over the next 12 months. Assets are divisible as Coty could sell individual brands without materially affecting its remaining operations. However, alternate liquidity is limited because all material assets are pledged to Coty's bank credit facilities (revolver and term loan).

Structural considerations

The B3 rating on Coty's senior secured debt is one notch higher than the Caa1 CFR and reflects cushion provided by the company's effectively subordinated unsecured notes.

The Caa3 rating on the unsecured notes is two notches lower than the CFR. This reflects the effective subordination to about $7.9 billion of secured debt that would weaken recovery in the event of a default. The notes benefit from upstream guarantees from Coty's domestic subsidiaries.

Rating methodology and scorecard factors

The mapping to the scorecard in the Consumer Packaged Goods Methodology (February 2020) is shown below, including a 12-18 month forward view. The projected scorecard-indicated outcome of Ba3 is higher than the actual rating of Caa1. The difference primarily relates negative free cash flow and our concerns regarding how quickly Coty will be able to stabilize its operations.

Exhibit 5

Rating Factors

Coty Inc

Consumer Packaged Goods Industry Scorecard [1][2]	Current LTM 12/31/2019		Moody's 12-18 Month Forward View As of 4/10/2020 [3]	
Factor 1 : Scale (20%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$8.4	Baa	$5.9 - $6.9	Baa
Factor 2 : Business Profile (30%)				
a) Geographic Diversification	A	A	A	A
b) Segmental Diversification	Ba	Ba	Ba	Ba
c) Market Position	Ba	Ba	Ba	Ba
d) Category Assessment	Ba	Ba	Ba	Ba
Factor 3 : Profitability (10%)				
a) EBITA Margin	11.6%	B	10.0% - 10.4%	B
Factor 4 : Leverage and Coverage (25%)				
a) Debt / EBITDA	5.7x	B	9.6x - 8.4x	Caa
b) RCF / Net Debt	6.3%	Caa	3.6% - 5.0%	Caa
c) EBITA / Interest Expense	2.7x	Ba	1.5x - 1.8x	B
Factor 5 : Financial Policy (15%)				
a) Financial Policy	Ba	Ba	Ba	Ba
Rating:				
a) Scorecard-Indicated Outcome		Ba2		Ba3
b) Actual Rating Assigned				Caa1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 12/31/2019(L)
[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures
Source: Moody's Financial Metrics™

Appendix

Exhibit 6

Peer Comparison

Coty Inc.

	Coty Inc. B2 Negative			Avon Products, Inc. B1 RUR-DNG			Church & Dwight Co., Inc. A3 Stable			Revlon Consumer Products Caa3 Negative			Clorox Company (The) Baa1 Stable		
(in US millions)	FYE Jun-18	FYE Jun-19	LTM Dec-19	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Jun-18	FYE Jun-19	LTM Dec-19
Revenue	$9,398	$8,649	$8,394	$5,716	$5,403	$4,695	$3,776	$4,146	$4,358	$2,694	$2,565	ri	$6,124	$6,214	$6,133
EBITDA	$1,581	$1,529	$1,499	$468	$311	$281	$938	$965	$1,038	$313	$258	$310	$1,406	$1,387	$1,388
Total Debt	$8,756	$8,880	$8,599	$2,246	$1,889	$1,890	$2,477	$2,207	$2,248	$3,261	$3,453	$3,532	$2,947	$3,199	$3,326
Cash & Cash Equiv.	$332	$340	$289	$882	$533	$651	$279	$317	$156	$87	$87	$104	$131	$111	$168
EBIT Margin	7.2%	7.3%	7.6%	5.2%	2.9%	2.9%	20.9%	19.3%	19.8%	4.7%	1.9%	5.0%	19.0%	18.4%	18.7%
EBIT / Int. Exp.	1.9x	1.7x	1.8x	1.9x	1.0x	0.9x	14.4x	9.7x	10.6x	0.7x	0.2x	0.5x	11.3x	10.0x	10.0x
Debt / EBITDA	5.5x	5.8x	5.7x	4.8x	6.1x	6.7x	2.6x	2.3x	2.2x	10.4x	13.4x	11.4x	2.1x	2.3x	2.4x
RCF / Net Debt	4.3%	6.4%	6.3%	36.8%	15.1%	18.0%	23.3%	29.5%	29.0%	1.0%	0.3%	0.3%	24.4%	18.3%	17.4%
FCF / Debt	-5.4%	-1.9%	2.7%	8.7%	0.8%	2.0%	18.0%	22.2%	25.2%	-7.5%	-6.4%	-2.5%	12.0%	11.2%	10.8%

All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade.
Source: Moody's Financial Metrics™

Exhibit 7

Moody's-Adjusted Debt Breakdown

Coty Inc.

(in US Millions)	FYE Jun-15	FYE Jun-16	FYE Jun-17	FYE Jun-18	FYE Jun-19	LTM Dec-19
As Reported Debt	**2,634.7**	**4,098.2**	**7,137.4**	**7,524.3**	**7,663.7**	**7,421.8**
Pensions	166.1	190.1	493.9	489.4	540.8	540.8
Operating Leases	318.8	404.9	653.2	643.9	593.1	563.5
Non-Standard Adjustments	0.0	71.9	78.2	98.9	82.1	72.9
Moody's-Adjusted Debt	**3,119.6**	**4,765.1**	**8,362.7**	**8,756.5**	**8,879.7**	**8,599.0**

All figures are calculated using Moody's estimates and standard adjustments.
Source: Moody's Financial Metrics™

Exhibit 8

Moody's-Adjusted EBITDA Breakdown

Coty Inc.

(in US Millions)	FYE Jun-15	FYE Jun-16	FYE Jun-17	FYE Jun-18	FYE Jun-19	LTM Dec-19
As Reported EBITDA	**535.6**	**483.7**	**116.7**	**871.6**	**-2,739.6**	**-1,780.1**
Pensions	9.4	7.4	20.9	6.6	-1.1	-3.1
Operating Leases	87.1	82.5	166.1	208.2	197.7	161.0
Unusual	187.1	269.5	796.0	495.0	4,071.5	3,121.3
Moody's-Adjusted EBITDA	**819.2**	**843.1**	**1,099.7**	**1,581.4**	**1,528.5**	**1,499.1**

All figures are calculated using Moody's estimates and standard adjustments..
Unusual items include impairment charges and one-time restructuring charges.
Source: Moody's Financial Metrics™

Ratings

Exhibit 9

Category	Moody's Rating
COTY INC.	
Outlook	Negative
Corporate Family Rating	Caa1
Sr Sec Bank Credit Facility	B3/LGD3

Senior Unsecured	Caa3/LGD5
Speculative Grade Liquidity	SGL-4

Source: Moody's Investors Service

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