MOODY'S
INVESTORS SERVICE

Rating Action: Moody's changes Coty's outlook to negative, CFR affirmed at B2

22 Nov 2019

New York, November 22, 2019 -- Moody's Investors Service ("Moody's") today changed the rating outlook for Coty Inc. ("Coty") to negative from stable. At the same time, Moody's affirmed Coty's Corporate Family Rating ("CFR") at B2, its Probability of Default at B2-PD, its senior secured term loan and revolver at Ba3 (LGD2), and its unsecured global notes at Caa1 (LGD5). Coty's Speculative Grade Liquidity Rating remains at SGL-4. The rating outlook is negative.

The change in the rating outlook to negative from stable reflects Moody's view that Coty's financial leverage will increase following its announced $600 million debt financed acquisition of a 51% majority interest in Kylie Cosmetics. Moody's estimates that enterprise debt to EBITDA will increase to about 7.3x from 7.0x today. These actions contrast with Moody's expectation that the company would refrain from making acquisitions, but would instead focus on deleveraging through debt reduction and some EBITDA growth. The outlook also reflects Moody's belief that Coty faces high execution risk. This reflects the company's multi-step turnaround plan that includes the divestiture of its Professional and Hypermarcus businesses, proceeds of which are to be used to repay debt, as well as the turnaround of its Consumer Beauty business.

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

Coty Inc.

Ratings Affirmed:

Corporate Family Rating at B2

Probability of Default at B2-PD

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

Guaranteed Unsecured Global Notes at Caa1 (LGD5)

Outlook changed to negative from stable

RATINGS RATIONALE

Coty's B2 CFR reflects the company's high enterprise debt to EBITDA financial leverage, estimated at about 7.3x. Debt to EBITDA includes the $1.77 billion term loan that JAB Holding Company S.a.r.l. ("JAB") incurred in 2019 in order to increase its ownership in Coty from 40% to 60%. While the term loan is not a direct obligation of Coty, the rating agency includes it in total enterprise debt to reflect that the ultimate source of repayment are cash flows generated by Coty. The JAB debt can also be repaid through the subsequent sale of Coty's shares, and stock price appreciation of those shares will in part reflect Coty's operating performance.

The high financial leverage is in part due to earnings weakness reflecting lackluster demand for the company's US 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 to generate modest free cash flow in 2020. The company relies on a $2.75 billion secured revolving credit facility that had $900 million drawn as of September 30, 2019. Moody's expects the revolver to be used to fund the acquisition of Coty's 51% majority interest in Kylie Cosmetics and the company's dividend in 2020. The revolver is subject to a maximum total net leverage financial covenant with step downs. As of September 30, 2019 total net leverage was at 4.08x 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.

In terms of Environmental, Social and Governance (ESG) considerations, the most important factor for Coty's ratings are governance considerations related to its financial policies and board independence. Moody's views 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 majority shareholder.

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 continues to pursue 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 $8.6 billion in annual revenues.

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Chedly Louis
VP - Senior Credit Officer
Corporate Finance Group
Moody's Investors Service, Inc.

250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Peter H. Abdill, CFA
MD - Corporate Finance
Corporate Finance Group
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

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