MOODY'S
INVESTORS SERVICE

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

21 Sep 2021

New York, September 21, 2021 -- Moody's Investors Service ("Moody's") today upgraded Coty Inc.'s ("Coty") Corporate Family Rating ("CFR") to B2 from Caa1, its probability of default rating to B2-PD from Caa1-PD, and the company's senior secured credit facility ratings to B1 from B3, including Coty's first lien revolving credit facility and its first lien term loan. Moody's also upgraded the company's senior secured notes rating to B1 from B3 and its unsecured notes rating to Caa1 from Caa3. Coty's Speculative Grade Liquidity fating was changed to SGL-3 from SGL-4. The rating outlook is stable.

The upgrade reflects Coty's good progress in reducing financial leverage, and Moody's estimates that debt-to-EBITDA leverage will improve to about 5.7x in fiscal 2022 ending June 30th, 2022 from about 7.1x in fiscal 2021 ending June 30, 2021. Improved leverage reflects additional debt repayment and continued earnings momentum. Reduced debt will be driven by good free cashflow due to improved earnings, inventory reduction, and proceeds from strategic initiatives, some of which include proceeds from the Brazil IPO and other potential dispositions. KKR's recent partial conversion of preferred stock into common stock also reduces cash dividends by approximately $30 million annually. In late 2020, Coty paid down a meaningful amount of debt from proceeds following the divestiture of a 60% interest in its Wella assets. Stronger earnings will be driven by improved market demand for Coty's products as consumers continue to get vaccinated and resume more away-from-home activities. Better earnings also reflect the effects of Coty's continued business transformation and ongoing cost reduction initiatives.

Coty faces high execution risk reflecting the company's multiple growth initiatives, which in part includes the continued premiumization of its Prestige business away from sales in low quality channels. Nonetheless, Moody's recognizes that Coty has shown good earnings momentum over the last 12 months driven by the successful turnaround strategies of its new management team led by Sue Nabi, the company's Chief Executive Officer since September 2020. Stronger earnings performance is necessary to further reduce leverage, improve reinvestment capacity in the highly competitive beauty industry, and provide more flexibility to address the still significant 2023 maturities.

The stable outlook reflects Moody's expectation that Coty will improve liquidity, including the successful refinancing of its significant 2023 debt maturities in a timely manner. The outlook also reflects that Coty will continue to improve credit metrics over the next 12-to-18 months through an ongoing recovery in earnings from the weakness experienced during the coronavirus downturn and continue debt repayment.

Ratings Upgraded:

..Issuer: Coty Inc.

.... Corporate Family Rating, Upgraded to B2 from Caa1

.... Probability of Default Rating, Upgraded to B2-PD from Caa1-PD

.... Speculative Grade Liquidity Rating, Upgraded to SGL-3 from SGL-4

....Senior Secured 1st Lien Revolving Credit Facility, Upgraded to B1 (LGD3) from B3 (LGD3)

....Senior Secured 1st Lien Term Loan, Upgraded to B1 (LGD3) from B3 (LGD3)

....Senior Secured Regular Bond/Debenture, Upgraded to B1 (LGD3) from B3 (LGD3)

....Senior Unsecured Regular Bond/Debenture, Upgraded to Caa1 (LGD5) from Caa3 (LGD5)

Outlook Actions:

..Issuer: Coty Inc.

....Outlook, Remains Stable

RATINGS RATIONALE

Coty's B2 CFR reflects the company's high debt to EBITDA financial leverage that Moody's estimates at about 7.1x in fiscal 2021 ending June 30th. Moody's expects debt-to-EBITDA leverage to improve by about one turn over the next year to about 5.7x due to stronger earnings and debt repayment funded from free cash flow and asset sales. Coty continues to recover from weak revenue levels driven by efforts to contain the coronavirus and pressure on discretionary consumer income. Demand for the company's products will improve over the next year as the number of vaccinated consumers continues to increase, and as consumers slowly resume more away-from-home activities that will help drive a rebound in beauty products demand. The rating also reflects Moody's belief that the company will generate strong free cash flow of about $350-400 million over the next year due to good earnings growth and a meaningful working capital improvement, driven by reduced inventory levels.

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. The company also relies more heavily on licenses to support its prestige brands relative to greater ownership of its mass beauty brands. Moody's believes reliance on licensing results in a weaker market position than many of its larger competitors that own the bulk of the prestige beauty brands. These factors create 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.

The upgrade to SGL-3 from SGL-4 reflects the company's improved free cash flow and higher potential to comply with a financial maintenance leverage covenant that contains meaningful step downs. The SGL-3 Speculative Grade Liquidity rating reflects Moody's view that Coty's liquidity is adequate because the company will have weak headroom under the total net leverage covenant over the next 12 months. The $2.75 billion revolver expiring in 2023 and the term loan A are subject to a maximum 5.25x total net leverage financial covenant with step downs. The covenant steps down to 5.0x in March 2022, 4.75x in June 2022, 4.50x in September 2022, 4.25x in December 2022 and 4.0x in March 2023 and thereafter. Coty will need to reduce leverage to meet the step downs, which creates reliance on a recovering economy, good execution, and, potentially, identification of additional cost saving opportunities to avoid a covenant violation.

ENVIRONMENTAL SOCIAL AND GOVERNANCE CONSIDERATIONS

The coronavirus outbreak and the government measures put in place to contain it continue to disrupt economies and credit markets across sectors and regions. Although an economic recovery is underway, the recovery is tenuous, and continuation will be closely tied to containment of the virus. As a result, a degree of uncertainty around our forecasts remains. Moody's regards the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

Social considerations impact Coty in several other ways. First, Coty is a "beauty" company. It sells products that appeal to customers almost entirely due to "social" considerations. That is, such products such as makeup and fragrance help individuals fit in to society and comply with social mores and customs. Hence social factors are the primary driver of Coty's sales, and hence the primary reason it exists. To the extent such social customs and mores change, it could have an impact -- positive or negative -- on the company's sales and earnings. However, Moody's believes such risk is manageable as such customs and mores change at a measured pace, and as the company is able to adapt to changing "fashion" trends, and hence offset such social changes. The company engages with social media influencers, which is in line with demographic and societal trends. While negative product reviews for the company have historically been modest, Moody's recognizes that a high number of adverse product reviews could negatively impact product demand.

Coty's ratings also reflect 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. The company favorably suspended the dividend to preserve cash and bolster liquidity until leverage is reduced. Coty's plan to reduce net debt-to-EBITDA leverage to 4.0x (based on the company's calculation) by the end of calendar 2022 from 5.1x as of June 2021 demonstrates a continued focus on lowering leverage and governance risk.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Coty's ratings could be downgraded if Coty is unable to successfully refinance its remaining debt due 2023 in a timely manner. The ratings could also be downgraded if operating performance does not continue to improve, as demonstrated by consistent revenue and earnings growth. The inability to further reduce financial leverage to below 6.5x and improve liquidity, or the pursuit of material debt funded acquisitions or shareholder returns could also lead to a downgrade.

Coty's ratings could be upgraded if the company successfully refinances its remaining debt due 2023 in a timely manner, and improves liquidity overall. The ratings could also be upgraded if Coty reduces financial leverage such that debt to EBITDA approaches 5.0x. Coty would also need to consistently generate good revenue and earnings growth such that the company continues to generate strong free cash flow.

The principal methodology used in these ratings was Consumer Packaged Goods Methodology published in February 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1202237. Alternatively, 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 $4.6 billion in annual revenues. Coty is 57% owned by a German based investment firm, JAB Holding Company S.a.r.l. (JAB), with the rest publicly traded or owned by management. KKR owns preferred stock that is convertible into a 11% interest in the company.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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