FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades Coty Inc. to 'BB+'; Outlook Stable

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Fitch Ratings - New York - 13 May 2024: Fitch Ratings has upgraded the Long-Term Issuer Default Ratings (IDR) for Coty Inc. and Coty B.V. to 'BB+' from 'BB'. The Rating Outlook is Stable.

Coty Inc.'s ratings reflect its leading market position as one of the world's largest beauty companies with a recently improved mix toward higher growth and higher margin prestige fragrance and skin care, and signs of stabilization in its consumer beauty business. The upgrade reflects continued progress towards improving its EBITDA leverage, which Fitch expects will trend just under 4x in fiscal 2024 (ending in June 2024) and mid 3x in fiscal 2025, versus 4.6x as of June 30, 2023 as the company expands EBITDA and deploys FCF towards debt reduction.

KEY RATING DRIVERS

Improved Business Profile: Coty's operating performance and financial profile have improved meaningfully over the last four years. Fiscal 2023 (which ended on June 30, 2023) revenue was USD5.6 billion and EBITDA was USD973 million, returning close to 2019 pro forma levels after adjusting for the sale of a majority stake in the Wella brand and over USD300 million reduction in revenue from a rationalized distributor network. The business continues to see strong momentum, and Fitch expects like-for-like revenue to increase by more than 10% in fiscal 2024.

Coty has seen strong growth in its prestige fragrance business and has taken meaningful steps to fill gaps in its consumer beauty portfolio and stem share losses in its key consumer brands, including Covergirl, Rimmel, Max Factor and Sally Hansen. It is investing heavily in skin care and natural products across legacy and newer brands. Investments in innovation, new product launches and marketing appear to have stabilized its share in the consumer beauty business after five years of declines.

Beginning FY25, Fitch expects Coty to sustain 2%-4% revenue growth (relative to Coty's expectation of 6%-8% medium term growth), with prestige fragrances to be the main contributor. Consumer beauty business revenue could be flat, given repositioning efforts across key brands while recognizing overall challenges in the mass market beauty space. Coty's emerging presence in categories like prestige makeup and skin care and in markets such as China (4% of consolidated revenue) provide medium-term growth opportunities.

Favorable Mix Shift Supports Revenue Growth: The company, under the leadership of Sue Nabi, a L'Oreal veteran who became CEO in September 2020, detailed its strategic initiatives in early 2021 to drive medium-term revenue growth of 6%-8% and has taken significant steps to invest in existing categories and new adjacencies, such as skin care and body care. The company's portfolio has improved with its prestige segment driving 62% of fiscal 2023 revenue versus 56% in fiscal 2019. Within the segment, fragrances made up around 55% of revenue in fiscal 2023, cosmetics around 3% and skin care around 4%. The prestige business carries close to 22% EBITDA margins and drives over 75% of EBITDA.

The consumer beauty business, which includes Coty's mass segment color cosmetics business at 25% of total revenue, body care at 7% and mass fragrances at 6%, has an EBITDA margin below 11%. The company has experienced some positive momentum in the consumer beauty business following recent investments, including indications of market share stabilization, although in a somewhat volatile spending environment.

Improved Credit Profile: Coty ended fiscal 2023 with around USD4.4 billion in debt, down from nearly USD9.0 billion at fiscal YE 2020. The company paid down debt using FCF and asset sale proceeds — including USD2.5 billion received from its sale of a stake in its Wella hair care business to Kohlberg Kravis Roberts & Co. L.P.(KKR). Debt was also reduced by the equitization and share exchange of most of the USD1 billion preferred stake, which Fitch includes in Coty's debt calculation, held by KKR. Coty has stated a goal of reducing net leverage to approximately 2.5x exiting CY24 and approximately 2.0x exiting CY25, assuming EBITDA growth and further debt reduction from FCF.

Company-calculated net leverage was 4.1x at June 30, 2023, which equates to Fitch-calculated gross EBITDA leverage of 4.6x. Fitch expects EBITDA leverage to decline under 4.0x in fiscal 2024, reflecting the $400 million in debt tenders in late 2023, and mid 3x in fiscal 2025, with continued debt reduction given Fitch's FCF projections in the $400 million-$500 million range. Fitch has not projected any proceeds from additional sales of Coty's 25.9% stake in Wella. Coty has publicly stated that it expects to fully exit its position by calendar 2025, with the stake at a fair value of just over USD1 billion at the end of the quarter.

Exposure to Dynamic Industry and Evolving Marketing Landscape: The fragrance and color cosmetics industries have demonstrated some positive long-term characteristics, including mid-single-digit annual growth and relatively high margins. The global beauty business is expected to continue to benefit from a growing middle class, premiumization of fragrances and skin care products and a focus on wellness.

However, the industry, and some of its most venerable brands, have been disrupted by new marketing and retail channels. In addition, there could be a moderation in the strong growth rates seen in prestige brands and fragrances given the overall pullback in discretionary consumer spending.

DERIVATION SUMMARY

Similarly rated peers in the consumer products market include Hasbro, Inc., Mattel, Inc., and Reynolds Consumer Products Inc.

Mattel's 'BBB-/Stable' rating reflects the impact of the company's efforts to revitalize and re-energize its portfolio of owned brands such as Barbie, Hot Wheels and Fisher Price over the past several years, which has supported market share gains. The rating also considers its low leverage, with Fitch defined EBITDA leverage expected to remain below 3x over the medium term.

Hasbro's 'BBB-/Negative' rating reflects brand health concerns and execution risks in returning to positive revenue growth and driving EBITDA expansion, and elevated leverage. Hasbro is investing in innovation and new product launches, which should support revenue growth in 2025 and beyond.

Reynolds Consumer Products' 'BB+'/Stable rating reflects its leading market position, supported by innovation and conservative financial policies and good liquidity. EBITDA leverage is expected to remain below 3x over the medium term. Reynolds' rating also reflects its relatively smaller scale and lower degree of diversity compared to larger consumer goods companies.

KEY ASSUMPTIONS

-- Revenue grows at approximately 10% in fiscal 2024 on a fiscal 2023 revenue base of USD5.6 billion, with particular strength in prestige fragrances and skincare. Fitch expects organic revenue to grow in the 2%-4% range thereafter, assuming faster growth in the fragrance business and flattish results at Coty's consumer beauty (mass market cosmetics) brands;

-- EBITDA increases to just over USD1 billion in fiscal 2024 from USD973 million in fiscal 2023 on revenue growth, with EBITDA margins stable around 17.6%; EBITDA generally grows in line with revenue thereafter;

-- FCF of around USD300 million in fiscal 2024, assuming some cash usage for working capital and USD400 million to USD500 million annually in fiscal 2025-2026, given EBITDA growth and assuming minimal working capital swings. Fitch expects Coty to divert a portion of this toward debt reduction, given USD1.5 billion of debt due in April 2026. The company maintains an approximate 26% stake in Wella and plans to fully monetize its stake by fiscal 2025, adding to potential liquidity sources;

-- EBITDA leverage is expected to decline to around 4.0x in fiscal 2024 and the mid 3x range in fiscal 2025 from 4.6x in fiscal 2023 on continued debt reduction and some EBITDA expansion. Fitch's debt calculations include USD143 million in preferred stock;

-- Coty's debt generally has fixed interest rate structures aside from its USD2 billion revolving credit facility; as such, borrowings under this facility could be subject to higher interest rates in the near term. Pricing is SOFR + 150bps for the USD1.67 billion revolver and Euribor +150 bp for the EUR300 million tranche.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- An upgrade of Coty's ratings to 'BBB-' could result from continued strong results, with annual organic top-line growth in the low-to-mid-single digits, stable to improving market shares, EBITDA of over USD1 billion, with EBITDA leverage, defined as gross debt/EBITDA, sustained under 3.5x.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

-- A downgrade to 'BB' could result from a deceleration in top-line growth and declining EBITDA margins such that EBITDA leverage sustains above 4x;

-- A downgrade could also result from a change in financial policy or debt financed acquisitions that result in EBITDA leverage sustained above 4.0x.

LIQUIDITY AND DEBT STRUCTURE

Coty's liquidity as of March 31, 2024 consisted of USD260 million in cash and approximately USD1.75 billion of availability under its revolving credit facilities after accounting for USD255 million of outstanding borrowings. The company has two tranches of senior secured revolving credit commitments, one in an aggregate principal amount of USD1.670 billion available in U.S. dollars and certain other currencies and the other in an aggregate principal amount of EUR300 million. Both are due to mature on July 11, 2028.

As of March 31, 2024, Coty had USD255 million of borrowings under its revolver, USD3.2 billion of senior secured notes due 2026-2030, USD520 million in senior unsecured notes due April 2026 and USD142 million of convertible series B preferred stock. Fitch treats the preferred stock as debt given what we view as a lack of permanence in the cap structure due to the high coupon.

Coty has significant maturities on April 15, 2026, when approximately USD1.4 billion of U.S. dollar and euro senior secured notes and approximately USD520 million of senior unsecured notes come due. Fitch expects the company to address these maturities through debt tenders/paydown and refinancing.

Fitch expects the company to generate USD300 million in FCF in fiscal 2024 and around USD450 million in fiscal 2025. On Dec. 7, 2023, the company completed cash tender offers and redeemed USD150 million of the company's USD 550 million 6.50% 2026 dollar notes (USD323 million amount outstanding as of March 2024) and USD250 million of the company's USD900 million 5.00% 2026 dollar senior secured notes (USD650 million amount outstanding as of March 2024).

Coty also could use FCF toward USD400 million in share buybacks over fiscal 2024-2025; in June and December 2022, the company entered into certain forward repurchase contracts to start hedging for two potential USD200 million and USD196 million share buyback programs, in 2024 and 2025, respectively. In February 2024, Coty completed the first tranche of the equity swap agreement at a cash cost of USD200 million, resulting in a share count reduction of 27 million at an effective share price of USD7.40.

Recovery Considerations: Fitch assigns Recovery Ratings (RRs) to the various debt tranches in accordance with Fitch's criteria, which allows for the assignment of RRs for issuers with IDRs in the 'BB' category. Given the distance to default, RRs in the 'BB' category are not computed by bespoke analysis. Instead, they serve as a label to reflect an estimate of the risk of these instruments relative to other instruments in the entity's capital structure.

Fitch has upgraded Coty's debt issuances by one notch, with the senior secured credit facilities and secured notes, which are pari passu, upgraded to 'BBB-'/'RR2' from 'BB+/RR2', indicating outstanding recovery prospects in the event of default. The senior credit facilities and secured notes are senior secured obligations of Coty and are guaranteed on a senior secured basis by each of Coty's wholly owned domestic subsidiaries. The unsecured notes are rated 'BB+'/'RR4', indicating average recovery prospects, and the series B preferred stock is rated 'BB-'/'RR6', given its deeply subordinated nature.

ISSUER PROFILE

Founded in 1904, Coty Inc. is one of the world's largest beauty companies, manufacturing, marketing and distributing prestige and mass market products with a top three global position in both fragrances and mass color cosmetics, and an emerging presence in skincare and body care categories.

SUMMARY OF FINANCIAL ADJUSTMENTS

Historical and projected EBITDA is adjusted to add back non-cash stock-based compensation and exclude non-recurring charges.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING	RECOVERY	PRIOR

Coty Inc.	LT IDR	BB+ Rating Outlook Stable	Upgrade			BB Rating Outlook Positive
senior unsecured	LT	BB+	Upgrade	RR4		BB
preferred	LT	BB-	Upgrade	RR6		B+
senior secured	LT	BBB-	Upgrade	RR2		BB+
Coty B.V.	LT IDR	BB+ Rating Outlook Stable	Upgrade			BB Rating Outlook Positive
senior secured	LT	BBB-	Upgrade	RR2		BB+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

Parent and Subsidiary Linkage Rating Criteria (pub. 16 Jun 2023)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 13 Oct 2023) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 03 Nov 2023) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Coty B.V.	EU Endorsed, UK Endorsed
Coty Inc.	EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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