Research Update:

Coty Inc. Upgraded To 'BB+' On Revised Business Risk; Outlook Stable

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Rating Action Overview

- Coty continues to execute its strategy and reduce leverage by paying down debt and expanding EBITDA, which resulted in S&P Global Ratings-adjusted leverage improving to 4x by the end of fiscal 2024 from 4.7x at the end of fiscal 2023.
- We revised our business risk assessment to satisfactory from fair to reflect its overall scale, diversity of brands and products in both prestige and mass beauty and improved operating efficiency.
- Therefore, we raised our issuer credit rating to 'BB+' from 'BB'. Concurrently, we raised the issue-level rating on the company's senior secured debt to 'BBB-' from 'BB+' and our issue-level rating on its senior unsecured debt to 'BB+' from 'BB'. The recovery ratings remain unchanged at '2' and '3', respectively.
- The stable outlook reflects our expectation that over the next 12 months Coty will continue to expand its topline in the mid-single-digit percent range, grow EBITDA, and use free operating cash flow (FOCF) to pay down debt such that its S&P Global Ratings-adjusted leverage improves to the mid-3x area by the end of fiscal-year 2025.

Rating Action Rationale

The upgrade reflects our more favorable view of Coty's business risk driven by overall scale and diversity of its brands and product portfolio as well as improved operating efficiency. Coty has improved its overall scale in the past three years and we expect continued topline growth as the company benefits from favorable industry trends. The company grew its revenue to over $6 billion in fiscal year 2024 from $4.6 billion in fiscal 2021, driven mainly by strong growth in prestige fragrance. We expect mid-single-digit percentage topline growth in the coming years as the company continues to benefit from favorable industry trends as the prestige fragrance category is expected to grow mid- to high-single-digit percent in the next few years according to Euromonitor.

Coty has a diverse portfolio of brands and products at different price points, across different channels, categories, and markets. Its portfolio consists of fragrance (around 60% of overall

revenue), color cosmetics (28%), and skincare and body care (12%). Coty's geographic footprint is diversified, generating about 70% of its total revenue outside North America.

The company has meaningfully improved its operating efficiency and EBITDA margins, driven by continued mix shift to prestige business, pricing, productivity, and ongoing cost control. The company has also consolidated its manufacturing footprint and improved capacity utilization in fragrance. As a result, EBITDA margins improved to around 18% to 19% in the past three years compared to just around 14% in fiscal 2021. We expect continued EBITDA margins improvement, driven by pricing and cost control, as well as positive mix shift as prestige fragrance has much higher EBITDA margins than mass beauty and drives about 75% of the total company EBITDA.

Coty has successfully stabilized its market share and is well positioned in growing categories. Coty continues to gain market share in its prestige fragrance business and focus on premiumization of its portfolio through existing leading brands as well as new premium fragrance launches, including Burberry Goddess, Kylie Jenner Cosmic, and Marc Jacobs Daisy Wild. The company has largely stabilized its share in the consumer beauty business over the past few years after consecutive market share losses from 2016 to 2020. It largely stabilized its consumer beauty business by investing in product innovation, brand repositioning and marketing, and closing pricing gaps versus competition. Coty's skincare business is under-indexed compared with its peers in the skincare category, but has high margins and presents white space opportunity for growth. We expect the company to accelerate the growth of its skincare brands, including Orveda, Lancaster, and Philosophy. We expect the digital channel to show strong momentum, supported by livestreaming, social media, TikTok activities, visual try-on capabilities, and expanded e-commerce presence. In addition, we expect travel retail to continue to benefit from a broad-based geographic footprint, multi-category expansion and collaborative partnership with key retailers.

We forecast S&P Global Ratings-adjusted leverage to further improve to 3.5x, driven by EBITDA growth as well as permanent debt reduction and FOCF of around $410 million by the end of fiscal 2025. Coty repaid around $390 million of debt in fiscal-year 2024 with $322 million of FOCF and the proceeds from its equity offering. We forecast FOCF of around $410 million in fiscal 2025, which the company will use to reduce debt and for the planned share repurchases via equity swaps. As a result, we forecast adjusted leverage to further improve to 3.5x by the end of fiscal 2025 from both EBITDA growth and debt reduction. We also expect Coty to monetize Wella by the end of calendar-year 2025 and use the proceeds from this asset sale to reduce debt, which could result in material permanent debt reduction close to $1 billion. We have not included it in our current forecast but this would lead to S&P Global Ratings-adjusted leverage to fall to the mid-2x area if Wella is monetized.

We expect Coty will remain committed to its current financial policy. The company-defined leverage at the end of fiscal-year 2024 was around 3.3x, within its mid- to long-term leverage target of 2.0x-3.5x, which is roughly equivalent to S&P Global Ratings-adjusted leverage of 2.7x-4.2x. We believe the company will remain committed to its current financial policy and will not buy back shares to the detriment of its credit ratios.

Outlook

The stable outlook reflects our expectation that over the next 12 months Coty will continue to expand its topline in the mid-single-digit percent range, grow EBITDA, and use FOCF to pay down debt such that its S&P Global Ratings-adjusted leverage improves to the mid-3x area by the end of

fiscal-year 2025.

Downside scenario

We could lower our ratings if growth momentum starts to slow down and we expect adjusted leverage to be sustained above 4x, which could occur due to:

- A worsening macroeconomic environment, lower discretionary spending, heightened competition, or an operational misstep, leading to lower demand for the company's products.
- The company pursues a more aggressive financial policy with debt-funded share repurchases and acquisitions.

Upside scenario

We could raise our ratings if the company:

- Achieves sustained organic growth, continues to gain market share, and improves its cost structure, leading to consistent EBITDA margin improvement and a stronger competitive position; or
- Continues to execute its strategy of utilizing all excess cash proceeds from future asset sales, including Wella, for debt reduction, and demonstrates a more conservative financial policy, such that adjusted leverage sustains below 3x.

Company Description

Coty, together with its subsidiaries, develops, manufactures, markets, and distributes fragrances, cosmetics, skin care and body care products worldwide. JAB Holding Co. is Coty's largest shareholder, with a 55% ownership in the company as of June 30, 2024.

Our Base-Case Scenario

- S&P Global Ratings economists expect U.S. GDP will grow 2.4% in calendar 2024 and 1.7% in calendar 2025, Europe GDP will increase 1.4% in calendar 2024 and 1.8% in calendar 2025, and China GDP will expand 4.8% in calendar 2024 and 4.6% in calendar 2025.
- Revenue increases about 5.5% percentage in fiscal 2025, driven by strong momentum across the prestige and consumer beauty segment and across all regions and key categories including fragrance, cosmetics, and body care. We expect revenue growth at a similar rate in fiscal 2026.
- Adjusted EBITDA margin to improve 50 bps in fiscal 2025 on pricing, favorable mix, and cost saving initiatives. We expect modest EBITDA margin expansion in fiscal 2026 due to operating leverage and cost savings.
- Capital expenditures (capex) of about $260 million annually over the next two years, mainly driven by maintenance capital spending requirements to support the higher sales volumes.
- FOCF around $410 million in fiscal 2025 and around $445 million in fiscal 2026.
- Total dividends around $30 million annually and share repurchases around $200 million in fiscal 2025 and $300 million in fiscal 2026.

Table 1

Coty Inc.--Key metrics*

	--Fiscal year ended June 30--			
Mil. $	2023a	2024a	2025f	2026f
Revenue	5554.1	6118	6454.5	6809.5
Revenue growth (%)	4.7	10.2	5.5	5.5
EBITDA	1054	1130.3	1229.4	1328.9
EBITDA margin (%)	19	18.5	19	19.5
Funds from operations (FFO)	739.4	678.4	904.4	995.1
Free operating cash flow (FOCF)	402.9	322.3	412.7	443.7
Debt	4977.5	4485.7	4309.7	4219.5
Debt to EBITDA (x)	4.7	4	3.5	3.2
FFO to debt (%)	14.9	15.1	21	23.6
EBITDA interest coverage (x)	3.7	4.1	4.9	5.1

*All figures adjusted by S&P Global Ratings except FOCF, which is reported. a--Actual. f--Forecast.

Liquidity

We continue to assess Coty's liquidity as adequate, reflecting our forecast that its sources will exceed uses by more than 3x over the next 12 months and remain positive even if EBITDA declines by 30%. We believe Coty has well-established and solid relationships with its banks--demonstrated by its ability to secure large, committed credit facilities--and satisfactory standing in credit markets. However, we continue to believe the company will need to refinance if it experiences a high-impact, low-probability event, such as severe market turbulence or a material decline in market share that leads to margin erosion.

Principal liquidity sources

- Cash balance of around $300 million as of June 30, 2024;
- Full availability under the $2 billion multi-currency revolving credit facility due 2028; and
- Cash FFO of about $860 million over the next 12 months.

Principal liquidity uses

- No near-term debt maturities and about $1.6 billion debt maturities due in the next 24 months;
- Capital spending of about $260 million over the next 12 months; and
- Seasonal peak to trough working capital of about $250 million.

Covenants

Requirements

Coty's credit agreements contain a maximum 4x total net leverage ratio maintenance covenant

requirement. The company's credit agreement allows it to add back 36 months of forward cost savings and excludes some restructuring costs.

Compliance expectations

We expect Coty to remain in compliance with all applicable covenants under the ABL revolving credit agreement and term loan agreement for the respective periods over the next 12 months. We expect the company to have sufficient headroom over 30% over the next 12 months under our base-case forecast.

Issue Ratings - Recovery Analysis

Key analytical factors

The company's debt structure consists of:

- $1.67 billion USD/Multicurrency revolving credit facility maturing in July 11, 2028;
- 300 million Eurocurrency revolver maturing in July 11, 2028;
- $900 million Dollar senior secured notes, maturing in April 2026 ($650 million outstanding as of June 30, 2024);
- 750 million Euro senior secured notes, maturing in April 2026;
- 500 million Euro senior secured notes, maturity in May 2027;
- 500 million Euro senior secured notes, maturing in Sept 2028;
- $500 million Dollar senior secured notes, maturing in January 2029;
- $750 million Dollar senior secured notes, maturing in July 2030;
- 2026 senior unsecured euro notes with $192.7 million outstanding as of June 30, 2024, maturing in April 2026.

All the senior secured notes, except the 2026 dollar senior secured notes due April 2026 and euro senior secured notes due April 2026, have a collateral fall away provision, whereby the collateral security will be released upon the notes achieving investment-grade ratings from two out of three rating agencies. The notes indenture also has a reversion clause that if two out of three rating agencies lower the notes below investment grade, the collateral springs back. Given the collateral spring back feature, we treat the notes with these provisions as senior secured debt in our simulated default scenario because at default the collateral would be in place. Note that as of today, the collateral has not been released, and in the case that it is released in the future, we will still view these notes as senior secured because we assume collateral springs back in our default scenario.

Coty Inc. is the borrower/issuer of all the debt. Coty BV is a co-borrower under the revolver. We continue to value the company on a going concern basis. The bank loans are guaranteed by the borrower and its direct and indirect wholly owned domestic subsidiaries and secured by perfected first-priority security interest in substantially all assets of the borrower and each subsidiary guarantor, subject to certain exceptions, whether owned on the closing date or thereafter acquired. (All facilities are cross-guaranteed.) The unsecured notes are guaranteed direct and indirect wholly owned domestic subsidiaries (dollar and euro notes cross-guaranteed).

The company's debt is incurred in the U.S. (with the exception of Coty BV being a co-borrower on the revolving credit facility), and each of the secured facilities are cross-guaranteed and cross-collateralized. In the event of an insolvency proceeding, the company would most likely file for bankruptcy protection under the auspices of the U.S. federal bankruptcy court system even though it has significant foreign operations, we do not assume any filings in foreign jurisdictions. The company could file for bankruptcy protection in foreign jurisdictions as well but in such a case, it would add complexity to the administration of the bankruptcy case and would incur additional bankruptcy-related costs, resulting in lower recovery prospects.

We believe the company would be reorganized rather than liquidated under a default scenario, given Coty's portfolio of well-recognized brand names with strong market shares and its geographic diversity.

We estimate around $5 billion in gross recovery value at the time of default under our projected scenario. We base this on assumptions of the realization rates for Coty's ownership stakes in Wella as well as an assumption of an EBITDA multiple applied against the company's distressed emergence EBITDA under our hypothetical default scenario.

Our analysis considers a 60% realization rate on the company's investments in Wella, resulting in a $699 million DAV at default. We have valued the company's base business, which includes 51% ownership in Kylie, based on an enterprise value to gauge recovery and apply a 6.5x multiple on an assumed distressed emergence EBITDA of $673 million that results in an estimate gross recovery value of $4.4 billion. To determine net recovery value available for distribution to creditors, we reduced our estimate of total gross recovery value around $5 billion by 5% to account for estimated bankruptcy administrative expenses. This results in a total net recovery value of about $4.8 billion.

Simulated default assumptions

Our simulated default scenario contemplates a default in 2029, primarily due to a steep decline in demand for the company's products or any operational missteps. We believe that in a distressed situation, funds from the company's operations would not be adequate to support the interest burden and cash needs for its operations.

Calculation of EBITDA at emergence

- Debt service: $327.7 million (default year interest plus amortization)
- Maintenance capex: $153 million
- Preliminary emergence EBITDA: $480.7 million
- Operational adjustment: 40% of preliminary emergence EBITDA)
- Emergence EBITDA: $673 million

Simplified waterfall

- Emergence EBITDA: $673 million
- Multiple: 6.5x
- Gross recovery value: $4.4 billion
- Gross asset value: $1.1 billion

- Realization rate: 60%
- DAV: $699 million
- Total gross recovery value: $5.1 billion
- Net recovery value for waterfall after administrative expenses (5%): $4.8 billion
- Valuation split (obligor/nonobligors): 30.2%/56%/13.8%
- Collateral for secured creditors: $3.2 billion
- First-lien claims: $5.58 billion
- --Recovery expectation: 70%-90%; rounded estimate: 80%
- Collateral for unsecured creditors: $1.6 billion
- Unsecured claims: $2.6 billion
- --Recovery expectation: 50%-70%; rounded estimate: 60%

Note: All debt amounts at default include six months accrued pre-petition interest.

Ratings Score Snapshot

Issuer Credit Rating: BB+/Stable/--

Business risk: Satisfactory

- Industry risk: Low
- Country risk: Low
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: bb+

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024

- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded; Outlook Action

	To	From
Coty Inc.		
Issuer Credit Rating	BB+/Stable/--	BB/Positive/--
Coty Inc.		
Senior Secured	BBB-	BB+
Recovery Rating	2(80%)	2(80%)
Coty Inc.		
Senior Unsecured	BB+	BB
Recovery Rating	3(60%)	3(55%)

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