FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades Natura&Co's IDRs to 'BB+'; Outlook Stable

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Fitch Ratings - Rio de Janeiro - 28 Mar 2024: Fitch Ratings has upgraded Natura &Co Holding S.A. (Natura) and Natura Cosmeticos S.A.'s Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) to 'BB+' from 'BB' and National Scale Rating to 'AAA(bra) from 'AA+(bra)'. Fitch has also upgraded Natura&Co Luxembourg Holdings S.a.r.l's unsecured notes to 'BB+' from 'BB'. In addition, Fitch has affirmed Avon Products, Inc. and its unsecured notes at 'BB'. Rating Outlook is Stable.

The upgrades reflect Natura's sustainably conservative capital structure, following the past year of asset sales, and its strategy to streamline operations. The company has raised USD2.6 billion in asset sale and effectively paid down 55% of its debt (around BRL7.6 billion). The stronger financial profile and financial flexibility better positioned the company to navigate current challenges, like the completion of Avon's turnaround and the profitability rebound at Natura Latam, its core operation. The net adjusted leverage ratio, which is stronger for the rating category, is expected to remain below 1.5x in the medium to long term.

KEY RATING DRIVERS

Robust Capital Structure: Fitch expects Natura to maintain a strong capital structure in the next few years, while it completes its Wave 2 Project focusing on improving its profitability, as well as managing Avon International's challenges and shareholders returns. Fitch estimates Natura's 2024 total and net adjusted leverage ratios, including rental obligations per Fitch's criteria, to be 2.6x and 0.6x, respectively, and around 2.3x and 0.4x on average for the next two subsequent years. This represents a significant improvement from a median net and total leverage ratio of 4.2x and 2.8x during the 2019-2022 period.

During 2023, Natura completed the sale of Aesop for USD2.525 billion, with resources received during 3Q23. Natura used a large part of this cash inflow to retire around BRL7.6 billion of debt and to paydown interests and derivatives settlements. At the end of FY 2023, total and net adjusted leverage ratios were 3.0x and 0.1x, respectively.

Return to Latin America Business Focused: Following the asset sales of Aesop and The Body Shop (4Q23), Natura is looking to simplifying its operations and focus on its core business (brands) and markets (Brazil and Latin America). During 2022, Aesop and The Body Shop (TBS) contributed around 17% and 12% of consolidated EBITDA. During 2019-2021, TBS contributed with on average 22% to the consolidated EBITDA, but operations dropped significantly over the last few years.

On proforma basis, Natura's FY 2023 revenue outside Latin America has declined to 26%, which compares to 47% in 2020, just after Avon's acquisition, and 37% in 2019 when it still had Aesop and The TBS operations. Natura has a solid business position in Brazil and Latin America, with a strong brand and product portfolio. Natura has also announced that it is studying a potential separation of Natura&Co and Avon. There is still limited visibility on this strategy; however, Fitch does not expect any major impact on Natura's business profile or ratings following a potential spin-off, considering the capital structure remains solid.

Ongoing Execution Risk: Natura continues to face challenges of turning around Avon's international operations. The operations in Latin America have advanced relatively better there was some fit with Natura's operations in the region. Natura is moving ahead with the second wave of integration (Wave 2), seeking to reshape its cost structure and focus on market portfolio, as well strategic, decisions to rightsized its operation in select markets.

Natura must also move forward with its strategy to transition from a direct sales single-model, with declining trends in certain markets, to an omnichannel strategy. Natura's strategy related to online and physical stores are key factors to watch. The company closed 2023, with 112 owned stores and 773 franchised stores.

Gradual Improvement in Profitability: Natura remains focused on its business simplification and improving profitability, with marginal improvements delivered during 2023. Per Fitch's criteria, Natura's adjusted EBITDAR margin during 2023 was 10.1%, an improvement from 8.7% during 2022. For 2024, Fitch expects an adjusted EBITDAR margin of 11.5%, then moving to around 12% during the next two years.

In terms of adjusted EBITDAR generation, the company should achieve BRL3.2 billion in 2024 and BRL3.4 billion in 2025. In past years, Natura has invested heavily in digitalization and on increasing its online sales, which have more than doubled. During 2023, 88% of total sales utilized the traditional direct selling model, 8% digital, 4% retail and 1% wholesale.

FCF Impacted by Extraordinary Dividends: Fitch expects Natura's FCF to be negative in 2024 at around BRL1.2 billion after BRL1 billion of capex and extraordinary dividends of BRL979 million to be paid during April 2024. Natura is expected to maintain a strong pipeline of innovation to keep up with fast-changing beauty trends and to digitalize to engage more directly with end consumers, which is expected to require solid capex levels.

Fitch's base case incorporates average annual capex of around BRL1 billion in 2024-2026, which will continue to pressure FCF. For 2025 and 2026, FCF should be around BRL332 million and BRL535 million. Fitch includes minimum dividends payments (30% of net income) for 2025 and 2026.

Top-Down-1 Approach for Avon: Natura wholly owns Natura Cosmeticos S.A. and Avon Products, which are separate legal entities. Fitch assesses the group on a consolidated basis, given the strong operational and strategic incentives, centralized treasury, substantial asset contribution via synergies at the Latin American operations, and the tangible financial support in the form of payment of Avon's secured and unsecured notes. Natura's operations supported the payment of around BRL4 billion at Avon's level.

Natura has indicated it is studying the separation of Avon International's operations and that currently there are limited synergies. Therefore, Fitch has reassessed the operational and strategic linkage to medium, resulting in a Top Down -1 rating approach. For Natura and Natura Cosméticos, the consolidated approach also includes cross-guarantees, and others cross defaults clauses support the consolidated approach.

DERIVATION SUMMARY

Natura's ratings reflect the combination of its good business position in the CF&T industry, underpinned by strong brand recognition and market position in Brazil and main markets in Latin America, as well as conservative credit profile. Current credit metrics (net adjusted leverage of 0.4x-0.6x) are strong for the rating category. This helps to mitigate the challenges the company continues to face to recover its business profitability and new industry dynamics moving to an omnichannel strategy and fierce competition. Any deviation in terms of implementing a more friendly-shareholder policies or inorganic cash outflows could pressure the ratings.

Rated peers in the consumer/beauty products space include Coty Inc. (BB/Positive Outlook). Coty'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 margined prestige fragrance and skincare, but still high to moderate leverage (estimated net leverage trending below 4.0x).

Natura also faces strong competition from a local player, O Boticario (not rated), which also presents a solid business profile, supported mainly by its bricks-and-mortar franchise chain, and adequate leverage.

Within the retail/consumer universe, Fitch rates MercadoLibre, Inc.'s (MELI) (BB+/Stable). MELI's ratings reflects its leadership position in the competitive and underpenetrated e-commerce and digital payments sectors in Latin America, and Fitch's expectation that MELI will preserve good financial discipline while it continues to invest in logistics and technology. MELI`s rating is also somewhat limited by operating environment of Brazil and Argentina.

KEY ASSUMPTIONS

--Fitch expects Natura's revenue to grow around low single digit during 2024-2026;

--Consolidated EBITDAR margins moving round 11%-12% in 2024-26;

--Capex of around BRL1 billion;

--Dividends of BRL979 million in 2024 and around 30% of net income afterwards.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Consistent EBITDA margins improvements commensurate with peers;

--Consolidated total adjusted debt/EBITDAR below 2,0x and net adjusted debt/EBITDAR ratio below 1.5x on a consistent basis;

--Maintenance of strong liquidity and no refinancing risks within 18-24 months.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Consolidated EBITDAR margins declining to below 10% on a recurrent basis;

--Consolidated net adjusted leverage consistently above 2.5x;

--Competitive pressures leading to severe loss in market-share for either Natura and Avon or a significant deterioration in its brands reputation.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity and Financial Flexibility: Natura has a track record of robust liquidity position and solid access to both local and international credit and debt markets. The company had BRL7.8 billion in cash and marketable securities at YE 2023 and total debt of BRL8.1 billion, including Fitch's adjusted rental obligations of BRL2.0 billion.

Natura's debt mainly consists of BRL3.5 billion at Natura&Co Lux (group's financial vehicle), BRL2.5 billion at Natura Cosmeticos and BRL131 million at Avon. Cross-border bonds (57%), local debentures (32%) and local commercial notes (8%) are the company's main debt. Natura& Co holding has no debt as of Dec. 31, 2023.

During 3Q23 and 4Q23, Natura paid more than BRL7.6 billion in debt using the resource of the Aesop sale. This includes accrued interests and derivatives settlements, Tender Offer of its USD 550 million due 2028 and USD 330 million due 2029 bonds, as well as USD 468 million in disbursements under its revolving credit facility due 2024 and USD 250 million in a Club Loan due 2025.

Following these debt prepayment, Natura's debt schedule amortization is currently quite extended with no refinancing exposure in the next three years. The company faces BRL164 million of short-term debt, BRL500 million in 2025, and next maturity is BRL1.1 billion at 2027, with a remaining balance of BRL4.4 billion from 2028 on. Fitch expects Natura to remain proactive in its liability management strategy to avoid exposure to high refinancing risks in the medium term.

ISSUER PROFILE

Natura&Co is composed by two iconic beauty companies: Natura and Avon with strong market presence in Latin America. During 2023, 74% of its revenues were originated in Latin America, with Brazil representing 45%. , 12% i .

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 ⬍			PRIOR ⬍
Natura Cosmeticos S.A.	LT IDR	BB+ Rating Outlook Stable	Upgrade	BB Rating Outlook Positive
	LC LT IDR	BB+ Rating Outlook Stable	Upgrade	BB Rating Outlook Positive

	Natl LT	AAA(bra) Rating Outlook Stable	Upgrade	AA+(bra) Rating Outlook Positive
Avon Products, Inc.	LT IDR	BB Rating Outlook Stable	Affirmed	BB Rating Outlook Positive
senior unsecured	LT	BB	Affirmed	BB
Natura &Co Holding S.A.	LT IDR	BB+ Rating Outlook Stable	Upgrade	BB Rating Outlook Positive
	LC LT IDR	BB+ Rating Outlook Stable	Upgrade	BB Rating Outlook Positive
	Natl LT	AAA(bra) Rating Outlook Stable	Upgrade	AA+(bra) Rating Outlook Positive
Natura &Co Luxembourg Holdings S.a r.l.				
senior unsecured	LT	BB+	Upgrade	BB

VIEW ADDITIONAL RATING DETAILS

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PARTICIPATION STATUS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

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

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

Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 03 Nov 2023)

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

Avon Products, Inc.	EU Endorsed, UK Endorsed
Natura &Co Holding S.A.	EU Endorsed, UK Endorsed
Natura &Co Luxembourg Holdings S.a r.l.	EU Endorsed, UK Endorsed
Natura Cosmeticos S.A.	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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