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Natura & Co Holding S.A.

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Natura & Co Holding S.A.

Credit Highlights

Issuer Credit Rating
BB/Stable/--
Brazil National Scale
brAAA/Stable/--

Overview

Key strengths	Key risks
Product and channel diversity, enabling revenue growth and stable margins in 2020 despite the pandemic.	Execution risks associated with Avon Products Inc.'s overhaul.
Geographic diversification, with leading market shares in Latin America, and strong branded portfolio.	The pandemic's harsh impact on product mix and retail operations.
Robust balance sheet and solid liquidity position, boosted by equity inflows in 2020.	Volatile economic conditions in Brazil, where the company generates 35%-40% of its revenue.
	Uncertain growth prospects of the direct sales model, which represents 77% of revenue.

Resilient business model and rapid digital expansion have sustained growth and margins. Natura & Co Holding S.A. (Natura&Co) has a broad geographic diversification with revenue distribution of 30%-35% in Brazil, 35%-40% in APAC and EMEA, 25% in Latin America excluding Brazil, and 0%-5% in other regions. It also has a diversified sales channel of direct selling mostly in Latin America, e-commerce, and retail. This diversification kept the group's sales resilient during the pandemic, along with agile execution to push the use of digital tools by its representatives, to increase the At-Home channel at The Body Shop (TBS), and to promote e-commerce in all divisions. The digital sales (including e-commerce and direct selling using digital apps) rose to 48% of the group's revenue in the first quarter of 2021 from 33% in the same period 2020. Those factors have offset most of the volume contraction in Natura&Co's retail stores during the lockdowns, while the Brazilian real's weakness boosted overall revenue.

Avon's overhaul is still a significant risk, but already shows signs of recovery. Avon's adjusted EBITDA margins dropped to 2.5% in 2020 from 6.0% in 2019 due to significant restructuring charges and one-off expenses related to the integration with Natura&Co and the pandemic's hit to its direct sales. This year should still be challenging for Avon's international operations, mainly in Europe, because of pandemic-related restrictions. Its first-quarter 2021 margins were only 0.9%. Nonetheless, restrictions are easing, and we forecast Avon's consolidated margins to return to 5%-7% by the end of 2021 and to reach 10%-12% in 2022 as the turnaround plan evolves, restructuring charges ease, and synergies gain traction. Avon's improved margins will boost the group's consolidated EBITDA margins to above 13% in 2022 from the estimated 10%-11% range for 2021. Avon's operations in Brazil and Latin America have strengthened, with revenue growth of about 20% in the first quarter of 2021. This growth has come mainly from aligning commercial practices, communication strategies, and expanding digital tools to the clients and representatives.

Robust balance sheet and liquidity, along with commitment to keep leverage low, support the ratings. Natura&Co has a strong balance sheet to withstand current volatile conditions and fund its growth strategy. It ended March 2021 with a cash position of R$6.6 billion and an adjusted net debt to EBITDA of 2.0x. Also, the group illustrated its commitment to a conservative capital structure through the capitalization of R$2 billion from the controlling shareholders in the second quarter of 2020 and the R$5.6 billion equity follow-on in the fourth quarter of 2020, along with the prepayment of $900 million (or about R$5.0 billion) of Avon's secured debt. The recent $1 billion (about R$5.4 billion) sustainability-linked notes issuance has further strengthened its capital structure, with the portion of the proceeds the group using to prepay Natura Cosmeticos S.A.' outstanding 2023 notes.

Natura's Cosmeticos decision to link its cost of debt to an environmental target illustrates the company's commitment to the ESG agenda. According to the terms of the 2028 notes, if Natura Cosméticos doesn't satisfy its Sustainability Performance Target of 2026 by reducing its greenhouse gas emissions intensity by another 13% and reaching 25% of post-consumer recycled plastic from its plastic packings, the interest rate payable on the notes will increase 65 basis points from November 2027 until the notes' maturity. The goals in line with Natura &Coś sustainability targets set under its "Sustainability Vision 2030". In our view, Natura&Co has a historical commitment to a cleaner business, an eco-efficient portfolio of products, and to work with local communities to foster social development.

Natura&Co is the main driver of Natura Cosméticos and Avonś credit quality. Natura Cosméticos and Avon are legally independent entities, with no cross guaranteed debt between them, but Natura&Co fully owns both companies. We view Natura Cosméticos as a core subsidiary of the group, given that the former generates 80%-90% of total EBITDA and cash flows, underscoring its integral role to the business strategy and reputational linkage. Also, Natura&Co guarantees Natura Cosmeticos' 2028 notes, which highlights the group's commitment to support Natura Cosméticos. Therefore, the group's credit profile drives the rating on Natura Cosméticos.

We view Avon as a strategically important subsidiary of Natura&Co. We believe Avon is important to the group's long-term strategies, that it's unlikely to be sold, and it would receive extraordinary support from the group in most foreseeable circumstances. However, the extent of group support is currently not fully clear, precluding a higher support category and us from assigning same ratings on it as on the group.

Outlook

The stable outlook on Natura&Co reflects our expectation that it will maintain its currently strong credit metrics and liquidity that provide cushion against volatility related to the pandemic, while it improves Avon's margins. Still high capex in 2021 will prevent a steeper deleveraging this year, but we expect debt to EBITDA close to 1.5x and funds from operations (FFO) to debt consistently above 35% in 2022. Also, the stable outlook on both subsidiaries, Natura Cosméticos and Avon, mirrors the one of the parent.

Downside scenario

We could take a negative rating action on Natura&Co in the next 12-24 months if rising cases of COVID-19 worldwide lead to operational disruptions for the group, weaker-than-expected demand, and/or higher working capital needs that could pressure its credit metrics. In addition, if Natura&Co keeps a more aggressive approach towards acquisitions or shareholders remuneration, or if the group's credit quality worsens because Avon continues to eat into cash holdings, leading to a downgrade. In those scenarios, we would likely see:

- Consolidated debt to EBITDA close to 4.0x and FFO to debt below 20% consistently.
- Weaker liquidity position and consequently tighter covenant headroom at Natura Cosméticos, which would also limit the group's ability to be rated above the sovereign.

A downgrade of Natura&Co would lead to the same rating action on its subsidiaries. We could also revise downward the subsidiaries' stand-alone credit profiles (SACPs):

- If Natura Cosméticos' debt to EBITDA is close to 4.0x and FFO to debt below 20% consistently.
- If Avon's debt to EBITDA remains above 5.0x in 2022 and FFO to debt below 12%.

Upside scenario

A positive rating action on Natura&Co would stem from a stronger-than-expected improvement of Avon's operations, boosting consolidated margins and EBITDA despite competition and currency swings. In this scenario, we would expect Natura&Co to maintain its debt to EBITDA below 2.0x, FFO to debt above 45%, and free operating cash flow (FOCF) to debt consistently above 15%. Also, we would expect the group maintain its healthy liquidity cushion and low margin volatility, and its ability to withstand a hypothetical default scenario in Brazil.

An upgrade of Natura&Co would lead to the same rating action on its subsidiaries. We could also revise upwards their SACP:

- If Natura Cosméticos maintains longer track record of debt to EBITDA below 2.0x, FFO to debt above 45%, and FOCF to debt above 15% amid stable profitability even while it continues pursuing growth.
- If Avon's debt to EBITDA is closer to 4.0x, FFO to cash interest consistently above 2.0x, margin volatility drops, while the company maintains manageable debt amortization profile.

Our Base-Case Scenario

Assumptions

- Consolidated revenue growth in Brazilian reals of about 10% in 2021 and 6% in 2022, mainly thanks to TBS and Aesop that should post growth of more than 20% in 2021 and 10% in 2022, but also reflecting currency fluctuation;
- Revenue growth of Natura&Co's operations in Latin America (including Brazil) of more than 5% in 2021 and 2022;
- Avon's international revenue to grow about 6% in 2021 and 4% in 2022;
- Natura&Co's consolidated EBITDA margin to rise modestly in 2021, but above 13% in 2022 and 2023 as the group captures synergies and reduces restructuring expenses;
- Avon's EBITDA margins of 5%-7% in 2021, hampered by expenses in its restructuring process and integration with Natura, and gradually recovering to double digits in 2022;
- Consolidated capex of R$1.4 billion in 2021 and R$1.2 billion - R$1.4 billion afterwards. The higher capex in 2021 will be mainly for expanding its digital platform, growth in Asia and the U.S., integrating Avon, executing postponed capex from 2020 due to the pandemic, and adhering with the 2030 sustainability action plan;
- Dividend payout of 30% of the companyś net income.

The following are our macroeconomic assumptions:

Table 1

Macroeconomic Forecast

(%)	2020a	2021e	2022e	2023a
Brazil's GDP growth	(4.4)	3.5-4.0	2.0-2.5	2.0-2.5
Brazil's interest rate	2.0	4.5	5.0	5.5
FX (average R$ per $)	5.2	5.5	5.5	5.5
Brazil's CPI	4.3	4.3	4.1	3.2
Argentina's GDP growth	(9.9)	6.1	2.5	2.0
FX (average ARS per $)	70.6	105.0	147.5	185.0
Mexico's GDP growth	(8.5)	4.9	2.7	2.2
FX (average MXN per $)	21.5	20.8	21.0	21.3
Eurozone's GDP growth	(6.8)	4.2	4.4	2.1
FX (average euro per $)	0.9	0.8	0.8	0.8
APAC GDP growth	(1.4)	6.7	4.7	4.9
Latam GDP growth	(6.7)	4.7	2.9	2.7

a--Actual. e--Estimate. MXN--Mexican peso.

Base-case projections

Natura & Co Holding S.A--Key Metrics Forecast

Natura&Co

(Bil. R$)	2019r	2020r	2021f	2022f	2023f
Revenues	33.0	37.0	40-43	42-45	44-47
EBITDA	3.6	4.0	4.3-4.8	5.5-6.0	5.7-6.2
EBITDA margin (%)	11.0	10.8	10-12	12-14	12-14
Funds from operations (FFO)	1.8	2.4	2.7-3.2	3.8-4.2	4.0-4.5
Capital expenditures	0.8	0.7	1.4	1.2-1.4	1.2-1.4
Free operating cash flow	1.0	0.6	0.6-0.8	1.5-2.0	2.5-3.0
Debt/EBITDA (x)	3.2	1.9	1.5-2.0	1.5	1.0-1.5
FFO to Debt (%)	15.5	32.2	30-35	40-45	45-50
FFO cash interest coverage ratio (x)	2.4	2.9	3.2-3.7	3.5-4.5	3.5-4.5
Free operating cash flow/debt (%)	8.3	8.2	5.0-10.0	15-20	30-35

Natura Cosméticos

(Bil. BRL)	2019r	2020r	2021f	2022f	2023f
Revenues	14.0	18.0	19-21	21-23	21-23
EBITDA	2.5	3.5	3.5-4.0	4.0-4.5	4.0-4.5
EBITDA margin (%)	17.4	19.4	18-20	18-20	18-20
Funds from operations (FFO)	1.5	2.8	2.7-3.0	3.0-3.5	3.2-3.7
Capital expenditures	0.58	0.49	0.7-1.0	0.7-1.0	0.7-1.0
Free operating cash flow	0.7	2.5	1.7-2.2	1.7-2.2	2.0-2.5
Debt/EBITDA (x)	2.9	1.5	1.5	1.0-1.5	1.0-1.5
FFO to Debt (%)	21.4	52.5	50-55	55-60	57-62
FFO cash interest coverage ratio (x)	3.4	6.0	6-10	6-10	6-10
Free operating cash flow/debt (%)	10.3	47.3	30-40	30-40	30-40

Avon Products

(Mil. $)	2019r	2020r	2021f	2022f	2023f
Revenues	4,763	3,625.0	3,600-3,800	3,800-4,100	4,000-4,200
EBITDA	288.0	91.0	200-250	350-400	400-450
EBITDA margin (%)	6.0	2.5	5-7	9-11	10-12
Funds from operations (FFO)	67.0	(101.0)	120-160	250-300	300-350
Capital expenditures	59.0	45.0	110-125	100-110	100-110
Free operating cash flow	60.0	(288.0)	(80-100)	60-80	125-175
Debt/EBITDA (x)	6.3	9.8	4.0-5.0	2.5-3.5	2.0-3.0
FFO to Debt (%)	3.7	(11.4)	12-15	23-27	30-35
FFO cash interest coverage ratio (x)	1.4	0.4	2.0-3.0	3.0-4.0	4.0-5.0
Free operating cash flow/debt (%)	3.3	-32.4	(5.0-10.0)	10-15	12-17

r-Realized. f--Forecast. Natura&Co's 2020 adjusted debt is R$7.5 billion and includes R$13.8 bilion of reported gross debt plus R$3.85 billion of reported lease liabilities, minus R$8.3 billion of accessible cash and R$1.85 bilion of foreign currency hedges.

Synergies guidance not fully incorporated in our base case, and could boost credit metrics. The group achieved $73 million of synergies in 2020 from the merger of Avon with Natura, mainly in the form of administrative and procurement gains. According to management, total synergies could reach $350 million - $450 million per year. On top of administrative and sourcing, the recurring synergies would also stem from revenue gains, integration of logistics, and product manufacturing. For example, Avon's Poland-based plant will produce some TBS products, replacing outsourced suppliers. The full achievement of synergies will likely boost consolidated EBITDA margins by 150-250 basis points (bps) above our base case and lead to additional R$500 million - R$1 billion of free operating cash flows per year.

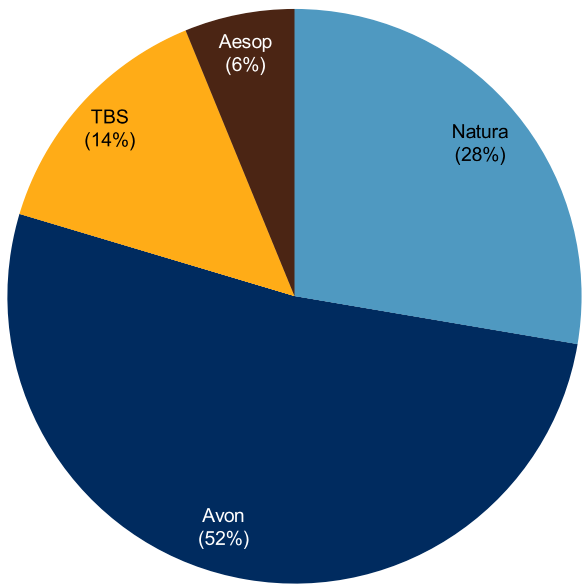
Geographic expansion and increasing digitalization will drive future revenue expansion. Despite the uncertain conditions from the restrictions caused by COVID-19 globally, we believe that Natura&Co's strategies will support revenue expansion over the next several years. The group is working on its entrance into the Chinese market through local Aesop and TBS stores, and it's expanding the At-Home and digital channels of TBS, and growing its operations in the U.S. and Japanese markets. We expect Aesop's growth momentum to continue in the next couple of years based on geographic expansion, higher digital sales, and the widening fragrance product portfolio. The group will also explore synergy opportunities to boost cross-selling revenues among Natura Cosmeticos and Avon that could add $90 million - $120 million of revenue per year.

Company Description

Natura&Co is the fourth-largest global cosmetics group, with annual revenue of R$39 billion and EBITDA of R$4.5 billion in the last 12 months ended in March 2021. The group controls Natura Cosmeticos S.A. (BB/Stable/--) and Avon Products Inc. (BB-/Stable/--), and owns the brands Natura, Avon, Aesop, and TBS. The group operates in more than 100 countries across all continents, with a leading position in Brazil, and has a wide portfolio diversification, with offerings to various customer tiers and channels. The group has strong brands with clear value propositions and a leading position in the direct sales model for cosmetics, with more than 6 million representatives and more than 3,000 stores globally.

Chart 1

Net Revenue Breakdown
As of the first quarter of 2021



Source: Natura&Co filling.

Business Risk

Natura&Co's business risk profile reflects its significant scale as the fourth-largest global cosmetics group, pricing power with a strong and diverse portfolio in various segments and pricing points, and ample geographic diversification. It also has a diversified sales channel with strong positions in direct selling, e-commerce, and retail. The company has a leading position in Latin America, and large market shares in several other countries. Digital operations support Natura&Co's credit profile, which allowed it to post resilient results despite the pandemic and related restrictions.

Nonetheless, current EBITDA margins at the 10%-13% range took a hit from the consolidation of Avon and are below industry average, highlighting the operating efficiencies challenges. Avon still has a weak profitability, which we expect to improve over the next few years through its turnaround plan and speed up the digitalization of its platform, leveraging on Natura&Co's expertise.

Peer comparison

Natura&Co has posted revenue growth above the global cosmetics, fragrances, and toiletries (CF&T) market average in past quarters. However, we view its cost structure as higher than those of global peers such as L'óreal and Estee Lauder, gross margins of which are in the 70%-75% range, compared with about 65% of Natura&Co. Those peers also have much stronger financial metrics.

L'Óréal S.A. (--/--/A-1+) is the world's leading cosmetics company, with about a 10% global market share. It has the most varied portfolio of well-known and complementary brands in the industry, diverse distribution channel, geographic diversification, and its size allows it to take advantages of scales, bolstering its margins. L'Óreal's revenue base is about 5 times larger than that of Natura&Co. It has also posted a resilient performance during the pandemic due to its mitigation plans, which limited a downside impact on margins and revenues. Its leverage has been constantly well below the 1.0x level.

The Estee Lauder Cos. Inc. (A+/Stable/A-1) maintains a solid position in the global beauty industry thanks to a geographically diversified revenue stream, and portfolio of well-known, prestige brands. The company enjoys strong brand recognition and is able to charge premium pricing for a wide array of its prestigious products. Estee Lauder increased its equity position in the multi-brand company, DECIEM Beauty Group Inc., to approximately 76% from 29%. This will diversify the existing business and only increase the leverage metric by about 0.2x. We expect Estee Lauder to maintain its leverage metric in the low-1x area.

Natura&Co has a stronger credit profile than Coty Inc. (B-/Negative/--), whose credit quality suffered from troubled integration of beauty assets from Procter & Gamble Co. it acquired in 2016, which resulted in market share losses and lower organic sales. It started a divestment program to reduce its leverage, but its results took a significant hit because of the pandemic. Coty's liquidity position has recently strengthened after raising $1 billion from the issuance of convertible preferred equity to KKR and $900 million senior secured notes. We believe the current turnaround plan will enable the company to stabilize sales, and reach EBITDA margins of about 14% in fiscal 2021.

Table 2

Natura & Co Holding S.A--Peer Comparison

Industry sector: Personal care and household products

	Natura & Co Holding S.A	**Coty Inc.**	**Estee Lauder Cos. Inc. (The)**	**L'Oreal S.A.**
Ratings as of April 16, 2021	(BB/Stable/--)	B-/Negative/--	A+/Stable/A-1	--/--/--
	--Fiscal year ended--			
	Dec. 31, 2020	**June 30, 2020**	**June 30, 2020**	**Dec. 31, 2020**
(Mil. $)				
Revenue	7,109.7	4,717.8	14,294.0	34,242.1
EBITDA	770.5	(182.8)	3,498.0	8,170.0
Funds from operations (FFO)	464.5	(613.9)	2,723.7	6,520.2
Interest expense	260.3	256.7	227.3	113.2
Cash interest paid	242.2	307.9	237.3	39.6
Cash flow from operations	247.6	(236.1)	2,820.7	7,894.2
Capital expenditure	129.8	267.4	623.0	1,189.5
Free operating cash flow (FOCF)	117.7	(503.5)	2,197.7	6,704.7
Discretionary cash flow (DCF)	101.8	(729.4)	791.7	4,025.0
Cash and short-term investments	1,606.4	308.3	5,037.0	7,836.2
Debt	1,440.6	9,524.6	4,780.2	0.0
Equity	5,273.6	3,267.2	3,962.0	35,473.6

Table 2

Natura & Co Holding S.A--Peer Comparison (cont.)					
Adjusted ratios					
EBITDA margin (%)	10.8	(3.9)		24.5	23.9
Return on capital (%)	5.4	(6.6)		32.6	16.6
EBITDA interest coverage (x)	3.0	(0.7)		15.4	72.2
FFO cash interest coverage (x)	2.9	(1.0)		12.5	165.5
Debt/EBITDA (x)	1.9	(52.1)		1.4	0.0
FFO/debt (%)	32.2	(6.4)		57.0	N.M.
Cash flow from operations/debt (%)	17.2	(2.5)		59.0	N.M.
FOCF/debt (%)	8.2	(5.3)		46.0	N.M.
DCF/debt (%)	7.1	(7.7)		16.6	N.M.

N.M.--Not meaningful.

Financial Risk

Our assessment incorporates stronger metrics following equity injections and consistently solid free operation cash flows despite the pandemic shock. Nonetheless, we penalize the financial risk profile by potential volatility, due to the execution risks regarding the turnaround of Avon's operations and risks associated with the pandemic. Our calculations of Natura&Co's debt position include the operating leasing reported under IFRS 16.

Financial summary

Table 3

Natura & Co Holding S.A--Financial Summary				
Industry sector: Personal care and household products				
	--Fiscal year ended Dec. 31--			
	2020	**2019***	**2018***	**2017***
(Mil. R$)				
Revenue	36,922.0	32,942.2	34,965.7	28,789.5
EBITDA	4,001.2	3,627.9	3,876.0	3,629.2
Funds from operations (FFO)	2,412.1	1,814.7	1,948.2	2,220.6
Interest expense	1,351.8	1,203.5	1,401.0	1,095.3
Cash interest paid	1,257.7	1,274.8	1,319.4	882.4
Cash flow from operations	1,285.6	1,794.1	1,729.6	2,548.2
Capital expenditure	674.2	813.6	852.4	684.9
Free operating cash flow (FOCF)	611.4	980.5	877.2	1,863.3
Dividends paid	133.9	152.9	201.7	109.4
Discretionary cash flow (DCF)	528.6	787.7	664.2	1,734.7
Cash and short-term investments	8,342.3	8,161.4	4,492.7	6,591.0
Gross available cash	8,342.3	8,161.4	4,492.7	6,591.0
Debt	7,481.2	11,744.7	13,705.8	13,015.0
Equity	27,387.1	1,728.9	(897.7)	(733.2)

Table 3

Natura & Co Holding S.A--Financial Summary (cont.)

Industry sector: Personal care and household products	--Fiscal year ended Dec. 31--			
	2020	2019*	2018*	2017*
Adjusted ratios				
Annual revenue growth (%)	12.1	(5.8)	21.5	N.M.
EBITDA margin (%)	10.8	11.0	11.1	12.6
EBIT margin (%)	3.6	6.2	6.7	7.5
Return on capital (%)	5.4	15.6	18.6	17.6
EBITDA interest coverage (x)	3.0	3.0	2.8	3.3
FFO cash interest coverage (x)	2.9	2.4	2.5	3.5
Debt/EBITDA (x)	1.9	3.2	3.5	3.6
FFO/debt (%)	32.2	15.5	14.2	17.1
Cash flow from operations/debt (%)	17.2	15.3	12.6	19.6
FOCF/debt (%)	8.2	8.3	6.4	14.3
DCF/debt (%)	7.1	6.7	4.8	13.3

N.M.--Not meaningful. *Proforma figures. R$--Brazilian real.

Liquidity

We consider Natura&Co's liquidity as adequate. We expect sources over uses of cash to be about 1.6x for the next 12 months and net sources to remain positive even if EBITDA drops 15%. The group has strengthened its cash position after the equity follow-on, although Natura&Co mostly used it to prepay Avon's 2022 senior secured notes. The group's May 2021 $1 billion senior unsecured note issuance has extended its debt maturity profile, primarily by the early redemption of Natura Cosméticos' $750 million senior notes due 2023 and the funding of the amortization of debentures due September 2021. We also consider that Natura&Co has a well-established relationship with banks and high standing in credit markets, as seen in its ongoing ability to access equity and debt capital markets.

We view liquidity of Natura Cosméticos and Avon as also adequate, and both entities have cash sources over uses comfortably above 1.2x for the next 12 months. As of March 2021, Natura Cosméticos had a solid cash position of R$3.8 billion plus the $1 billion bond, versus a short-term debt of R$2.5 billion. In May 2021, the company prepaid its 2023 notes of $750 million with the cash proceeds from the 2028 notes issuances. As of March 2021, Avon had a cash position of $239.7 million and very low short-term position of $38 million. The company's most significant maturity is its $462 million note due March 15, 2023.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash position of R$6.5 billion as of March 31, 2021; • FFO of R$2.1 billion in the next 12 months;	• Short-term debt of R$3.2 billion as of March 31, 2020; • Working capital outflows of R$800 million in the

- Unsecured notes issuance of $1 bilion (or about R$5.4 billion) in May 2021 and TBS's £100 million (or about R$750 million) credit facility received in May 2021.

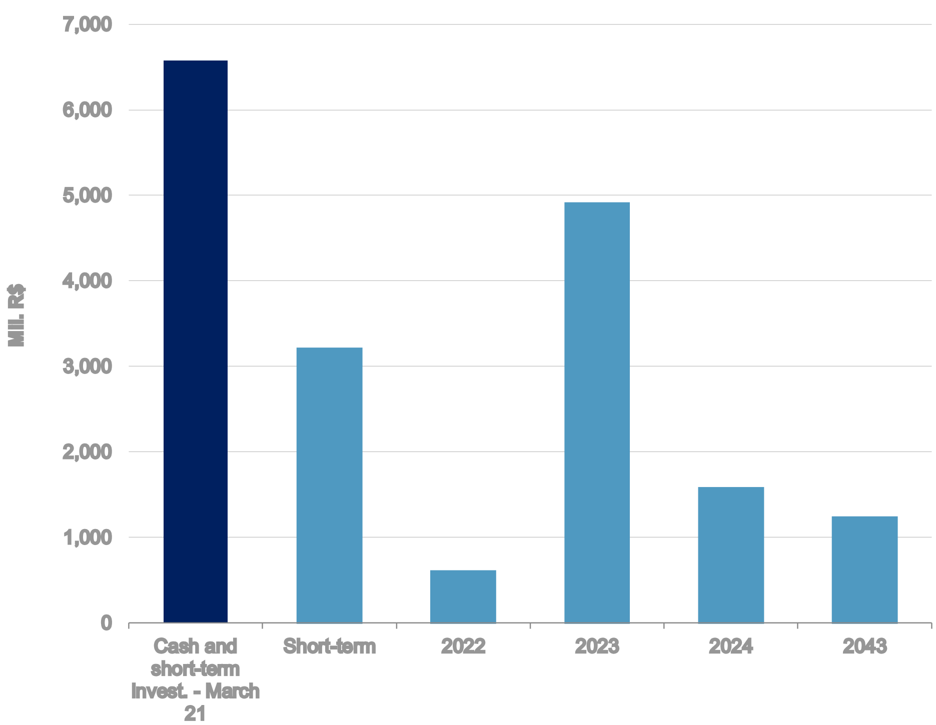
next 12 months;

- Seasonal working capital of R$700 million along the year;
- Capex of R$1.4 billion;
- Dividend payment of R$263 million; and
- Prepayment of Natura Cosmeticos' 2023 notes of R$2.5 billion (net of the hedge settlement).

Debt maturities

Chart 2

Amortization Schedule



R$--Brazilian real. Gross debt net of hedge effect, and excludes Purchase Price Allocation (PPA) effects and includes accrued interests. Source: S&P Global Ratings.

Covenant Analysis

Natura&Co and Avon don't have financial covenants on their debts. Natura Cosméticos' debenture has a 3.0x net debt to EBITDA covenant that could trigger a debt payment acceleration, but we expect the company to have more than a 50% cushion for this covenant. The covenant calculation excluded the impact of International Financial Reporting

Standards (IFRS) 16, with reported lease liabilities of R$3.8 bilion in December 2020.

Group Influence

Natura&Co is the ultimate parent, and sole shareholder of Natura Cosméticos and Avon. The subsidiaries are legally independent entities, with no cross-guaranteed debt between them. We view Natura Cosméticos as a core subsidiary of the group, given that it generates 80%-90% of total EBITDA and cash flows, underscoring its integral role to the business strategy and reputational linkage. Also, Natura&Co guarantees Natura Cosmeticos' 2028 notes, which highlights the group's commitment to support the subsidiary. Therefore, the group's credit profile drives the rating on Natura Cosméticos.

We view Avon as a strategically important subsidiary to Natura&Co. We believe Avon is important to the group's long-term strategy, that it's unlikely to be sold, and would receive extraordinary support from the group in most foreseeable circumstances. However, the extent of group support isn't fully clear at the moment, which precludes a higher support category and prevent us to equalize the ratings on Avon with those on Natura&Co. Due to Avon's strategically important status, the 'BB-' final rating receives a two-notch uplift from its 'b' SACP.

Rating Above The Sovereign

We tested Natura&Co's ability to withstand a sovereign default scenario in order for us to rate it above our 'BB-' foreign currency rating on Brazil. We tested the company's in a hypothetical default of Brazil because it's the only country to which the group has more than a 25% exposure, even considering TBS operations. In the stress test, we assumed the following:

- GDP contraction of 10% in Brazil in the next 12 months, hurting the company's domestic volumes;
- Inflation at about 12% in that year, increasing costs and selling, general and administrative expenses;
- Limited ability to adjust prices;
- A 10% haircut on cash and bank deposits, and a 70% haircut on short-term investments held in Brazil;
- Currency depreciation of 50%, affecting costs indexed to the dollar, and debt and cash position held in foreign currency;
- Capex at maintenance level; and
- Doubling of interests rates for floating debt.

The sizable cash and cash flows from outside Brazil, and a low debt maturity schedule for the next 12 months enable Natura&Co to pass the stress test.

Issue Ratings - Recovery Analysis

Key analytical factors

The group's capital structure in March 2021 mainly consisted of the following:

- Avon's $500 million, 5% unsecured notes due 2023 ($462 million outstanding);
- Avon's $250 million, 6.95% unsecured notes due 2043 ($216 million outstanding);
- Natura Cosméticos' $750 million, 5.375% unsecured notes due 2023, which were prepaid in May 2021;
- Aggregate amount of about R$4 billion in Natura Cosmeticos' local unsecured debentures due 2021, 2023, and 2024;
- Natura&Co's R$524 million of promissory notes, which were prepaid in April 2021;
- Natura Cosméticos' R$262 million of promissory notes, which were prepaid in April 2021;
- We are considering in our recovery model Natura Cosméticos' $1 bilion (or about R$5.4 billion) senior unsecured sustainability-linked notes issued in May 2021. The notes are guaranteed by the parent company, therefore, the recovery prospect for these notes will benefit from the residual value of Avon that would upstream to Natura&Co.
- Also, in May 2021, TBS obtained a £100 million (or about R$760 million) unsecured credit facility guaranteed by Natura&Co, which we're also including in our recovery model as a priority debt.

We consider that following a hypothetical bankruptcy process, the group would be restructured and continue to operate, generating higher value to creditors, compared with a scenario of its liquidation. We value Natura Cosméticos using a 6.0x multiple applied to our projected emergence-level EBITDA of R$1.1 billion, arriving at a stressed enterprise value of R$6.5 billion. We value Avon using a 5.5x multiple applied to our projected emergence-level EBITDA of $173 million, arriving at a stressed enterprise value of $950 million. Avon's multiple is lower than that of Natura Cosmeticos because the company is still amid a difficult operational turnaround.

Simulated default assumptions

- Year of default: 2026 for Natura Cosméticos and 2025 for Avon
- EBITDA multiple: 6.0x for Natura Cosméticos and 5.5x for Avon
- EBITDA at emergence: $173 million (about R$935 million) for Avon and R$1.1 billion for Natura Cosméticos
- Enterprise value: R$11.3 billion (R$4.9 billion of Avon and R$6.4 billion of Natura Cosméticos)

Simplified waterfall

- Net enterprise value after administrative costs: R$10.7 billion
- Unsecured debt at Avon: $734 million (about R$3.9 billion)
- Avon's residual value upstream to parent company: $170 million (or about R$915 million)
- Unsecured debt recovery expectation at Avon: 50%-70% (rounded estimate: 65%)
- Secured debt at Natura Cosméticos and debt position at its subsidiaries (mainly TBS): R$859 million
- Unsecured claims at Natura Cosméticos (debentures, working capital lines, and unsecured note): R$7.5 billion
- Unsecured debt recovery expectation at Natura Cosméticos: 50%-70% (rounded estimate: 65%)

*All debt amounts at default include six months accrued prepetition interest.

Reconciliation

Table 4

Natura & Co Holding S.A--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. R$)

	--Fiscal year ended Dec. 31, 2020--				
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**S&P Global Ratings' adjusted EBITDA**
Reported	13,822.9	27,364.3	3,508.5	789.6	4,001.2
S&P Global Ratings' adjustments					
Cash taxes paid	--	--	--	--	(331.5)
Cash interest paid	--	--	--	--	(1,257.7)
Reported lease liabilities	3,858.5	--	--	--	--
Postretirement benefit obligations/deferred compensation	--	--	25.2	25.2	--
Accessible cash and liquid investments	(8,342.3)	--	--	--	--
Share-based compensation expense	--	--	232.0	--	--
Nonoperating income (expense)	--	--	--	264.3	--
Noncontrolling interest/minority interest	--	22.8	--	--	--
Debt: Foreign currency hedges	(1,857.9)	--	--	--	--
EBITDA: Gain/(loss) on disposals of PP&E	--	--	(11.9)	(11.9)	--
EBITDA: Other	--	--	247.4	247.4	--
Total adjustments	(6,341.7)	22.8	492.7	525.0	(1,589.1)
S&P Global Ratings' adjusted amounts					
	Debt	**Equity**	**EBITDA**	**EBIT**	**Funds from operations**
Adjusted	7,481.2	27,387.1	4,001.2	1,314.6	2,412.1

The consolidated gross debt position of R$13.8 billion consists of R$9.13 billion at Natura Cosméticos, $703 million (R$3.65 billion) at Avon, and R$1.0 billion at Natura&Co. The reported lease liabilities of R$3.86 billion consist of R$2.97 billion at Natura Cosméticos and R$884 million at Avon.

Ratings Score Snapshot

Ratings Score Snapshots

Natura &Co Holdings S.A.	
Issuer Credit Rating:	
Global scale	BB/Stable/--
National scale	brAAA/Stable/--
Business risk:	Fair

Ratings Score Snapshots (cont.)	
Country risk:	Moderately high
Industry risk:	Low
Competitive position:	Fair
Financial risk:	Significant
Cash flow/Leverage:	Significant
Anchor:	bb
Modifiers:	
Diversification/Portfolio effect:	Neutral (no impact)
Capital structure:	Neutral (no impact)
Financial policy:	Neutral (no impact)
Liquidity:	Adequate (no impact)
Management and governance:	Fair (no impact)
Comparable Rating analysis:	Neutral
SACP:	bb
Natura Cosméticos S.A.	
Issuer Credit Rating:	
Global scale	BB/Stable/--
National scale	brAAA/Stable/--
Business risk:	Fair
Country risk:	Moderately high
Industry risk:	Low
Competitive position:	Fair
Financial risk:	Significant
Cash flow/Leverage:	Significant
Anchor:	bb
Modifiers:	
Diversification/Portfolio effect:	Neutral (no impact)
Capital structure:	Neutral (no impact)
Financial policy:	Neutral (no impact)
Liquidity:	Adequate (no impact)
Management and governance:	Fair (no impact)
Comparable Rating analysis:	Neutral
SACP:	bb
Entity status within group:	Core
Avon Products Inc.	
Issuer Credit Rating:	
Global scale	BB-/Stable/--
Business risk:	Weak
Country risk:	Intermediate
Industry risk:	Low
Competitive position:	Weak
Financial risk:	Highly Leveraged

Ratings Score Snapshots (cont.)	
Cash flow/Leverage:	Highly Leveraged
Anchor:	b
Modifiers:	
Diversification/Portfolio effect:	Neutral (no impact)
Capital structure:	Neutral (no impact)
Financial policy:	Neutral (no impact)
Liquidity:	Adequate (no impact)
Management and governance:	Fair (no impact)
Comparable Rating analysis:	Neutral (no impact)
SACP:	b
Entity status within group:	Strategically important (+2 notch from SACP)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- 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: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of June 25, 2021)*		
Natura & Co Holding S.A		
Issuer Credit Rating		BB/Stable/--
Brazil National Scale		brAAA/Stable/--
Issuer Credit Ratings History		
21-Apr-2021		BB/Stable/--
21-Apr-2021	*Brazil National Scale*	brAAA/Stable/--
Related Entities		
Avon International Operations Inc.		
Issuer Credit Rating		BB-/Stable/--

Ratings Detail (As Of June 25, 2021)*(cont.)	
Avon Products Inc.	
Issuer Credit Rating	BB-/Stable/NR
Senior Unsecured	BB-
Natura Cosmeticos S.A.	
Issuer Credit Rating	BB/Stable/--
Brazil National Scale	brAAA/Stable/--
Senior Unsecured	
Brazil National Scale	brAAA

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.