

05 APR 2023

Fitch Affirms Natura &Co's IDRs at 'BB'; Outlook Remains Positive

Fitch Ratings - Rio de Janeiro - 05 Apr 2023: Fitch Ratings has affirmed Natura &Co Holding S.A.'s (Natura) Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) at 'BB' and its National Scale Rating at 'AA+(bra)'. Fitch has also affirmed Natura Cosméticos S.A.'s FC and LC IDR at 'BB', its unsecured notes at 'BB' and its National Scale Rating at 'AA+(bra)'. Fitch has affirmed Avon Products, Inc.'s BB rating and its unsecured notes. Fitch has also affirmed and withdrawn Avon International Operations Inc.'s IDR of 'BB'. The Rating Outlooks remains Positive.

Natura's 'BB' ratings reflect its strong brand and business position within the CF&T market, its diversified asset base and its ongoing challenges related to the turnaround of Avon and The Body Shop. The Positive Outlook reflects the expectation of a significant reduction in Natura's net leverage following the sale of Aesop. The more robust credit profile is mitigated by its above-average business risks and subdued profitability.

Fitch has withdrawn the rating of Avon International Operations Inc. as it is no longer considered by Fitch to be relevant to the agency's coverage following the payment of outstanding bonds.

Key Rating Drivers

Robust Capital Structure Following Aesop Sale: The sale of Aesop to L'Oreal for a total amount of USD2.53 billion will improve the group's financial flexibility and net leverage. Fitch estimates around BRL11.6 billion of net cash to be received by Natura at closing, which is expected to occur in the third quarter of 2023 and is subject to regulatory approvals. Aesop contributed 17% of Natura's consolidated EBITDA in 2022, while cash proceeds represented around 85% of Natura's consolidated debt, excluding leasing.

Lower Net Leverage: Natura is expected to use cash proceeds for debt reduction and to lower its interest expense burden. Fitch estimates the pro-forma total adjusted leverage ratio, including leasing obligations, to reach 5.7x and a net cash position of BRL3 billion in 2022. The total leverage ratio is forecast at 4.4x and 3.3x, and on a net basis, 0.4x and 0.6x in 2023 and 2024, respectively. This represents a significant improvement from a median net leverage ratio of 2.6x during 2019-2021 and 4.2x during 2022.

Ongoing Execution Risk Remains: Natura's key business risk relates to the turning around of Avon International and The Body Shop (TBS) operations, and the move toward omnichannel from a direct sales single model, that presents declining trends in certain markets. Natura is moving to its second wave of integration at Avon, seeking to reshape its cost structure and to optimize its geographic footprint aiming for profitable markets. For TBS, the focus is on business rightsizing and improvement on the core retail model. The integration of Avon's operations in Latin America have advanced relatively better as they fit with Natura's own operations in the region, yet profitability remains subdued.

Profitability Challenges: Natura should continue to face negative headwinds in the short term related to macroeconomic scenario, including foreign exchange volatility, higher interest rates, and consumer patterns

changes in a post-pandemic world. Fitch forecasts Natura's consolidated EBITDAR margin to be around 9%-10% during 2023-24, which represents an improvement from 8.1% during 2022, but still below 10.3% of 2021 and 11.4% of 2020. Fitch forecasts include only six months of Aesop's operations for 2023. EBITDAR is projected to reach BRL3.5 billion in 2023 and BRL3.6 billion in 2024.

Capex to Pressure FCF: Fitch projects negative FCF due to high capex related to investments in innovation, digitalization and minimum dividend payments (30% of net income) from 2024 on. Natura has invested heavily in digitalization focusing on increasing online sales. Fitch's base case incorporates an average annual capex of around BRL1.5 billion in 2023-2024, leading to negative FCF. Cashflow from the operation will benefit from lower interest expenses related to future debt repayment.

No Rating Constraints: Natura's ratings are not constrained by Brazil's 'BB' country ceiling due to its operations outside Brazil (69% of its revenue in 2022) as well as an off-shore stand-by credit facility of USD625 million due 2024. The company has a diversified portfolio of operations, with some hard currency EBITDA from its assets abroad that should continue to cover its interest expenses in hard currency following the stronger capital structure profile and the exit of Aesop's operating cash flow. Other considerations that mitigate transfer and convertibility risks include cash held abroad as per Fitch's "Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria." Consolidated Approach: Fitch assesses the group on a consolidated basis, given the strong operational and strategic incentives, centralized treasury, asset contribution via synergies and the tangible financial support in the form of payment of Avon's cross-border notes and inter-company loans. In addition, cross default clause and guarantees provided by Natura to the cross-border debt issuances by Natura Cosméticos support the consolidated approach. Natura owns Natura Cosméticos S.A. and Avon Products, which are two separate legal entities.

Derivation Summary

Natura's ratings reflect the combined credit quality of Avon and Natura and its low adjusted net leverage post divestment of Aesop. It also incorporates execution risks related to the integration of Avon and The Body Shop and the challenge to develop its digital platform and move toward an omni-channel strategy. Natura has a solid business position in the CF&T industry, underpinned by strong brand recognition, and large scale.

In terms of comparable companies, Fitch rates Oriflame Investment Holding Plc 'B' (Outlook Negative); it also operates in the direct-selling beauty market. Natura has a stronger business and financial profile than Oriflame. In Brazil, Natura also faces strong competition from a local participant, O Boticario (not rated), which has a record of maintaining a solid credit and business profile, and enjoys a strong brand and higher profitability.

Key Assumptions

Fitch Key's Assumptions Within the Rating Case for the Issuer

--Fitch expects Natura's revenue to be relatively stable during 2023, considering Aesop's sale during 3Q22, and to decline in the low single digits during 2024, reflecting a full year of a lower revenue base;

--Consolidated EBITDAR margins around 9%-10% in 2023-2024;

--Average capex of around BRL1.5 billion to support the digitalization and innovation process;

--Dividends at around 30% of net income on 2024 afterwards;

--Gross leverage moving below 3.5x by 2024

RATING SENSITIVITIES

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

--Consolidated EBITDAR Margins above 11% on consistent basis;

--Consolidated total adjusted debt/EBITDAR below 3.5x and net adjusted debt/EBITDAR ratio below 2.5x on a consistent basis;

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

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

--Consolidated EBITDAR margins declining to below 9% on a recurrent basis;

--Consolidated net adjusted leverage consistently above 3.5x from 2024 on;

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

Best/Worst Case Rating Scenario

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

Liquidity and Debt Structure

Strong Liquidity: Natura has maintained strong liquidity and solid access to credit markets. The company had BRL5.9 billion in cash and marketable securities at YE 2022, with BRL331 million of short-term debt. Cash is sufficient to support debt amortization until 2027. On a proforma basis, taking into account the Aesop transaction, Fitch estimates Natura to reach a net cash position of BRL3 billion, and to repay debt seeking to reduce interest expenses. As of Dec. 31, 2022, Natura had total debt of around BRL18.2 billion, including Fitch's adjusted leasing obligations of BRL4.6 billion. Natura's debt mainly consists of BRL7.6 billion at Natura Cosméticos, BRL4.4 billion at Natura&Co Holding and BRL1.5 billion at Avon. Cross-border bonds (61%) and local issuances (18%) are the company's main debt.

Issuer Profile

Natura&Co is composed by four beauty companies: Natura, The Body Shop, Aesop and Avon. It is the fourth-largest pure play beauty group in the world with around 2.0% global market share as a result of its sizable operations in Latin America, Europe, North America, Asia Pacific and Oceania.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Natura Cosméticos S.A.	LT IDR	BB 	Affirmed	BB 
	LC LT IDR	BB 	Affirmed	BB 
	Natl LT	AA+(bra) 	Affirmed	AA+(bra) 
• senior unsecured	LT	BB	Affirmed	BB

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Avon Products, Inc.	LT IDR	BB 	Affirmed	BB 
• senior unsecured	LT	BB	Affirmed	BB
Avon International Operations, Inc.	LT IDR	BB 	Affirmed	BB 
	LT IDR	WD	Withdrawn	BB 
Natura &Co Holding S.A.	LT IDR	BB 	Affirmed	BB 
	LC LT IDR	BB 	Affirmed	BB 
	Natl LT	AA+(bra) 	Affirmed	AA+(bra) 
Natura &Co Luxembourg Holdings S.a r.l.				
• senior unsecured	LT	BB	Affirmed	BB

RATINGS KEY OUTLOOK WATCH

POSITIVE



NEGATIVE



EVOLVING



STABLE



Applicable Criteria

[Corporate Rating Criteria \(pub.28 Oct 2022\) \(including rating assumption sensitivity\)](#)

[Corporates Exceeding the Country Ceiling Criteria \(pub.08 Dec 2022\) \(including rating assumption sensitivity\)](#)

[National Scale Rating Criteria \(pub.22 Dec 2020\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(pub.01 Dec 2021\)](#)

[Sector Navigators: Addendum to the Corporate Rating Criteria \(pub.28 Oct 2022\)](#)

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

[Solicitation Status](#)

Endorsement Status

Avon International Operations, Inc.	EU Endorsed, UK Endorsed
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 Cosméticos S.A.	EU Endorsed, UK Endorsed

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