

21 APR 2021

Fitch Assigns 'BB' First-Time Rating to Natura&Co's; Outlook Positive

Fitch Ratings - Rio de Janeiro - 21 Apr 2021: Fitch Ratings has assigned a Long-Term (LT) Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) of 'BB' to Natura&Co Holding S.A. (Natura) and a National Scale rating of 'AA+(bra)'. Fitch has also affirmed Natura Cosmetics S.A.'s (Natura Cosmetics) FC and LC IDR at 'BB', its unsecured notes at 'BB' and its National Scale rating at 'AA+(bra)'. In a related move, Fitch has affirmed Avon Products, Inc. and Avon International Operations's LT IDRs at 'BB', and Avon Product's unsecured notes at 'BB'. A Positive Rating Outlook has been assigned to Natura, while the Rating Outlooks of Avon and Natura Cosmetics have been revised to Positive from Stable.

Fitch has assigned a 'BB' rating to the proposed senior unsecured sustainability-linked notes to be issued by Natura Cosmetics, and guaranteed by Natura. Proceeds will be used to refinance debt, including the existing notes.

The Positive Outlooks reflect ongoing improvements in Natura's credit profile as it captures synergies from Avon's acquisition and intensifies the revitalization of its product portfolio and its digitalization plan. Natura remains with the challenge to complete Avon International's turnaround. The company's low leverage due to equity issuance have also positive impacted the companies' Positive Rating Outlooks.

Key Rating Drivers

Rating Equalization: Natura Cosmetics and Avon are separate legal entities that are both wholly owned by Natura. Fitch assesses the group on a consolidated basis given the strong operational and strategic ties, centralized treasury, substantial asset contribution via the expected recurring synergies and, more recently, by the tangible financial support in the form of the payment of Avon's secured notes. The current cross-border debt issuance by Natura Cosmetics with a guarantee from Natura further supports the consolidated approach.

Not Capped by Brazil: Natura's ratings are not constrained by Brazil's 'BB' Country Ceiling, per Fitch's 'Rating Above the Country Ceiling Rating Criteria'. Natura has a diversified portfolio of operations, with a solid hard currency EBITDA generation from its assets abroad in relative to its interest expenses in hard currency. Other considerations increasing Natura's ability to mitigate transfer and convertibility risks include cash held abroad and generated abroad in several countries. Natura currently does not have a material available undrawn standby credit lines. Brazil represents the bulk of Natura's operations and accounted for 31% of revenues during 2020, followed by EMEA (ex-UK - 20%), UK (11%), Mexico (9%), Asia (8%), US and Canada (5%), others South America (15%) and Oceania (2%).

Large and Diversified Business Scale: The acquisition of Avon significantly increased Natura's business scale, making it the fourth largest pure beauty company globally. The company brings a large consultant base and opportunities to amplifying its product portfolio and market presence in Latin America. The combined entity

benefits from up-selling opportunities in terms of channel and brands. Synergies are projected to be captured mainly in Brazil and Latin America as it leverages its manufacturing and distribution capabilities.

Execution Risks: Natura faces the challenge of integrating Avon's global operations outside of Latin America. Avon International's operations continues to decelerate in constant currency, mostly due to COVID-19 restrictions in Central and Eastern Europe but has been showing some improving fundamentals. Natura is in the process of capturing synergies, with estimates of recurring gains of around USD300 million-USD400 million to be fully captured by 2024. Estimated costs are around USD190 million. Natura will have to maintain a strong pipeline of innovation to compete with fast-changing beauty trends and digitalize to engage more directly with end consumers. Fitch's base case incorporates an average capex of around BRL1.7 billion during 2021-2022, up from the BRL675 million in 2020.

Challenging Industry Dynamics: Natura has the challenge to move forward with its strategy to move from a direct sales single-model (with declining trends in selected markets) to an omni-channel strategy. The challenges related to coronavirus pandemic remains as a negative headwind. The CF&T industry is attractive due to its resilience throughout economic cycles but the restrictive lockdowns implemented in some countries had a direct impact on retail operations. Natura has invested heavily in digitalization and increasing its online sales that have more than doubled, which has helped to offset the loss from the temporary closing of retail stores.

Deleveraging Trend: Natura's capital structure has strengthened primarily due to equity issuances of USD1.5 billion during 2020. Fitch expects Natura to remain committed to a sound credit profile in the medium term while it focuses on the integration of Avon and the transformation of its business. Natura's better than expected operating performance over recent quarters, better product mix, brand repositioning for Avon and increasing digitalization are expected to accelerate the deleverage trend. Fitch's rating case forecasts Natura's net adjusted debt/EBITDAR ratio to remain around 2.0x during 2021-2022. This represents a significant improvement from the pro forma adjusted leverage after the merger with Avon of 4.5x.

Strategic Capex to Pressure FCF: Fitch expects Natura's adjusted EBITDA to be around BRL5.0 billion for 2021 and BRL5.7 billion in 2022. The company's ongoing strategy to improve its product portfolio, complete Avon's turnaround, increase digitalization, and postponed capex from 2020 will pressure FCF generation in 2021. Fitch forecasts total capex to be around BRL1.7 billion during 2021 and to slightly decline during 2022. FCF are expected to be negative around BRL1 billion during 2021. This incorporates dividend distributions per company's by law (30% net income). In weaker EBITDA generation scenario, Fitch expects Natura to reduce capex and dividends to limit the deterioration in FCF generation and maintain its credit metrics below 2.5x in the medium term.

Derivation Summary

Natura's 'BB'/AA+(bra)/Positive Rating Outlook reflects the combined credit quality of Avon and Natura. Natura's 2.0x consolidated adjusted net leverage (YE 2021-YE 2022) ratio is strong for the rating category and incorporates execution risks related to the integration of Avon and medium term refinancing exposure. Natura has a solid business position in the CF&T industry, being the fourth largest player, underpinned by strong brand recognition, large scale, a competitive cost structure and a large direct-sales structure. The operations of The Body Shop and Aesop further complement the company's product portfolio and broad geographical diversification. Natura has the challenge of adapting its business model to an omnichannel strategy and to boost its digital platform while integrating Avon.

In terms of comparable companies, Fitch rates Walnut Bidco Plc (Oriflame) 'B' that also operates in the direct-selling beauty market. Natura has strong business and financial profile than Oriflame, which is reflected in the higher rating. Fitch also rates the cosmetic Anastasia Intermediate Holdings, LLC's (ABH) 'CCC', which currently presents an unsustainable capital structure. The company has a narrow product and brand profile and has been facing declining revenue and EBITDA trend as result of the beauty industry market shifts. In Brazil, Natura also faces strong competition from a local player, O Boticario (not rated), which also has a track record of solid credit and business profile, and strong brand.

Key Assumptions

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

- Fitch expects Natura's revenue to grow around 6%-8% during 2021 and more close to 10% in 2022.
- Consolidated EBITDAR margins around 12.4% in 2021 and improving to around 13.5% in 2022.
- Capex increase to around BRL1.8 billion in 2021 and BRL1.7 billion in 2022 to support the digitalization and innovation process.
- Dividends around 30% of net income in 2020.
- Natura to maintain its proactive approach on refinancing its short-term debt.

RATING SENSITIVITIES

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

- Consolidated EBITDAR margins around 14% on consistent basis.
- Consolidated net adjusted debt/EBITDAR ratio below 2.5x on a consistent basis.
- Successful ongoing refinancing strategy with no major debt maturities within two to three years.

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 2021 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 a track record of maintaining adequate liquidity and solid access to the local credit market. As of Dec. 31, 2020, the company had BRL8.3 billion in cash and marketable securities, which compares with BRL3.8 billion million of short-term debt, leading to a cash/short-term debt ratio of 2.2x. This compares with an average ratio of 1.5x from 2015 to 2019. At Dec. 31 2020, Natura had total debt of around BRL17 billion, including on balance leasing obligations (BRL4.7 billion). Natura's debt is mainly composed of BRL0.5 billion at the holding level, BRL7.5 billion at Natura Cosméticos (net of derivatives) and BRL4.2 billion at Avon. Cross-border bonds (51%), local debentures (33%) and promissory notes (4%) are the company's main debt.

Fitch expects Natura to remain proactive on its liability management strategy to avoid exposure to high refinancing risks in the medium term. The company will need to continue to access credit market during 2021 to extend its debt maturities. Natura faces long-term debt amortization of BRL3.8 billion in 2021, BRL0.5 billion in 2022, BRL4.7 billion in 2023 and BRL3.1 million from 2024 onwards. The company's refinancing risks has reduced as it used around BRL4.7 billion (USD900 million) of the follow-on process to prepay Avon's 2022 secured bonds.

The proposed sustainability-linked securities framework establishes a greenhouse gas emissions intensity target by 13% by 2026 against the 2019 baseline, and to reach 25% of post-consumer recycled plastic usage in plastic product packaging by 2026 with an interest rate step up if Natura fails to meet the targets.

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 Cosmeticos S.A.	LT IDR	BB 	Affirmed	BB 
	LC LT IDR	BB 	Affirmed	BB 
	Natl LT	AA+(bra) 	Affirmed	AA+(bra) 
<ul style="list-style-type: none">senior unsecured	LT	BB	New Rating	
<ul style="list-style-type: none">senior unsecured	LT	BB	Affirmed	BB
Avon Products, Inc.	LT IDR	BB 	Affirmed	BB 
<ul style="list-style-type: none">senior unsecured	LT	BB	Affirmed	BB

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Avon International Operations, Inc.	LT IDR	BB 	Affirmed	BB 
Natura &Co Holding S.A.	LT IDR	BB 	New Rating	
	LC LT IDR	BB 	New Rating	
	Natl LT	AA+(bra) 	New Rating	

RATINGS KEY OUTLOOK WATCH

POSITIVE



NEGATIVE



EVOLVING



STABLE



Applicable Criteria

[Corporate Rating Criteria \(pub.21 Dec 2020\) \(including rating assumption sensitivity\)](#)

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub.09 Apr 2021\) \(including rating assumption sensitivity\)](#)

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

[Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria \(pub.08 Jan 2021\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(pub.26 Aug 2020\)](#)

Applicable Models

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Avon International Capital P.L.C. EU Endorsed, UK Endorsed

Avon International Operations, Inc. EU Endorsed, UK Endorsed

Avon Products, Inc. EU Endorsed, UK Endorsed

Natura Cosméticos S.A. EU Endorsed, UK Endorsed

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