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

Fitch Ratings - Rio de Janeiro - 12 Apr 2022: Fitch Ratings has affirmed Natura &Co Holding S.A. (Natura)'s 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 Cosmeticos 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., its unsecured notes and Avon International Operations Inc. at 'BB'. The Rating Outlooks remains Positive.

Natura's 'BB' ratings reflect its solid business position, large and diversified asset base, strong capital structure, and challenges with Avon. Inputs cost pressures, supply chain constrains and rising inflation will impact profitability in the short term, but Natura's ratings have some headroom. Ongoing synergies and lower cash outflows should favor results. The Positive Outlook reflects Natura's credit profile improvements in the next 18-24 months due to integration and more steady cash flow, and net adjusted leverage below 2.5x, with no refinancing risks.

Key Rating Drivers

Consolidated Approach: 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 expected recurring synergies and, the tangible financial support in the form of payment of Avon's secured notes and inter-company loans. The cross-border debt issuances by Natura Cosmeticos with a guarantee from Natura and others cross defaults clauses supports the consolidated approach.

Ratings Not Capped by Brazil's Country Ceiling: Natura has a diversified portfolio of operations, with some hard currency EBITDA from its assets abroad relative to its interest expenses in hard currency, therefore, Natura's ratings are not constrained by Brazil's 'BB' Country Ceiling, per Fitch's "Non-Financial Corporates Exceeding the Country Ceiling Rating Criteria".

Other considerations increasing Natura's ability to mitigate transfer and convertibility risks include cash held abroad and generated abroad in several countries, as well as a stand-by credit facility of USD625 million. Brazil accounted for 26% of revenue in 2021, followed by EMEA (excluding the U.K.) at 19%, the U.K.at 10%, Mexico at 10%, Asia at 9%, the U.S. and Canada at 6%, other South America at 17% and Oceania at 3%. Natura's revenues in Russia and Ukraine were lower than 5% of consolidated revenue and 3% of EBITDA in 2021, including The Body Shop operations via head franchisees.

Large and Diversified Business Scale: The acquisition of Avon significantly increased Natura's business scale, making it the world's fourth-largest pure beauty company. The company brings a large consultant base and opportunities to amplify its product portfolio and market presence in Latin America. The combined entity benefits from up-selling opportunities in terms of channels and brands. Synergies are projected to be captured mainly in Brazil and Latin America as it leverages its manufacturing and distribution capabilities. Natura estimates recurring gains of around USD350 million-USD450 million to be fully captured by 2024. Around USD195 million has been captured during fiscal 2021.

Ongoing Execution Risk: Natura faces the challenge of integrating Avon's operations in Latin America as well as its global operations. During the past quarters, the company has been improving Avon's profitability. The strong recovery of 4Q21 should not sustain during 1H22, but the decline trend in the number of Avon reps in Brazil seems to have reached an inflection point in last October and it should help to sustain a recovery by YE 2022. Natura has the challenge to move forward with its strategy to move from a direct sales single-model, with declining trends in certain markets, to omnichannel.

Natura has invested heavily in digitalization and increasing its online sales, which have more than doubled. During 2021, 51.5% of total sales were using digital platform. 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. Fitch's base case incorporates average annual capex of around BRL1.7 billion in2022-2023, from BRL675 million in 2020. In a weaker EBITDA generation environment, Fitch expects Natura to reduce capex and dividends to limit deterioration in FCF and maintain leverage around 2.5x in the medium term.

Challenging Macroeconomic Headwinds in the Short-Term: Natura is expected to face negative headwinds related to continued erosion of disposable income caused by high inflation and lower government income support, as well as in terms of cost structure and rising competition (substitute products in mass retail channel and a likely increase in imported products with BRL appreciation) during most of 2022. As result, Fitch expects some deterioration in operating margins from previous forecasts that will be partially offset by the ongoing capture of synergies.

Fitch expects adjusted EBITDAR margins to range 10.6%-11.7% for 2022-2023. This compares with 10.3% in 2021 and 11.4% in 2020, and around 13% from previous forecast. Natura's adjusted EBITDAR is forecasted to be around BRL4.5 billion for 2022 and BRL5.2 million in 2023.

Deleveraging Trend to 2023: Fitch's rating case forecasts Natura's net adjusted debt/EBITDAR to decline 2.6x (2.7x in 2021) and to around 2.1x-2.4x during 2023-2024. This represents a significant improvement from the pro forma adjusted leverage after the merger with Avon of 4.5x.

Derivation Summary

Natura's ratings reflect the combined credit quality of Avon and Natura. Natura's current adjusted net leverage anticipated is strong for the rating category and incorporates execution risks related to the integration of Avon. Natura has a solid business position in the CF&T industry, underpinned by strong brand recognition, large scale, a competitive cost structure and a large direct-sales structure. The operations of The Body Shop International Limited and Emeis Holding Pty Ltd. Aesop further complement the company's product portfolio and broad geographical diversification. Natura is challenged to adapt its business model to an omnichannel strategy and boost its digital platform while integrating Avon.

In terms of comparable companies, Fitch rates Oriflame Investment Holding Plc 'B'; it also operates in the direct-selling beauty market. Natura has a stronger business and financial profile than Oriflame, reflected in the higher rating. 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 a strong brand.

Key Assumptions

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

--Fitch expects Natura's revenue to grow around 5%-6% during 2022-2023.

--Consolidated EBITDAR margins around 10.6% in 2021 and improving to around 13.5% in 2022.

--Capex increase to around BRL1.5 billion in 2022 and BRL1.7 billion in 2022-2023 to support the digitalization and innovation process.

--Dividends of USD180 million in 2022 and around 30% of net income afterwards.

--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 above 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 maintained strong liquidity and solid access to credit markets. The company had BRL5.9 billion in cash and marketable securities at YE 2021, with BRL945 million of short-term debt. Cash is sufficient to support debt amortization until 2027. Natura's liquidity is further enhanced by USD625 million revolving credit facility due 2024. In March 2022, Natura drew down USD200 million.

Natura had total debt of around BRL17.1 billion at YE 2021, including Fitch's adjusted leasing obligations of BRL4.8 billion. Natura's debt mainly consists of BRL7.9 billion at Natura Cosmeticos net of derivatives and BRL4.4 billion at Avon. Cross-border bonds (76%), local debentures (16%) are the company's main debt. Natura& Co holding has no debt as of Dec. 31, 2021.

Fitch expects Natura to remain proactive in its liability management strategy to avoid exposure to high refinancing risks in the medium term. The company will need to continue to access credit markets in the short to medium term to extend its debt maturities. Natura faces long-term debt amortization of BRL945 million in 2022, BRL2.8 billion in 2023 (including Avon's bonds), BRL2.2billion in 2024 and BRL6.3 billion from 2025 onward. The company's refinancing risks have diminished, as it used around BRL4.7 billion (USD900 million) of the follow-on process to prepay Avon's 2022 secured bonds.

Issuer Profile

Natura&Co is composed by four iconic beauty companies: Natura, The Body Shop, Aesop and Avon. It is the fourth-largest pure play beauty group in the world with a 2.0% global market share in 2021 as a result of its sizeable 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.

Fitch Ratings Analysts

Debora Jalles
Director
Primary Rating Analyst
+55 21 4503 2621
Fitch Ratings Brasil Ltda. Av. Barão de Tefé, 27 – Sala 601 Saúde Rio de Janeiro, RJ 20220-460

Renato Donatti

Director
Secondary Rating Analyst
+55 11 4504 2215

Martha Rocha
Managing Director
Committee Chairperson
+1 212 908 0591

Media Contacts

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

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)
• senior unsecured	LT	BB	Affirmed		BB
Avon Products, Inc.	LT IDR	BB	Affirmed		BB
• 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	Affirmed		BB
	LC LT IDR	BB	Affirmed		BB
	Natl LT	AA+(bra)	Affirmed		AA+(bra)

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Corporate Rating Criteria (pub.15 Oct 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.01 Dec 2021)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub.15 Oct 2021)

Applicable Models

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.0.2 (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 Cosmeticos S.A.	EU Endorsed, UK Endorsed

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Endorsement policy

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