

Tear Sheet:

Natura & Co Holding S.A.

November 21, 2023

The announced sale of The Body Shop (TBS) is credit neutral for now. TBS' performance has been sluggish in the past few years and has demanded significant efforts from management to improve its retail business model that differs from Natura's core business of direct sales. We expect TBS to contribute about 12% of revenues and about 6% EBITDA in 2023. In our updated forecast, we excluded TBS figures from 2024 on, which helps to improve Natura's consolidated margins and don't affect the business for now, despite losing business channels and geographic diversification. The sale will also result in a cash inflow of about R\$1.2 billion to be received in up to five years, but this doesn't change our view of Natura's already deleveraged balance sheet.

A reliable plan for turning around Avon and capital allocation decisions will drive future rating actions. Since the capital inflow from the sale of Aesop for about R\$13 billion, Natura pursued liability management for some of its more expensive debt, reducing by almost half the expected interest payments in 2024. We expect a positive net cash position for Natura by the end of 2023, and estimate that even with capex of R\$1.5 billion to R\$2.0 billion and dividends of R\$500 million to R\$1 billion, debt to EBITDA will remain below 1x in the next several years. However, we could take a negative rating action if Natura has a continued weak operating performance and is unable to efficiently turn around Avon, or if the company adopts a more aggressive approach about dividends and acquisitions amid consistently weak margins.

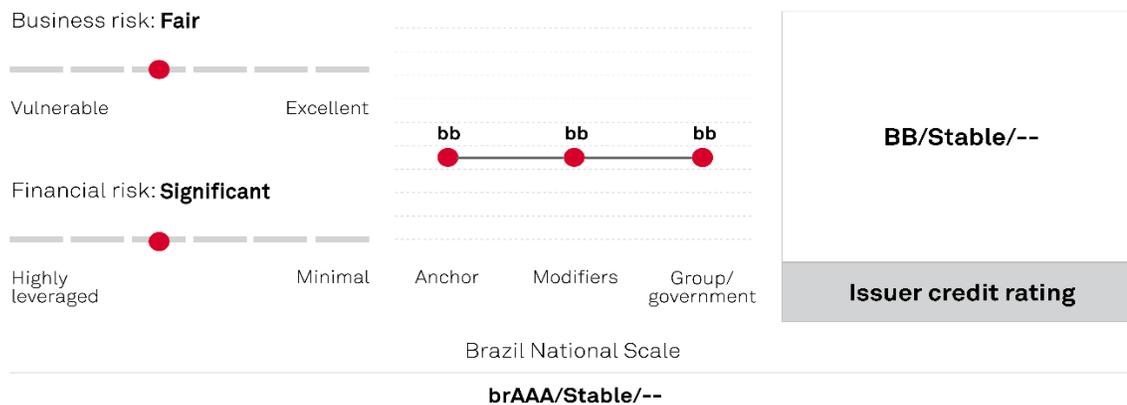
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Ratings Score Snapshot



Recent Research

- Research Update: Avon Products Inc. 'BB-' Rating Affirmed On Group Status Change To Highly Strategic; Outlook Stable, Oct. 10, 2023
- Research Update: Natura & Co, Natura Cosmetics, And Avon Products Ratings Affirmed On R\$13 Billion Asset Sale, Outlook Remains Stable, April 5, 2023
- Bulletin: Natura&Co Posts Weaker-Than-Expected 2022 Results, But Potential Asset Sale Could Boost Metrics, March 14, 2023

Company Description

Natura&Co is the fourth-largest global cosmetics group, with revenue of R\$33 billion and EBITDA of R\$2.4 billion in the past 12 months ended September 2023. The group controls Natura and Avon, and owns the brands Natura, Avon, and TBS. The group operates in more than 100 countries, with a leading position in Brazil, and has a diversified portfolio with product offerings to various customer tiers and channels. Natura&Co has strong brands and a leading position in the direct sales model for cosmetics, with more than 7.5 million representatives and more than 2,000 stores and franchises globally.

Outlook

The stable outlook reflects that although Natura&Co and Natura's net leverage will be very low once the proceeds from the sale of TBS are disbursed, we will monitor the group's growth strategy in terms of mergers and acquisitions and investments, along with shareholders' returns, to assess if the group returns to more historically normal capital structure, cash flow, and leverage. In addition, we expect the performance of Avon to gradually improve, despite depressed consumption and a long road to complete the turnaround.

Downside scenario

We could downgrade Natura&Co in the next 12-24 months if the performance of Avon remains lackluster and the group's revenues and margins continue to decline, which along with volatile profits could lead us to revise our view of its business risk. Also, although unlikely in the next 24 months, if the group becomes more aggressive in acquisitions or shareholders' returns, raising debt to EBITDA to about 4x, we will lower the ratings.

Upside scenario

We could upgrade Natura&Co if margins at Avon recover, Natura's operations in Latin America continue to expand and benefit from integrating businesses, and we see consistent results and a conservative financial policy regarding leverage. Even as the group pursues other growth initiatives, we would expect debt to EBITDA to remain below 2x, funds from operations (FFO) to debt above 45%, and free operating cash flow (FOCF) to debt above 15%.

Natura Cosmetics S.A. Outlook

The ratings on Natura move in tandem with those on its parent, Natura&Co, because of Natura's status as a core subsidiary. We expect Natura to continue benefiting from consultants' higher sales of Natura and Avon products and from synergies stemming from the integration. We expect its debt to EBITDA to be comfortably below 3x.

Upside scenario

We could revise upward the stand-alone credit profile (SACP) following a longer track record of debt to EBITDA remaining below 2x, FFO to debt above 45%, and FOCF above 15%, along with improving profitability if it were to pursue growth opportunities.

Downside scenario

We could revise downward Natura's SACP if we see margin compression on a consistent basis, which could lead us to view its business risk as weaker. A lower SACP could also result from debt to EBITDA approaching 4x and FFO to debt below 20%.

Key Metrics

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026
(Mil. R\$)	2020a	2021a	2022a	2023e	2024f	2025f	2026f
Revenue	36,922	40,165	36,350	32,239	28,980	29,982	30,893
Gross profit	23,908	28,945	25,786	19,788	17,377	17,991	18,561
EBITDA (reported)	3,508	3,910	2,134	2,368	2,488	2,866	3,086
Plus: Operating lease adjustment (OLA) rent	--	--	--	--	--	--	--
Plus/(less): Other	493	274	296	159	159	159	159
EBITDA	4,001	4,183	2,430	2,527	2,647	3,025	3,245
Less: Cash interest paid	(1,258)	(1,004)	(1,009)	(1,223)	(763)	(702)	(708)
Less: Cash taxes paid	(331)	(977)	(580)	(166)	(199)	(270)	(306)
Plus/(less): Other	--	--	--	--	--	--	--
Funds from operations (FFO)	2,412	2,203	841	1,138	1,685	2,052	2,230
EBIT	1,315	1,467	301	891	1,419	1,627	1,750
Interest expense	1,352	858	964	1,267	782	720	724
Cash flow from operations (CFO)	1,286	(114)	672	1,023	1,908	1,651	2,394
Capital expenditure (capex)	674	1,479	1,103	1,934	1,739	1,799	1,854
Free operating cash flow (FOCF)	611	(1,593)	(431)	(912)	170	(147)	541
Dividends	134	--	181	700	700	1,000	1,000
Share repurchases (reported)	(51)	174	120	--	--	--	--
Discretionary cash flow (DCF)	529	(1,768)	(732)	(1,612)	(530)	(1,147)	(459)
Debt (reported)	13,823	12,717	13,592	7,592	7,592	7,592	7,592
Plus: Lease liabilities debt	3,858	3,548	3,271	2,453	2,453	2,502	2,627
Plus: Pension and other postretirement debt	--	--	--	--	--	--	--
Less: Accessible cash and liquid investments	(8,342)	(5,986)	(5,996)	(10,908)	(10,000)	(8,677)	(9,273)
Plus/(less): Other	(1,728)	(132)	635	636	636	636	636
Debt	7,611	10,147	11,502	--	680	2,053	1,582
Equity	27,387	28,567	22,351	21,415	21,301	21,076	20,985
FOCF (adjusted for lease capex)	1	(2,440)	(1,508)	(622)	(208)	(373)	229
Interest expense (reported)	1,334	845	945	1,248	763	701	705
Capex (reported)	674	1,479	1,103	1,934	1,739	1,799	1,854
Cash and short-term investments (reported)	8,342	5,986	5,996	10,908	10,000	8,677	9,273

Adjusted ratios

Natura & Co Holding S.A.

Debt/EBITDA (x)	1.9	2.4	4.7	--	0.3	0.7	0.5
FFO/debt (%)	31.7	21.7	7.3	NM	247.6	100.0	140.9
FFO cash interest coverage (x)	2.9	3.2	1.8	1.9	3.2	3.9	4.1
EBITDA interest coverage (x)	3.0	4.9	2.5	2.0	3.4	4.2	4.5
CFO/debt (%)	16.9	(1.1)	5.8	NM	280.5	80.4	151.3
FOCF/debt (%)	8.0	(15.7)	(3.7)	NM	24.9	(7.2)	34.2
DCF/debt (%)	6.9	(17.4)	(6.4)	NM	(77.9)	(55.9)	(29.0)
Lease capex-adjusted FOCF/debt (%)	0.0	(24.1)	(13.1)	--	(30.5)	(18.1)	14.5
Annual revenue growth (%)	12.1	8.8	(9.5)	(11.3)	(10.1)	3.5	3.0
Gross margin (%)	64.8	72.1	70.9	61.4	60.0	60.0	60.1
EBITDA margin (%)	10.8	10.4	6.7	7.8	9.1	10.1	10.5
Return on capital (%)	5.4	4.0	0.8	3.2	6.5	7.2	7.7
Return on total assets (%)	2.8	2.4	0.5	1.8	3.1	3.6	3.9
EBITDA/cash interest (x)	3.2	4.2	2.4	2.1	3.5	4.3	4.6
EBIT interest coverage (x)	1.0	1.7	0.3	0.7	1.8	2.3	2.4
Debt/debt and equity (%)	21.7	26.2	34.0	--	3.1	8.9	7.0
Debt fixed-charge coverage (x)	3.0	4.9	2.5	0.3	3.4	4.2	4.5
Debt/debt and undepreciated equity (%)	21.7	26.2	34.0	--	3.1	8.9	7.0

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. R\$--Brazilian real.

Financial Summary

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022
Reporting period	2020a	2021a	2022a
Display currency (mil.)	R\$	R\$	R\$
Revenues	36,922	40,165	36,350
EBITDA	4,001	4,183	2,430
Funds from operations (FFO)	2,412	2,203	841
Interest expense	1,352	858	964
Cash interest paid	1,258	1,004	1,009
Operating cash flow (OCF)	1,286	(114)	672
Capital expenditure	674	1,479	1,103
Free operating cash flow (FOCF)	611	(1,593)	(431)
Discretionary cash flow (DCF)	529	(1,768)	(732)
Cash and short-term investments	8,342	5,986	5,996
Gross available cash	8,342	5,986	5,996
Debt	7,611	10,147	11,502
Common equity	27,387	28,567	22,351
Adjusted ratios			
EBITDA margin (%)	10.8	10.4	6.7
Return on capital (%)	5.4	4.0	0.8
EBITDA interest coverage (x)	3.0	4.9	2.5

Natura & Co Holding S.A.

FFO cash interest coverage (x)	2.9	3.2	1.8
Debt/EBITDA (x)	1.9	2.4	4.7
FFO/debt (%)	31.7	21.7	7.3
OCF/debt (%)	16.9	(1.1)	5.8
FOCF/debt (%)	8.0	(15.7)	(3.7)
DCF/debt (%)	6.9	(17.4)	(6.4)

Peer Comparison

Natura & Co Holding S.A.--Peer Comparisons

	Natura & Co Holding S.A	Coty Inc.	Estee Lauder Cos. Inc. (The)	L'Oreal S.A.
Foreign currency issuer credit rating	BB/Stable/--	BB/Positive/--	A+/Negative/A-1	AA/Stable/A-1+
Local currency issuer credit rating	BB/Stable/--	BB/Positive/--	A+/Negative/A-1	AA/Stable/A-1+
Period	Annual	Annual	Annual	Annual
Period ending	2022-12-31	2023-06-30	2023-06-30	2022-12-31
Mil.	R\$	R\$	R\$	R\$
Revenue	36,350	26,780	76,713	216,172
EBITDA	2,430	5,082	15,290	53,762
Funds from operations (FFO)	841	3,565	10,619	41,529
Interest	964	1,373	1,488	434
Cash interest paid	1,009	1,234	1,464	376
Operating cash flow (OCF)	672	3,141	10,156	35,472
Capital expenditure	1,103	1,074	4,836	7,589
Free operating cash flow (FOCF)	(431)	2,067	5,320	27,883
Discretionary cash flow (DCF)	(732)	1,981	(446)	9,847
Cash and short-term investments	5,996	1,190	19,427	12,699
Gross available cash	5,996	1,190	19,427	12,699
Debt	11,502	24,000	38,511	20,757
Equity	22,351	19,725	30,941	153,604
EBITDA margin (%)	6.7	19.0	19.9	24.9
Return on capital (%)	0.8	9.8	14.4	26.9
EBITDA interest coverage (x)	2.5	3.7	10.3	123.7
FFO cash interest coverage (x)	1.8	3.9	8.3	111.5
Debt/EBITDA (x)	4.7	4.7	2.5	0.4
FFO/debt (%)	7.3	14.9	27.6	200.1
OCF/debt (%)	5.8	13.1	26.4	170.9
FOCF/debt (%)	(3.7)	8.6	13.8	134.3
DCF/debt (%)	(6.4)	8.3	(1.2)	47.4

Rating Component Scores

Foreign currency issuer credit rating	BB/Stable/--
Local currency issuer credit rating	BB/Stable/--
Business risk	Fair
Country risk	Moderately High
Industry risk	Low
Competitive position	Fair
Financial risk	Significant
Cash flow/leverage	Significant
Anchor	bb
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)
Stand-alone credit profile	bb

Rating Component Scores

Natura Cosméticos S.A.

Foreign currency issuer credit rating	BB/Stable/--
Local currency issuer credit rating	BB/Stable/--
Business risk	Fair
Country risk	Moderately High
Industry risk	Low
Competitive position	Fair
Financial risk	Significant
Cash flow/leverage	Significant
Anchor	bb
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)
Stand-alone credit profile	bb

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 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: 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

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