04 Nov 2020 | Upgrade

Fitch Upgrades Natura and Avon's IDR to 'BB'; Outlook Stable

Fitch Ratings-Rio de Janeiro-04 November 2020:

Fitch Ratings has upgraded Natura Cosmeticos S.A.'s (Natura Cosmeticos) Long-Term Foreign Currency (FC) Issuer Default Rating (IDR) and Local Currency (LC) IDR to 'BB' from 'BB-', as well as its unsecured USD750 million notes due 2023 to 'BB' from 'BB-'. The National Scale Rating has been upgraded to 'AA+(bra)' from 'AA-(bra)'. The Rating Outlook has been revised to Stable from Negative.

In conjunction with these rating actions, Fitch has upgraded Avon Products, Inc. (Avon)'s LT IDR to 'BB' from 'B+' and its unsecured notes to 'BB' from 'B/RR5'. In a related move, Fitch has also upgraded to 'BB' from 'B+' the LT IDR of Avon International Operations, Inc. The Rating Outlook is Stable.

The upgrade of Natura Cosmeticos and Avon's ratings reflect the improved credit profile of Natura & Co S.A. (Natura), the holding company of the two sister companies, as a result of an equity inflow of BRL5.6 billion from the recent follow-on transaction. A major part of the follow-on proceeds was used to optimize capital structure and to reduce the group's exposure to USD dollar-denominated debt with the payment of USD900 million (around BRL5 billion) of Avon's secured notes due in 2022. The remaining cash will be used to accelerate the group's growth strategy and its digitalization process.

Natura's leverage profile has significantly improved following the new equity proceeds as well as relatively better than expected operating performance during the pandemic so far. Fitch's projected 2020 net adjusted debt/EBITDAR ratio declined to 3.0x, from around the previously expected 4.5x. The company's refinancing risks and financial flexibility have also improved following the payment of Avon's secured notes. Fitch expects Natura to remain proactive on its liability management strategy to avoid exposure to high refinancing risks in the medium term as some debt concentration with both Natura Cosmeticos and Avon's bonds come due in 2023. The elimination of restrictive covenants related to Avon's secured notes also aid in the completion of the restructuring of Avon and Natura's operations in Latin America, allowing the acceleration of the expected synergies.

Key Rating Drivers

Rating Equalization: Natura Cosmeticos 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 with the resources from Natura. In the medium term, Fitch expects that debt at Avon will likely be replaced by debt with guarantees from the holding Natura&Co.

Deleveraging Trend: Natura has raised in total BRL7.6 billion of equity during 2020, via a private placement in June 2020 (BRL2 billion) and the recent follow-on (BRL5.6 billion). Fitch's rating case forecasts Natura's net adjusted debt/EBITDAR ratio declining to 3.0x by the end of 2020 and to 2.5x by 2021. This represents a significant improvement from the pro forma adjusted leverage expected for 2020, after the merger with Avon, was completed of 4.5x. The ongoing improvement in leverage during 2021 also reflects the increasing operating cash flow generation as the company moves forward with its integration process, as well as improvements related to better product mix, brand repositioning for Avon and increasing overall digitalization.

Challenging Industry Dynamics: The challenges related to coronavirus and uncertainties around the impact of the second wave to the group's international operations, including other countries in Latin America, 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 partially offset the loss from closing retail stores. Fitch forecasts Natura's consolidated revenue to grow, compared to a pro forma 2019 figures, in the range of 7%-9% in 2020, benefiting from FX rates.

Execution Risks: Natura faces the challenge of integrating Avon's global operations outside of Latin America, more than half of Avon's revenues, which have been pressured by declining active representatives and sales volumes in complex emerging markets. 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. 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 scenario incorporates an average capex of around BRL1.4 billion per year during 2021-2022, up from the BRL800 million expected to 2020.

EBITDA Margin Remains Pressured: For 2020, Fitch expects the group's consolidated EBITDA margin at around 9%, pressured by Avon's integration. In the medium term, the synergy gains and the implementation of digitalization are expected to drive EBITDA margins up to 10.5% in 2021 and 12% in 2022. In comparison, Natura Cosmeticos had a 14.2% margin in 2018 and 13.7% during 2019, which compares to an average EBITDA margin of 16.9% between 2015 and 2017. Since 2018, Natura's margin has also been affected by the acquisition of TBS, that presents lower profitability. Natura's track record of higher EBITDA margins reflect its strong brand value and recognition, large operating scale, extensive direct-sales structure and in-house manufacturing capabilities.

Large Business Scale: The acquisition of Avon significantly increases Natura's business scale to rank as the fourth largest pure beauty company globally, enhancing the company's consultant base to 4.15 million reps and amplifies its product portfolio and market presence in Latin America. The combined entity benefits from up-selling opportunities in terms of channel and improves its value proposition. The expected synergies are to be captured mainly in Brazil and Latin America as it leverages its combined manufacturing and distribution capabilities. Fitch considers that an important part of the savings from the synergies obtained will need to be reinvested to improve the companies' competitive positions within the highly competitive global beauty sector. Natura and Avon both have high exposure to the decline in direct sales and are attempting to gravitate to an omnichannel strategy.

Expanded Geographic Presence: The purchase of Avon improves Natura's geographic diversification. Brazil represents the bulk of Natura's operations and accounted for 44% of revenues during 2019. During the first six months of 2020, and including Avon's operations, Brazil's decreased to 31%. As of 2019, Brazil and

Argentina represent 45% of Avon's operating profit, while Europe, the Middle East and Africa account for 36%, North Latin America accounts for 11% and Asia Pacific for approximately 8%.

Derivation Summary

Natura's BB/AA+(bra)/Stable Rating Outlook reflects the combined credit quality of Avon and Natura. Natura's 2.5x-3.0x consolidated net leverage (YE20-YE21) ratio 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, 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 unstainable 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 presents a stronger financial profile and solid business profile, supported mainly by its strong brand and bricks-and-mortar franchise chain.

Key Assumptions

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

--Fitch expects Natura's revenue to grow around 7%-9% during 2020 and 2021.

--Consolidated EBITDA margins around 9.2% in 2020 and improving to around 10.5% in 2021.

--Reduced capex of around BRL800 million in 2020, with an increase to around BRL1.5 billion in 2021 and BRL1.4 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 above 14% on consistent basis.

--Consolidated net adjusted debt/EBITDAR ratio around 2.5x on a consistent basis.

--Successful ongoing refinancing strategy with no major debt maturities within 2 years-3 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 June 30, 2020, the company had BRL7.4 billion in cash and marketable securities, which compares with BRL2.6 billion million of short-term debt, leading to a cash/short-term debt ratio of 2.8x. This compares with an average ratio of 1.5x from 2015 to 2019. On June 30, 2020, Natura had total debt of around BRL18.8 billion, excluding on balance leasing obligations of BRL4.1 billion. Natura's debt is mainly composed of BRL1.3 billion at the holding company level, BRL7.6 billion at Natura Cosmeticos (net of derivatives) and BRL9.9 billion at Avon. Cross-border bonds (63%), local debentures (22%) and promissory notes (7%) comprise the company's main debt.

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 market during 2021 to extend its debt maturities. Currently, Natura has the strategy to reduce its exposure to USD-denominated debt and better match debt to operating cash flow generation currency. As of June 2020, around 70% of the company's debt was in hard currency. Natura faces long-term debt amortization of BRL2.3 billion in 2021, BRL0.5 billion in 2022 (excluding Avon's secured bond), BRL4.6 billion in 2023 and BRL3.7 million from 2024 onwards.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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

Natura Cosmeticos S.A.; Long Term Issuer Default Rating; Upgrade; BB; Rating Outlook Stable
; Local Currency Long Term Issuer Default Rating; Upgrade; BB; Rating Outlook Stable
; National Long Term Rating; Upgrade; AA+(bra); Rating Outlook Stable
----senior unsecured; Long Term Rating; Upgrade; BB
Avon Products, Inc.; Long Term Issuer Default Rating; Upgrade; BB; Rating Outlook Stable
----senior unsecured; Long Term Rating; Upgrade; BB
Avon International Operations, Inc.; Long Term Issuer Default Rating; Upgrade; BB; Rating Outlook Stable

Contacts:
Primary Rating Analyst
Debora Jalles,
Director
+1 312 606 2338
Fitch Ratings Brasil Ltda.
Av. Barão de Tefé, 27 – Sala 601 Saúde
Rio de Janeiro, RJ 20220-460

Secondary Rating Analyst
Renato Donatti,
Director
+55 11 4504 2215

Committee Chairperson

Jay Djemal,
Senior Director
+1 312 368 3134

Media Relations: Elizabeth Fogerty, New York, Tel: +1 212 908 0526, Email: elizabeth.fogerty@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 01 May 2020) (including rating assumption sensitivity)
National Scale Rating Criteria (pub. 08 Jun 2020)
Parent and Subsidiary Linkage Rating Criteria (pub. 26 Aug 2020)

Applicable Model

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

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status
Endorsement Policy

 In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

ENDORSEMENT POLICY - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.