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Coty Inc.: A rough start to grow into a cosmetic giant

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Coty is a North American beauty products manufacturer based in New York with its history dated back to 1904 in Paris, France. On 7 April 2017, Coty's market capitalization dropped 31.99% from USD 18.73bn in October 2016 to USD 12.74bn after Coty announced the USD 11.4bn acquisition of Procter & Gamble's (P&G) Specialty Beauty business which helped Coty to become the third biggest maker in the fragrances and beauty business globally. Coty's RMI-CRI 1-year Probability of Default (PD) went from below 10 bps at the beginning of October 2016 to 185.8 bps in the end April 2017 (see Figure 1) signifying higher credit risk.

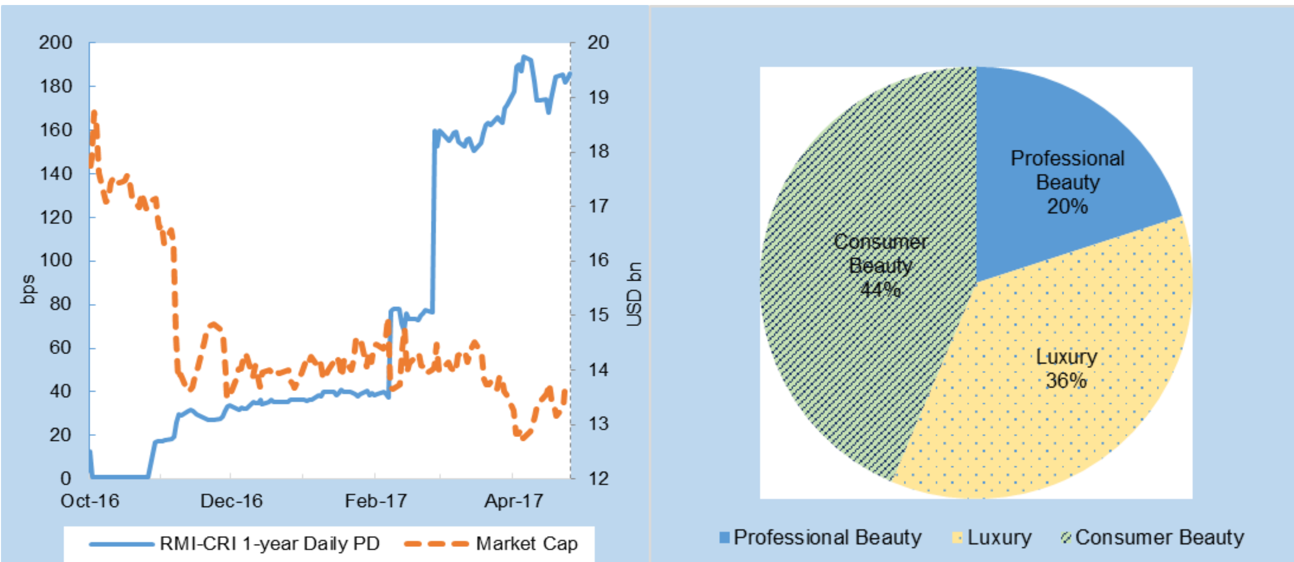

Figure 1: RMI-CRI 1-year PD (LHS) with market capitalization (RHS) for Coty Inc. (left panel). Sales mix by division of Coty Inc. (Inclusive of P&G Brands) in Q2 FY2017 (right panel). *Source: RMI-CRI, Bloomberg*

Coty's products are supplied to department stores, specialty retailers, mass-market retailers, and duty free shops in airports worldwide. Coty operates three divisions, namely, the Luxury, Consumer Beauty and Professional. Coty's acquisition of P&G business was to boost its image in the beauty products industry together with creating cost savings and cross selling brands opportunities. Right after Coty's acquisition, Moody's assigned a rating of Ba1 to Coty with the assumption that there would be no more significant acquisitions as the company focuses on integrating the acquired businesses. However, Coty's ambition is larger than expected. In just 15 days after it completed the acquisition of P&G's business, Coty agreed to acquire a London-based hairstyling-appliances company, Good Hair Day (GHD), for USD 511mn in cash. Following the acquisitions and the release of lower than expected Q1 FY2017 earnings (for the quarter ended 30 September 2016), Coty's market capitalization tanked and by end 2016, it reached its lowest point in the past two years. The dismay share price performance did not stop Coty's aggressive acquisition strategy. On 10 January 2017, Coty announced a partnership with Younique, a leading online peer-to-peer social selling platform in beauty, by acquiring 60% of its business amounting USD 600mn, funded through a combination of cash on hand and available debt facilities. In the latest of acquisitions, Coty announced on 3 April 2017 that it is acquiring the exclusive long-term global license rights for Burberry Beauty luxury fragrances, cosmetics and skincare.

	Q2 FY2016	Q3 FY2016	Q4 FY2016	Q1 FY2017	Q2 FY2017
Sales (USD mn)	1210.5	950.7	1075.6	1080.2	2296.7
Net Debt (USD mn)	3173.8	3763.9	3790.4	3989.0	5555.9
EBITDA Margin (%)	17.17	8.53	5.40	9.84	6.87
Total Debt/T12M EBITDA	6.62	8.92	8.56	9.63	16.11

Table 1: Credit metrics and financials for Coty Inc. *Source: Bloomberg*

Coty's acquisitions came at a cost as resources were being utilized for completing the transaction and integrating the newly acquired businesses. The management cited the distraction caused by the significant merger transition process for the poor results in 1Q FY2017 results. Sales slipped 2.9% on a YoY basis to USD 1.08bn and its adjusted operating income decreased 15.8% YoY to USD 145.2mn. In Q2 FY2017 results, after the completion of the acquisition from P&G, Coty reported a 60% YoY decrease in EBITDA margin to 6.87% and a 75.1% YoY increase in net debt to USD 5.56bn. The huge rise in net debt is mainly due to the further acquisitions made during Q2 FY2017.

The management has set the target of generating USD 1bn free cash flow by FY2018. In order to do so, Coty needs to limit its cash expenditure and achieve its sale growth target. However, the Q2 results reported a 11% YoY decline in sales within the Consumer Beauty division and a 4% YoY decrease in the Luxury division. The two underperforming divisions generated 80% of total sales (see Figure 1 right panel) which put pressure on Coty to achieve its sales growth target. Together with the cash constraint, an estimated USD 1.1bn expenses due by FY2020 (75% occurring through FY2018), Coty may find difficulties in hitting its target and repaying the minimum required term loan payments. At the same time, the cash constraint also has a negative impact on realizing its synergies and its investment needs to build its global distribution capabilities and brand presence.

Despite all the risks and challenges faced by Coty, there is a potential for Coty reach its target and success in transforming the group into an invigorated global leader. To achieve its ambition Coty needs to improve performances both in its organic business and acquired beauty brands to generate more cash flow. At the same time, the management team should work to integrate the newly acquired brands to realize its synergy plan in a quicker fashion. However, all these improvements are not easy to achieve. With a high debt level and deteriorating sales performances, Coty may be in for a rough ride.

Credit News
MAS cautious about outlook despite pickup **Apr 28.** The Monetary Authority of Singapore (MAS) is cautious of Singapore's outlook despite some manufacturing segments benefitting from the improving global economy. While a surge in global chip demand has boosted Singapore's semiconductor manufacturing and had positive spillovers on trade-related services such as air and sea cargo handling, it noted that growth has been volatile and soft labour demand could drive unemployment marginally upwards. Singapore's central bank also noted that recovery in the rest of the manufacturing sector has been poor, including the marine and offshore engineering sectors, and sectors relying mainly on local demand. It also noted that Singapore is dealing with longer-term structural challenges that could still weigh on growth. (Straits Times)
Bond buyers blacklist some Chinese provinces after run of defaults **Apr 27.** Corporate defaults from the Liaoning and Shandong provinces formed the lion's share of China's corporate defaults in 2017 – attributed to high-profile scandals which soured sentiment towards certain regions, as well as the central government's deleveraging drive which increased borrowing costs. Liaoning, which posted the slowest economic growth of China's 31 provinces, also paid the most in 2017 to issue bonds last week, while Tieling Public Asset Investment and Management Co., one of the province's financing vehicles, failed to sell dollar debt offshore in November 2016. The province is also home to China Huishan Dairy Holdings Co., which plunged 85% last month. Bond investors, who used to be indifferent in the risk profiles of different provinces betting that the central government will step in if provinces have trouble repaying debt, may also be shifting their preferences. (Bloomberg)
Shares in Takata suspended after reported bankruptcy filing plan **Apr 27.** Trading in Takata's shares was suspended after a report that states that the Japanese airbag maker is considering a bankruptcy plan that will create a new company and ring-fence its liabilities. News have reported that the Chinese-owned car parts maker Key Safety Systems (KSS) would sponsor the turnaround plan by injecting JPY 200bn and help create a new operating company. The funds would be helpful in settling claims linked to its faulty air bags that have claimed at least 16 deaths worldwide. There have also been increasing pressure from potential bidders and automaker clients for Takata to agree to a court-ordered restructuring process, which provides more transparency, but Takata has been insisting to go

for a privately arranged restructuring. The discussion involving the automaker's clients, suitors and bankers are likely to last till the end of May before a decision is reached. (Reuters)

China's bad loans, capital outflows stabilize, PBOC's Yi Says

Apr 25. The Deputy Governor of China's central bank, Yi Gang, remarked that China's non-performing loans have stabilized and the pressure from capital outflows has eased. China's non-performing loans ratio has declined in Q4 2016 for the first time since 2012 and the nation's big four banks posted higher than forecast profit. Capital outflows also show signs of easing as the yuan stabilizes, exhibited by rising foreign reserves in February and March. The central bank will continue to pursue prudent monetary policy and balance between economic stability and reducing financial leverage. Improving transparency and regulation in the shadow banking industry is also of priority to prevent systemic risks. The government also plans to open up its financial sector as it grant licenses to foreign banks and brokers for bond settlement and cut red tapes to facilitate yuan transactions. (Bloomberg)

Retailers are going bankrupt at a record pace

Apr 25. The rapid acceleration of online shopping are forcing brick and mortar retailers out of business at a record rate. From the start of 2017 to 6 April, 14 chains have stated that they will seek court protection, almost more than the whole of 2016. Retailers in America are closing their physical storefronts while shifting more business online. S&P analysis of public companies revealed that Sears Holding Corp., Bon-Ton Stores Inc. and Perfumania Holdings Inc. are the most vulnerable this year. S&P also stated that department stores, electronics retail and apparel shops are at highest risk, while the food and home improvement sectors are the least risky. (Bloomberg)

Credit quality of Singapore firms largely unchanged over the past year: SCCB (Business Times)

UOB Q1 profit rises 5.4%, topping forecasts, as income offset provisions (Straits Times)

Singapore bank lending up 6.3% year on year in March (Straits Times)

Regulatory Updates

Draghi fends off German critics and keeps stimulus untouched

Apr 28. Despite pressure from Germany to scale back European Central Bank's (ECB) stimulus program, Mr Draghi cautioned that the euro area economy is still at risk. Even though recent data has shown that the economic expansion continue to be firm and risks were more balanced, a rising trend in inflation has yet to happen. Inflation figures are expected to come in just below ECB's target and it is widely attributed to the rise in oil and food prices. However, the core inflation rate remains weak as wages are not rising as quickly as the central bank expected. Therefore the ECB maintained its overnight deposit rate at negative 0.4% and continue to run its bond-buying programme till the end of this year. Expectations among analysts and economists are also rising for a more significant adjustment in ECB's statement in June, after the presidential election in France. (FT)

Trump team unveils sharp cuts in corporate and individual taxes

Apr 27. Steven Mnuchin, the Treasury secretary, proposed a slash to corporate taxes from 35% to 15% and a 'one-time' cut-rate tax to induce companies to repatriate trillion of dollars of profits that is being held overseas. Estimates of the measures suggest that it would cost USD 5.5tn over a 10-year period, with the corporate tax cut being the most expensive measure. For individuals, the proposal also includes a cut in the top tax rate from 39% to 35% and a reduction in the number of tax brackets from seven to three. However, details of the proposal are still scant and investors' reactions were muted. Despite the ambitious broad measures, Mr Mnuchin acknowledged that there were few details on how the new measures would be implemented. (FT)

Basel puts new banking policy initiatives on hold until 2019 pending review (FT)

SGX regulatory body will take hard look at rules (Straits Times)

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