

Rating: **BUY** | Current Price: **\$7.53** | Price Target: **\$12.1** | Horizon: **12 Months** | December 2020

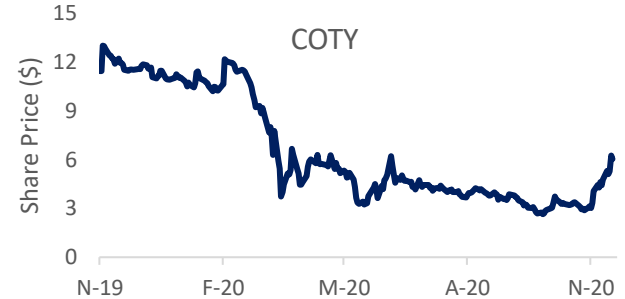
Price	\$7.53	52wk High	\$13.01	Market Cap	\$5767 M	EPS FY 20	(\$0.48)
Upside	61%	52wk Low	\$2.65	Shares Out.	766 M	Industry	Personal Care

COMPANY OVERVIEW

COTY is a color cosmetics and fragrance company that develops, markets, and distributes prestige perfumes (56% of sales), mass cosmetics (31%) and prestige skincare (13%)

EV/Sales Multiple Valuation

2021E Sales	\$	5,765
EV/Sales		2.9x
EV (M)	\$	16,718
Market Cap (M)	\$	9,257
Price	\$	12.11



INVESTMENT THESIS

COTY suffered COVID stress- the decline in EBITDA breached the covenant and stock traded to \$2.7. Since then, COTY was able to shore up balance sheet and is expected to meet covenant in the next test. The street is overly pessimistic. It misunderstood the perfume demand, attributing to a behavioral change rather than a channel disruption, and it underestimated the Covergirl (15% sales) market share gain

INVESTMENT SUMMARY

Key measures in place to secure liquidation and de-lever

- Preferred equity injection and revolver secure liquidity: KKR invested \$1B pref'd converts. Moreover, \$1.2B revolver capacity remaining
- Asset sale proceeds to de-lever, cost-cut to increase EBITDA coverage: COTY closed the Wella sale to KKR on 11/30/20, netting \$2.5B, of which \$2B to be used in paying down term loans. COTY also committed to a \$600M cost-cutting, improving leverage ratio

Counter-market View:

- Expect to comply with financial covenant once waiver expires: Next test in 6/21 should yield a 5.20x net leverage < covenant 5.25x

Perfume to recover faster due to unchanged behavior and consumption rate during the pandemic

- People continue to wear perfume despite staying at home, building up demand: Survey shows 83% of people wore perfumes when staying-at-home and an additional 13% wore perfumes when leaving the house in COVID, indicating unchanged perfume consumption
- COVID perfume decline caused by channel disruption thus to recover with reopening: Physical retail accounts for 67% (-30% YoY) of perfume sales and travel accounts for 13% (-70% YoY). With consumption rate unchanged, sales will realize once reopening takes hold

Counter-market View:

- Street's perfume topline assumption implies no physical reopening for 2021FY: E-comm accounts for 20% of channel. E-comm doubled in 2020 and grew at 30% CAGR since 2016. Assuming a 20% growth in 2021, perfume should grow 4% in 2021, the street implied growth rate, suggesting no physical reopening. With half of travel and physical reopening, the perfume segment will see a 18% YoY growth

Covergirl turnaround with market share gains outpacing the secular decline in mass cosmetics

- Covergirl gains shelf space driven by new launches, retailer leverage: Covergirl launched twice as many new products as competitors. Retailers have 15% of floor space in end-cap and special displays for new launches. Surveys of NYC drugstores give 10% gain for CG
- Leader in e-commerce ahead of peers: Covergirl has 13% penetration in e-comm (vs. industry avg 1%). Furthermore, web analytics shows 10% of all visits of CG converts to sales, the closest second L'Oreal at 7%

Counter-market View:

- Street overly focused on the declined market size ignoring share gain: Market fixated on the -3% declining p.a. declining mass cosmetic market. However, the strength of Covergirl in physical and e-comm will translate into 3pcp market share gain to 14%

KEY METRICS

CONSOLIDATED INCOME STATEMENT	2018	2019	2020	2021E	2022E
Net Revenues	9,398	8,649	6,376	5,765	6,172
Like-for-like Revenues	6,708	5,930	4,300	5,765	6,172
% chg Y/Y	22.84%	-7.98%	-26.27%	-9.59%	7.06%
Like-for-like % chg Y/Y		-11.61%	-27.48%	34.05%	7.06%
Gross Profit	5,852	5,351	3,524	3,214	3,476
% margin	62.27%	61.88%	55.26%	55.76%	56.31%
Total SG&A	4,853	4,402	3,379	2,854	2,867
% chg Y/Y	21.30%	-9.29%	-23.23%	-15.55%	0.49%
% of sales	51.63%	50.90%	52.99%	49.50%	46.46%
EBIT	1000	950	145	361	608
% margin	10.64%	10.98%	2.27%	6.26%	9.85%
Net Income	581	517	-160	75	300
Pro Forma EPS	\$0.69	\$0.65	(\$0.21)	\$0.11	\$0.45

Like-for-like adjusted for Wella, Younique divestitures and Kylie, KKW acquisitions

RISKS

Mass cosmetics decline accelerates despite share gain for Covergirl

All else equal, mass cosmetics will need to decline 30% to bring projection to consensus level

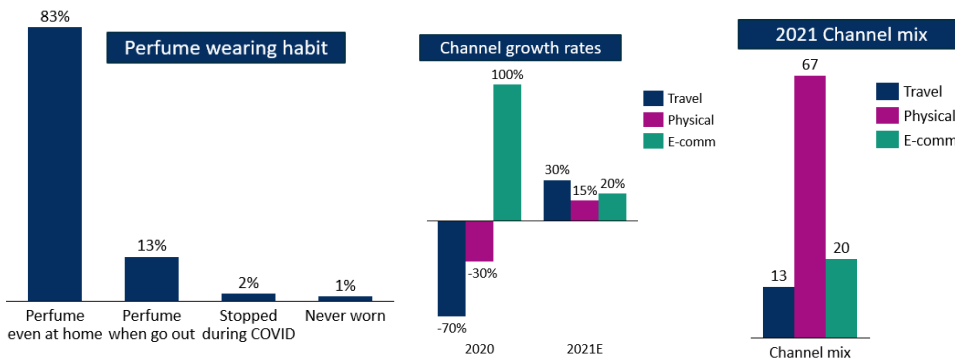
Reopening slower driven by a complete halt of int'l travel (duty-free)

All else equal, assume no travel growth, 2021E sales is \$5,622M, versus consensus \$4,750M

DELEVERAGING

BALANCE SHEET	2018	2019	2020	2021E
Cash & Cash Equivalents	\$362.2	\$380.4	\$352.0	\$957.4
Total Current Assets	3,651.0	3,272.7	6,495.0	4,239.7
Total Assets	\$22,630.2	\$17,665.4	\$16,728.8	\$15,419.0
Total Current Liabilities	4,044.0	3,477.1	3,585.7	3,777.0
Long-Term Debt	7,305.4	7,469.9	7,892.1	5,892.1
Total Liabilities	13,113.7	12,620.2	12,705.1	10,896.4
Non-Controlling Interest	661.3	451.8	79.1	79.1
Total Equity	8,855.2	4,593.4	3,944.6	4,443.5
Total Liabilities & Equity	\$22,630.2	\$17,665.4	\$16,728.8	\$15,419.0
Total Net Leverage	5.17x	5.48x	14.93x	5.20x

PERFUME RECOVERY

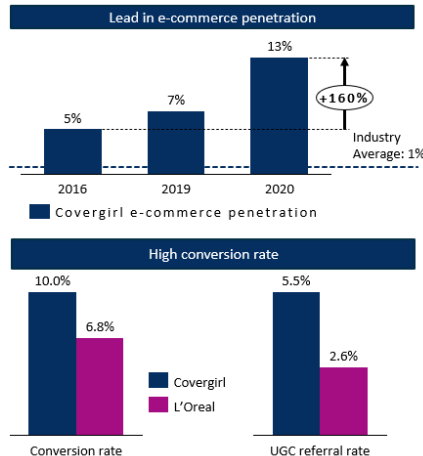
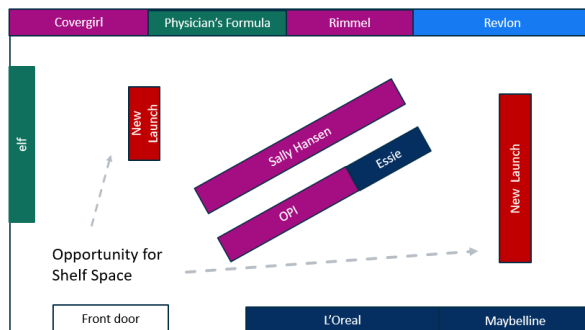


COVERGIRL TURNAROUND

Ave. of Americas Harmon Makeup Section Study

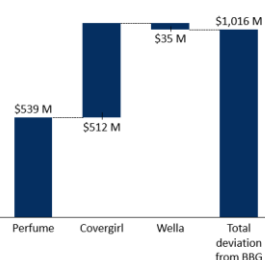
Legend: L'Oreal (Blue), Coty (Pink), Revlon (Green), Others (Grey)

Red box: New launch end-cap/special display -> opportunity zones



VALUATION SUPPORT

2021E deviation from consensus sales



EV/Sales comp

Coty	2.90x
Estee Lauder	5.70x
Inter Parfumes	2.60x
L'Oreal	5.70x
Fancil	3.90x
Amorepacific	2.20x
Shiseido	3.00x
Kose	2.90x
Comp Avg	3.71x

Yield on 10-Year Treasury	2.5%
Market Risk Premium	6.5%
YTM on LT Debt	5.3%
Tax Rate	20.0%
Total Debt / Total Capitalization	56.8%
Terminal Growth Rate	2.0%
Equity Beta	1.03
Cost of Equity	9.2%
WACC	6.4%

WACC	Terminal Growth Rate				
	1.0%	1.5%	2.0%	2.5%	3.0%
5.4%	\$13	\$15	\$18	\$22	\$28
5.9%	\$10	\$12	\$15	\$17	\$21
6.4%	\$9	\$10	\$12	\$14	\$17
6.9%	\$7	\$8	\$10	\$12	\$14
7.4%	\$6	\$7	\$8	\$9	\$11