

Coty, Inc. (COTY)

\$10.75 (As of 01/09/20)

Price Target (6-12 Months): **\$12.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/11/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: D

Growth: C

Momentum: D

Summary

Coty's shares have lagged the industry in the last three months. The company's Consumer Beauty segment has been posting soft organic sales for a while now. The segment continued to be under pressure in the first quarter of fiscal 2020, wherein revenues dropped 13.5% while LFL sales declined 9.7%. Results were hurt by declines in Younique, which was divested on September, 2019. Nevertheless, the company is focused on reiving Consumer Beauty segment as part of its transformation plans. Moreover, Coty is gaining from its turnaround plans and Luxury unit, which was strong in first-quarter fiscal 2020. During the quarter, the Luxury unit gained from growth in ALMEA and Europe regions, along with strength in the fragrance category. Also, the company's operating margin continued benefiting from enhanced gross margin and fixed cost control.

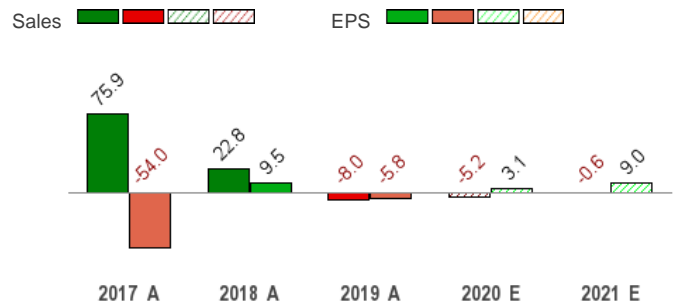
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$14.14 - \$6.90
20 Day Average Volume (sh)	4,259,079
Market Cap	\$8.1 B
YTD Price Change	-4.4%
Beta	0.71
Dividend / Div Yld	\$0.50 / 4.7%
Industry	Cosmetics
Zacks Industry Rank	Top 43% (108 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	16.7%
Last Sales Surprise	-1.8%
EPS F1 Est- 4 week change	-1.0%
Expected Report Date	02/05/2020
Earnings ESP	-6.4%
P/E TTM	17.9
P/E F1	16.0
PEG F1	2.4
P/S TTM	1.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,910 E	2,372 E	1,904 E	2,044 E	8,145 E
2020	1,943 A	2,335 E	1,878 E	2,015 E	8,195 E
2019	2,031 A	2,511 A	1,991 A	2,115 A	8,649 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.09 E	\$0.27 E	\$0.17 E	\$0.23 E	\$0.73 E
2020	\$0.07 A	\$0.25 E	\$0.16 E	\$0.21 E	\$0.67 E
2019	\$0.11 A	\$0.24 A	\$0.13 A	\$0.16 A	\$0.65 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/09/2020. The reports text is as of 01/10/2020.

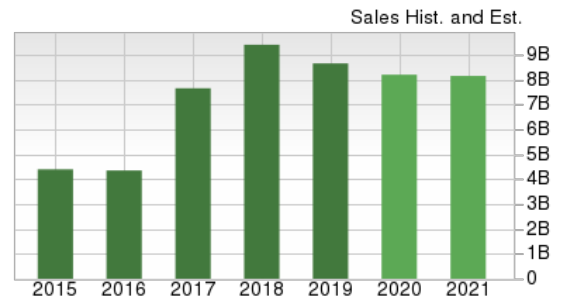
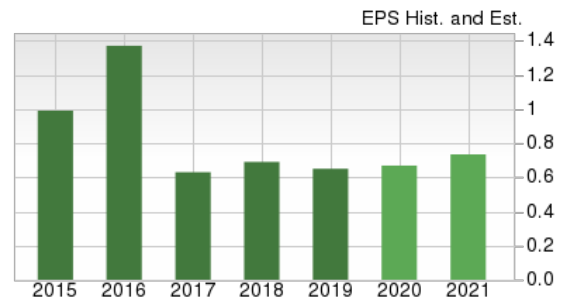
Overview

New York-based **Coty Inc.**, along with its subsidiaries, manufactures, markets, and distributes beauty products worldwide. The company sells its products through retailers, including hypermarkets, supermarkets, independent and chain drug stores and pharmacies, upscale perfumeries, upscale and mid-tier department stores, nail salons, specialty retailers, duty-free shops and traditional food, and drug and mass retailers. It also markets products under the Astor, Coty, Joop!, Jovan, Manhattan, and N.Y.C. New York Color brands.

After the P&G Beauty Business acquisition in Oct 2016, the company reorganized its business into three new divisions:

- **Luxury** division (38% of fiscal 2019 sales) is focused on prestige fragrances, premium skin care and premium cosmetics. Some of the brands under this segment include Burberry, Hugo Boss, Escada, Gucci, Chloe, Bottega Veneta, Marc Jacobs, Miu Miu, Tiffany, Davidoff, Alexander McQueen, Balenciaga, Lacoste and Calvin Klein among others.
- **Consumer Beauty** division (41% of fiscal 2019 sales) is focused on color cosmetics, retail hair coloring and styling products, mass fragrance, mass skin care and body care. The segment includes brands such as Nautica, Jovan, Enrique, Cover Girl, Clairol, Wella, Younique, Max Factor, Mexx, Risque, Stetson, Sally Hansen, Adidas, Beckham and Beyonce among others.
- **Professional Beauty** division (21% of fiscal 2019 sales) is focused on hair and nail care products for professionals. This division incorporates Clairol Professional, ghd (Good Hair Day), Kadus Professional, Nioxin, OPI, Sebastian, Wella Professional, Sassoon Professional, System Professional and Londa Professional.

Additionally, in connection with the company's acquisition of the P&G Beauty Business, Coty reorganized its geographical structure into three regions: North America (Canada and the United States), Europe and ALMEA (Asia, Latin America, the Middle East, Africa and Australia).



Reasons To Buy:

- ▲ **Robust Luxury Segment:** Coty's Luxury segment has been performing well for quite some time now, primarily backed by solid brand performances, innovations and strong consumer demand. Net revenues in the segment inched up 1.7% to \$806.7 million in the first quarter of fiscal 2020, while LFL revenues increased 4.4%. The unit's performance was driven by growth in ALMEA and Europe regions, along with strength in the fragrance category. Fragrance sales were buoyed by brands like Burberry, Gucci, Hugo Boss and Chloe.

Coty's Luxury beauty segment has been performing impressively. Further, the company is on track with transformation efforts.

Further, adjusted operating income grew 26% to \$128.3 million and adjusted operating margin improved 310 bps to 15.9% on solid gross margin and fixed-cost reductions. Management is committed toward bolstering performance of the Luxury segment, which accounted for 41.5% of Coty's revenues in the first quarter.

- ▲ **Transformation Plans on Track:** Coty is on course to turn around its operations. The company is on track with building and streamlining operations, upgrading systems, optimizing manufacturing and logistics, and simplifying overall operations. Simultaneously, the company is focused on investing in brands and transforming digital capabilities to drive sustainable growth. Prudent promotional tactics are an important part of the company's efforts to build brands.

The company is encouraged by the progress that it has made in the last two years. In fact, the company has eliminated many of the supply chain hurdles that limited its performance in the first half of fiscal 2019. Further, the company is on track with efforts to revive the Consumer Beauty business. In this context, the company divested its 60% stake in Younique, which was delivering a sluggish performance for quite some time now. Also, it is on track with various working media strategies for the Consumer Beauty unit. Apart from this, Coty is seeking options for the Professional Beauty unit and related hair brands. Further, the company unveiled plans to explore alternatives for its Brazilian operations. The review process also includes intentions of a divestiture. These moves are likely to help Coty shift focus to areas with higher growth potential like fragrances, skin care and cosmetics.

- ▲ **Strategic Acquisitions to Drive Top Line:** Coty has made several strategic acquisitions to enhance its brand portfolio. In this regard, the company concluded the buyout of the iconic Burberry brand, in the second quarter of fiscal 2018, is noteworthy. This acquisition has been supporting growth in the Luxury segment. Other evidences in this regard include the buyout of Good Hair Day or ghd, which was a growth driver at Coty's Professional Beauty segment in the first quarter. Additionally, the company is benefiting from its buyout of Procter & Gamble Company's global fine fragrances, salon professional, cosmetics and retail hair color businesses, along with select hair styling brands (the P&G Beauty Business).

- ▲ **Saving Efforts Aid Margins:** Management is committed to optimizing the overall cost structure, which is helping Coty witness margin expansion. Stringent cost control, along with adjusted gross margin expansion, contributed to Coty's adjusted operating margin in the first quarter of fiscal 2020. During the quarter, adjusted operating margin came in at 8%, up 110 bps. Similar trends were witnessed in the Luxury and Professional Beauty segments. The company plans to keep undertaking efforts to eliminate unnecessary costs.
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Reasons To Sell:

- ▼ **Soft Consumer Beauty Unit:** Coty's Consumer Beauty segment has been posting soft organic sales since the last few quarters. The segment continued to be under pressure in the first quarter of fiscal 2020, wherein revenues dropped 13.5% to \$716.5 million while LFL sales declined 9.7%. Results were hurt by declines in Younique, which was divested on September 16. Region-wise, revenues in North America continued to be pressurized by reductions in shelf space and persistent weakness in the mass beauty market.

Coty's Consumer Beauty category has been sluggish. The segment has been struggling with persistent sluggishness in Younique.

Further, the segment saw revenue declines across color cosmetics, retail hair, body care and mass fragrances categories. Also, the Consumer Beauty segment posted an adjusted operating loss of \$14.2 million, against income of \$14.8 million in the year-ago period. As a result of sluggishness in the Consumer Beauty unit, Coty's top line fell 4.4% year over year in the first quarter, while organic (LFL basis) revenues slipped 1.1%. Markedly, shares of the company have gained 1.7% in the last three months, compared with the industry's growth of 37.9%.

- ▼ **Market Trends and Consumer Preferences:** As Coty operates in a consumer centric market, its ability to garner profits depends largely on how well it can predict changes in consumer preferences and spending patterns for beauty products and respond in a timely manner to fulfill the same. Additionally, material shifts in market demand for a product for any reason may result in increased inventory levels, which may lead to selling goods at lower prices. This could ultimately hurt the company's top and bottom lines.
- ▼ **Stiff Competition:** Coty faces competition from various products and product lines, in both domestic and international markets. The beauty and beauty-related products industry is highly competitive with the number of competitors and degree of competition varying widely from country to country. Worldwide, Coty competes against products sold to consumers by other direct-selling and direct-sales companies and through the Internet, and against products sold through the mass market and prestige retail channels.
- ▼ **Risk of Operating in Overseas Markets:** Coty's financial performance may be largely affected by its significant presence in the international markets, which exposes it to the risk of unfavorable foreign currency translations, economic or political instability, and other governmental actions on trade and repatriation of foreign profits. We note that during the first quarter, the company's top line was negatively impacted by adverse currency impacts of 2.4%. Volatility in currency rates is a threat to Coty's performance.
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Last Earnings Report

Coty's Q1 Earnings Beat Estimates, Revenues Miss

Coty posted first-quarter fiscal 2020 results. Adjusted earnings of 7 cents per share came a penny ahead of the Zacks Consensus Estimate. However, the bottom line declined 36% year over year, due to the absence of last year's tax benefit.

Coty generated revenues of \$1,942.8 million, which missed the Zacks Consensus Estimate of \$1,977 million. Moreover, the top line fell 4.4% year over year. Currency translations negatively impacted revenues to the tune of 2.4% and organic (Like for Like or LFL basis) revenues slipped 1.1%. Declines at Younique had a 1% adverse impact on Coty's LFL revenues. Further, strength in Luxury and Professional Beauty LFL revenues was offset by weakness in the Consumer Beauty unit.

Adjusted gross margin expanded 160 basis points (bps) to reach 62%, courtesy of increased mix of higher-margin Luxury and Professional Beauty divisions. Also, improved margins at both divisions, better COGS productivity in the Luxury unit, and improved price and mix in the Professional Beauty unit aided gross margin expansion.

Additionally, adjusted operating income came in at \$154.7 million, up 9.9% year on year. This includes negative currency impacts of 4%. Adjusted operating margin came in at 8%, up 110 bps on the back of gross margin growth and stringent fixed cost control.

Quarter Ending **09/2019**

Report Date	Nov 06, 2019
Sales Surprise	-1.75%
EPS Surprise	16.67%
Quarterly EPS	0.07
Annual EPS (TTM)	0.60

Segmental Details

Luxury: Net revenues in the segment inched up 1.7% to \$806.7 million, while LFL revenues increased 4.4%. The unit's performance was driven by growth in ALMEA and Europe regions, along with strength in the fragrance category. Fragrance sales were buoyed by brands like Burberry, Gucci, Hugo Boss and Chloe. Geopolitical disturbances in Hong Kong and the nearby Travel Retail network acted as deterrents. Adjusted operating income surged 26% to \$128.3 million and adjusted operating margin improved 310 bps to 15.9%.

Consumer Beauty: Consumer Beauty revenues decreased 13.5% to \$716.5 million, while LFL sales declined 9.7%. Results were hurt by declines in Younique. Region-wise, revenues in North America were under pressure due to reductions in shelf space and persistent weakness in the mass beauty market. Further, the segment saw revenue declines across color cosmetics, retail hair, body care and mass fragrances categories. The segment posted an adjusted operating loss of \$14.2 million against income of \$14.8 million in the year-ago period.

Professional Beauty: Net revenues in the segment amounted to \$419.6 million, up 2.4% year over year and 5.1% on a LFL basis. The unit's performance was fueled by strength across all regions. Ghd continued to deliver solid growth in all channels and regions. Adjusted operating income in the category soared to \$41.6 million, with the margin expanding 410 bps to 9.9%.

Regional Results

On a regional basis, net revenues in North America declined 9% (7.1% on a LFL basis) year on year to \$586.6 million. Sales in Europe dropped 0.3% (up 4.4% at LFL) to reach \$869.6 million. Sales in the ALMEA region declined 5.4% (down 3.1% at LFL) to \$486.6 million.

Other Financial Updates

Coty ended the quarter with cash and cash equivalents of \$350.4 million and net long-term debt of \$7,453.5 million. During the quarter, the company provided \$39.9 million of net cash from operating activities. Also, it used a free cash flow of \$46.5 million. Further, the company paid out a dividend of 12.5 cents a share on Sep 30. Also, concurrent with its earning release, Coty declared a dividend of 12.5 cents per share, payable on Dec 27, to shareholders of record as of Nov 18.

Other Developments

On Sep 16, Coty concluded the divestiture of its 60% stake in Younique. Also, on Oct 21, the company stated that it is seeking options for its Professional Beauty unit and related hair brands. The company also unveiled plans to explore alternatives for its Brazilian operations. The review process also includes the intentions of a divestiture.

Outlook

For fiscal 2020, management expects net LFL revenues to be stable to slightly lower from the fiscal 2019 level. Further, it expects adjusted operating income (at constant currency) to increase 5-10% year on year, after considering investments for brand growth. Adjusted earnings are likely to depict mid-single-digit growth. Free cash flow is likely to improve moderately year on year.

Recent News

Coty Enters into Strategic Partnership With Kylie Jenner - Jan 6, 2020

Coty forms a long-term strategic partnership with Kylie Jenner with an aim to further develop the latter's beauty business into a global powerhouse brand.

Coty Explores Professional Beauty Sale - Oct 21, 2019

In order to unlock prospective areas and ramp up turnaround efforts, Coty is seeking options for Professional Beauty unit and related hair brands. The company also plans to explore alternatives for its Brazilian operations. The review process, which is likely to be completed by summer 2020, also includes intentions of a divestiture.

Coty's Board Approves Dividend - Aug 28, 2019

Coty's board has approved a quarterly dividend of 12.5 cents per share to be payable on Sep 30, 2019 as of shareholder's record on Sep 9, 2019.

Coty Chalks Out Restructuring Plans – Jul 1, 2019

To boost performance across segments and enhance margins, Coty has revealed a strategic Turnaround Plan. It includes numerous organization-wide measures to strengthen business capabilities.

Management also set certain financial targets for fiscal 2023. It expects operating margin in the range of 14-16%. Further, free cash flow is estimated at \$1 billion and net debt to EBITDA ratio is expected to be below 4x.

To implement the turnaround plans, the company expects to incur costs worth almost \$600 million, from fiscal 2020 to fiscal 2023. Apart from this, the company has costs worth nearly \$160 million associated with previous development programs.

Valuation

Coty shares are up 48.5% for the trailing 12-month period. Stocks in the Zacks sub-industry are up significantly and in the Zacks Consumer Staples sector are up 16.8% over the past year.

The S&P 500 index is up 24.4% in the past year.

The stock is currently trading at 15.13X forward 12-month earnings, which compares to 37.81X for the Zacks sub-industry, 19.75X for the Zacks sector and 18.81X for the S&P 500 index.

Over the past five years, the stock has traded as high as 33.52X and as low as 8.71X, with a 5-year median of 20.82X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$12 price target reflects 16.58X forward 12-month earnings.

The table below shows summary valuation data for COTY

Valuation Multiples - COTY					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	15.13	37.81	19.75	18.81
	5-Year High	33.52	37.81	22.39	19.34
	5-Year Low	8.71	18.69	16.65	15.17
	5-Year Median	20.82	24	19.75	17.44
P/S F12M	Current	1	4.38	9.83	3.49
	5-Year High	2.69	4.38	11.03	3.49
	5-Year Low	0.51	1.45	8.02	2.54
	5-Year Median	1.4	2.16	9.78	3
EV/EBITDA F12M	Current	11.42	21.22	34.12	12.66
	5-Year High	17.7	21.23	36.97	12.66
	5-Year Low	6.7	9.36	29.14	9.08
	5-Year Median	12.26	15.46	33.27	10.78

As of 01/09/2020

Industry Analysis Zacks Industry Rank: Top 43% (108 out of 254)



Top Peers

Avon Products, Inc. (AVP)	Outperform
Helen of Troy Limited (HELE)	Outperform
The Estee Lauder Companies Inc. (EL)	Neutral
e.l.f. Beauty Inc. (ELF)	Neutral
Revlon, Inc. (REV)	Neutral
Inter Parfums, Inc. (IPAR)	Underperform
Nu Skin Enterprises, Inc. (NUS)	Underperform
Shiseido Co. (SSDOY)	Underperform

Industry Comparison Industry: Cosmetics				Industry Peers	
	COTY Neutral	X Industry	S&P 500	EL Neutral	SSDOY Underperform
VGM Score	D	-	-	F	C
Market Cap	8.15 B	1.19 B	23.94 B	76.27 B	28.77 B
# of Analysts	7	4.5	13	10	1
Dividend Yield	4.65%	0.00%	1.78%	0.91%	0.64%
Value Score	D	-	-	F	F
Cash/Price	0.05	0.05	0.04	0.03	NA
EV/EBITDA	-5.67	20.60	13.97	26.44	NA
PEG Ratio	2.37	2.82	2.03	2.78	1.72
Price/Book (P/B)	1.82	3.23	3.33	16.77	6.36
Price/Cash Flow (P/CF)	6.63	28.82	13.73	30.20	28.82
P/E (F1)	16.04	30.72	18.79	35.52	34.31
Price/Sales (P/S)	0.95	2.25	2.64	5.01	2.89
Earnings Yield	6.23%	3.25%	5.32%	2.82%	2.92%
Debt/Equity	1.77	0.27	0.72	1.15	NA
Cash Flow (\$/share)	1.62	1.62	6.94	7.02	2.50
Growth Score	C	-	-	D	A
Hist. EPS Growth (3-5 yrs)	-13.66%	5.72%	10.56%	15.21%	NA
Proj. EPS Growth (F1/F0)	2.86%	9.63%	7.49%	11.76%	14.13%
Curr. Cash Flow Growth	-2.37%	-0.29%	14.83%	13.88%	3.64%
Hist. Cash Flow Growth (3-5 yrs)	17.39%	8.22%	9.00%	9.29%	30.36%
Current Ratio	0.97	1.77	1.23	1.53	NA
Debt/Capital	64.20%	33.32%	42.99%	53.43%	NA
Net Margin	-43.46%	4.59%	11.08%	12.34%	NA
Return on Equity	7.57%	10.22%	17.16%	46.14%	NA
Sales/Assets	0.44	0.95	0.55	1.12	NA
Proj. Sales Growth (F1/F0)	-5.24%	4.13%	4.20%	8.25%	8.99%
Momentum Score	D	-	-	D	C
Daily Price Chg	2.19%	0.00%	0.53%	2.04%	0.38%
1 Week Price Chg	0.82%	0.00%	-0.30%	-1.56%	-0.58%
4 Week Price Chg	-7.88%	1.95%	1.92%	5.65%	3.25%
12 Week Price Chg	5.39%	0.07%	6.54%	12.93%	-11.75%
52 Week Price Chg	49.51%	0.00%	22.58%	69.16%	25.35%
20 Day Average Volume	4,259,079	28,038	1,580,816	1,146,906	19,804
(F1) EPS Est 1 week change	-1.06%	0.00%	0.00%	0.03%	0.00%
(F1) EPS Est 4 week change	-0.95%	0.00%	0.00%	0.11%	0.00%
(F1) EPS Est 12 week change	-1.86%	-0.32%	-0.50%	-0.38%	-11.21%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-0.07%	NA

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	C
Momentum Score	D
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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