

Coty, Inc. (COTY)

\$4.12 (As of 07/22/20)

Price Target (6-12 Months): **\$5.00**

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:C

Value: C

Growth: D

Momentum: A

Summary

Shares of Coty have underperformed the industry year to date. The company has long been bearing the brunt of softness in its Consumer Beauty segment. Also, the stock came under further pressure recently due to coronavirus-led concerns, which weighed on Coty's third-quarter fiscal 2020 results. During the quarter, both top and bottom lines fell year over year. Revenues were weak across all units and channels, stemming from coronavirus-led concerns like salon closures, retail store closures and restricted air travel. Nonetheless, the company's e-commerce business remained strong in all segments. Also, Coty remains committed toward its turnaround plans. This is evident from its strategic deal with KKR as well as planned fixed cost reductions of \$700 million. Apart from this, the company's inclusion of Kylie products bodes well.

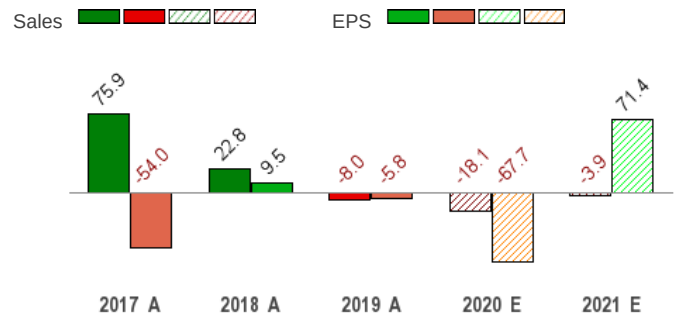
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$13.42 - \$3.02
20 Day Average Volume (sh)	11,971,645
Market Cap	\$3.1 B
YTD Price Change	-63.4%
Beta	1.04
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Cosmetics
Zacks Industry Rank	Top 20% (51 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-700.0%
Last Sales Surprise	0.9%
EPS F1 Est- 4 week change	5.9%
Expected Report Date	08/26/2020
Earnings ESP	-495.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,686 E	2,291 E	1,519 E	1,322 E	6,809 E
2020	1,943 A	2,345 A	1,528 A	1,265 E	7,086 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	\$0.05 E	\$0.23 E	\$0.04 E	\$0.11 E	\$0.36 E
2020	\$0.07 A	\$0.27 A	-\$0.08 A	-\$0.01 E	\$0.21 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.

P/E TTM	9.8
P/E F1	11.4
PEG F1	1.7
P/S TTM	0.4

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 07/22/2020. The reports text is as of 07/23/2020.

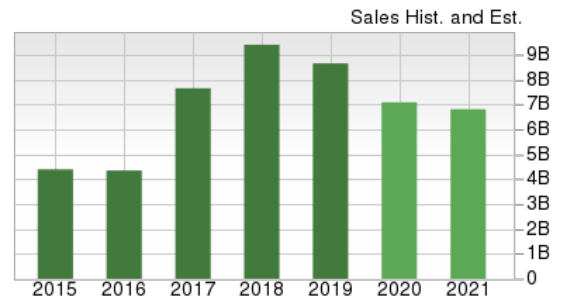
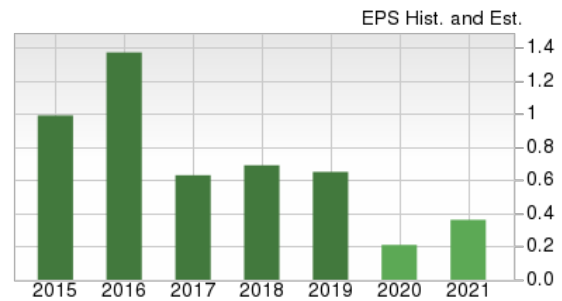
Overview

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:

- ▲ **Transformation Plans on Track:** Coty is on course to turn around its operations. Coty's latest move in this regard is its strategic alliance with KKR, including an immediate investment of \$750 million by KKR. KKR and Coty inked an MOU and are in talks for a 60/40 partnership for Coty's Professional Beauty and Retail Hair businesses for an enterprise value of \$4.3 billion. This is likely to boost the company's balance sheet.

Coty is on track with transformation efforts. The company's latest move in this regard includes its strategic alliance with KKR.

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 has eliminated many of the supply-chain hurdles that limited its performance in the past. 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 in September 2019. Also, the company had earlier 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. Recently, Coty revealed a new sustainability strategy —Beauty that Lasts — which is a part of its Turnaround Plan.

- ▲ **Cost-Saving Efforts:** Management is committed to optimizing the overall cost structure. Incidentally, with its third-quarter fiscal 2020 results, management announced an expansion to its turnaround plan, per which it intends to cut fixed costs by 25% or \$700 million in the next 30 months. More than two-thirds of the savings will be added to the company's original turnaround plan. Coty plans to curtail costs through supply network consolidation, headcount restructuring and a significant curtailment in non-people costs. Notably, Coty still targets an operating margin in the mid-teens range by fiscal 2023.
 - ▲ **Strategic Acquisitions Aid Top Line:** Coty has made several strategic acquisitions to enhance its brand portfolio. Recently, the company announced partnership with one of the most influential celebrity with nearly 300 million followers on social media platforms—Kim Kardashian West. Per the deal, Coty will buy a 20% ownership stake in Kim Kardashian's beauty business for \$200 million. The partnership is aimed at introducing new beauty categories and expanding into new product lines for the beauty business. The agreement is expected to be closed in third-quarter fiscal 2021. Further, Coty acquired a 51% stake in King Kylie this January and entered into a deal to produce, promote, distribute and sell certain products of King Kylie. Apart from this, the company's buyout of the iconic Burberry brand, in the second quarter of fiscal 2018, has been yielding favorably. This acquisition has been supporting growth in the Luxury segment. Other instances in this regard include the buyout of Good Hair Day or ghd, which aided Coty's Professional Beauty segment in fiscal third quarter, courtesy of solid e-commerce business. Additionally, the company's 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) has been yielding favorable results for quite some time.
 - ▲ **E-Commerce Strength:** While Coty saw soft sales in the third quarter due to coronavirus-led concerns, the company's e-commerce business was quite strong. E-commerce sales jumped across all segments. In Americas and EMEA, e-commerce sales were particularly strong for the mass business. Even APAC and Professional segments saw e-commerce growth amid the pandemic. Such trends along with a continued focus on innovation bode well.
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Reasons To Sell:

▼ **COVID-19 Hurts Q3 Results, Stock Underperforms:** Shares of Coty have slumped 63.4% year to date compared with the industry's decline of 31.5%. The company has long been bearing the brunt of softness in its Consumer Beauty segment. The stock came under further pressure recently due to coronavirus-led concerns, which also weighed on Coty's third-quarter fiscal 2020 results. During the quarter, both top and bottom lines declined year over year. In fact, the company posted an adjusted loss of 8 cents per share, wider than the Zacks Consensus Estimate of a loss of a cent.

Coty's Consumer Beauty segment has been sluggish. Also, the company is reeling under coronavirus-led concerns.

Results were hurt by soft revenues, reduced gross margin, currency headwinds and escalated fixed costs. Revenues were hampered by weakness across all segments and channels, stemming from coronavirus-led concerns like salon closures, retail store closures and receding traffic at the stores that were open in March. Moreover, restricted air travel has been a blow to the travel retail network.

▼ **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 fiscal third quarter, wherein revenues declined 28.3% year over year to \$602.7 million while LFL sales fell 16.9%. In March, sales in the segment declined significantly, courtesy of reduced traffic in drugstores and mass retailers globally amid the coronavirus outbreak. Also, softness in the color cosmetic category was a headwind as consumers' preference shifted toward more important personal care categories.

▼ **Debt Analysis:** Coty's long-term debt of \$9,601 million increased 24.9% sequentially at the end of the third quarter of fiscal 2020 — Mar 31, 2020. Further, the company's debt-to-capitalization ratio of 0.71 has deteriorated from 0.64 as of the end of the second quarter of fiscal 2020. Incidentally, the industry's debt-to-capitalization ratio stood at 0.7 as of the end of the third quarter.

▼ **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.

Last Earnings Report

Coty's Earnings Miss Estimates in Q3, Sales Down

Coty released third-quarter fiscal 2020 results, with the bottom line missing the Zacks Consensus Estimate and declining year over year. Nevertheless, the top line beat the consensus mark. However, the metric fell from the prior-year quarter's figure.

Adjusted loss of 8 cents per share was wider than the Zacks Consensus Estimate of a loss of a cent. Moreover, the bottom line deteriorated on a year-over-year basis due to lower adjusted net income.

Coty generated revenues of \$1,528 million, which surpassed the Zacks Consensus Estimate of \$1,513.8 million. However, the top line fell 23.2% year over year. Currency translations negatively impacted revenues to the tune of 2.3% and organic (Like for Like or LFL basis) revenues slipped 19.5%. The downside was caused by weakness across all segments thanks to coronavirus-induced lockdowns.

Adjusted gross margin contracted 260 basis points (bps) to 60.3%, thanks to reduced volumes induced by the coronavirus outbreak. Also, higher excess and obsolescence expenses along with underutilization costs resulting from manufacturing plant closures were deterrents.

Adjusted operating income came in at \$0.1 million, down from \$229.5 reported in the year-ago quarter. Adjusted operating margin came in at 0.0%, down from 11.5% reported in the year-ago quarter, thanks to reduced gross margin, fixed cost deleverage along with unfavorable foreign currency impact.

Channel-Wise Details

Luxury: Net revenues in the segment fell 22.7% to \$563.9 million, while LFL revenues declined 26.3%. The downside was caused by closures of perfumeries, department stores as well as specialty retailers worldwide.

Consumer Beauty: Consumer Beauty revenues declined 28.3% year over year to \$602.7 million while LFL sales fell 16.9%. In March, sales in the segment declined significantly thanks to reduced traffic in drugstores and mass retailers globally amid the coronavirus outbreak. Also, softness in the color cosmetic category was a headwind.

Professional Beauty: Net revenues in the segment amounted to \$361.4 million, down 14.2% year over year and 12% on a LFL basis. The unit's performance was marred by shutdown of salons during March. Growth in ghd was not enough to offset declines in Hair and Nail product categories.

Segment Results

Net revenues in Americas declined 15% (down 19% on a LFL basis) year on year to \$492.6 million. Sales in EMEA dropped 22% (down 20% at LFL) year over year to \$550.6 million. Sales in the Asia Pacific region declined 37% (down 35% at LFL) year on year to \$124.7 million. Net revenues in Professional dropped 14% (down 12% at LFL) year over year to \$360.1 million.

Other Financial Updates

Coty ended the quarter with cash and cash equivalents of \$1,278.5 million and net long-term debt of \$9,172.0 million.

During nine months ended Mar 31, 2020, the company provided \$204.5 million of net cash from operating activities.

On Mar 27, the company paid out a quarterly dividend of 12.5 cents per share. Further, in an attempt to preserve its cash amid the coronavirus crisis, management has decided to suspend its dividends until at least Apr 1.

Other Developments

On May 11, management formed a strategic partnership with a global investment firm, KKR, which resulted in an instant investment of \$750 million by the latter via convertible preferred shares in Coty. Moreover, KKR and Coty are likely to sign a partnership deal for the Professional Beauty and Retail Hair businesses. Per the deal, KKR is expected to buy majority stake in the above mentioned business for an enterprise value of \$4.3 billion.

The company also unveiled its plans to reduce fixed costs by \$700 million over the next 30 months amid the coronavirus crisis. This will support Coty to remain on track to achieve its target to report mid teens operating margins by fiscal year 2023.

Quarter Ending **03/2020**

Report Date	May 11, 2020
Sales Surprise	0.94%
EPS Surprise	-700.00%
Quarterly EPS	-0.08
Annual EPS (TTM)	0.42

Recent News

Coty to Buy Stake in Kim Kardashian's Beauty Business – Jun 29, 2020

Coty announced partnership with one of the most influential celebrity with nearly 300 million followers on social media platforms—Kim Kardashian West. Per the deal, Coty will buy a 20% ownership stake in Kim Kardashian's beauty business for \$200 million. The partnership is aimed at introducing new beauty categories and expanding into new product lines for the beauty business. The agreement is expected to be closed in third-quarter fiscal 2021.

Per the agreement, Coty will focus on developing new products for the beauty business in skincare, personal care, hair care as well as nail categories. Meanwhile, Kim Kardashian and her team will assume creative responsibilities like product as well as communications initiatives. The products will be sold via renowned luxury beauty retailers as well as various online channels.

Coty Provides Update in the Wake of Coronavirus – Mar 20, 2020

Amid the coronavirus outbreak, Coty is taking measures to remain committed toward shareholders, while maintaining business continuity. The company, which is focused on its employees' safety is also producing and offering and sanitizers to medical and emergency services.

Apart from this, Coty has been making adjustments to its business, owing to the pandemic. In this regard, it has prioritized open networks and markets, with particular emphasis on e-commerce. Management also expects increased demand (starting in Asia) after the virus-led disruptions are over. Further, the company has undertaken increased measures to curtail expenses and preserve cash flows.

Given the current situation, Coty expects its net revenues in the third quarter of fiscal 2020 to fall by around 20% on a like-for-like basis, with a considerable effect on profits. Also, the company withdrew its guidance for fiscal 2020. Notably, management remains on track with the strategic review of its Professional hair and Brazilian businesses.

Valuation

Coty shares are down 63.4% in the year-to-date period and 62.6% for the trailing 12-month period. Stocks in the Zacks sub-industry are down 31.5% and the Zacks Consumer Staples sector is down 10.2% in the year-to-date period. Over the past year, the Zacks sub-industry and sector are down 26.2% and 8.8%, respectively.

The S&P 500 index is up 1.4% in the year-to-date period and 8.7% in the past year.

The stock is currently trading at 11.13X forward 12-month earnings, which compares to 37.07X for the Zacks sub-industry, 19.88X for the Zacks sector and 23X for the S&P 500 index.

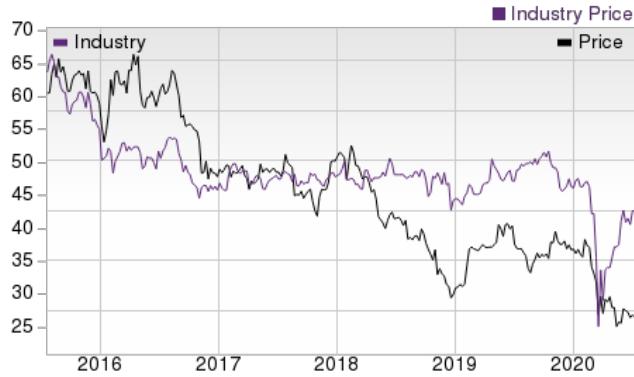
Over the past five years, the stock has traded as high as 30.48X and as low as 5.34X, with a 5-year median of 19.49X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$5 price target reflects 13.51X forward 12-month earnings.

The table below shows summary valuation data for COTY

Valuation Multiples - COTY					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	11.13	37.07	19.88	23
	5-Year High	30.48	38.37	22.37	23
	5-Year Low	5.34	19.65	16.63	15.25
	5-Year Median	19.49	24.84	19.58	17.52
P/S F12M	Current	0.46	4.32	9.55	3.61
	5-Year High	2.48	4.39	11.15	3.61
	5-Year Low	0.35	1.53	8.1	2.53
	5-Year Median	1.14	2.86	9.89	3.02
EV/EBITDA F12M	Current	9.85	31	32.76	13.21
	5-Year High	16.59	34.06	37.49	14.22
	5-Year Low	6	8.72	25.81	9.05
	5-Year Median	10.77	17.83	33.81	10.99

As of 07/22/2020

Industry Analysis Zacks Industry Rank: Top 20% (51 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Helen of Troy Limited (HELE)	Outperform	1
L'Oreal SA (LRLCY)	Outperform	2
Nu Skin Enterprises, Inc. (NUS)	Outperform	1
The Estee Lauder Companies Inc. (EL)	Neutral	3
e.l.f. Beauty Inc. (ELF)	Neutral	3
Inter Parfums, Inc. (IPAR)	Neutral	3
Revlon, Inc. (REV)	Neutral	4
Shiseido Co. (SSDOY)	Underperform	4

Industry Comparison Industry: Cosmetics				Industry Peers		
	COTY	X Industry	S&P 500	EL	HELE	SSDOY
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Outperform	Underperform
Zacks Rank (Short Term)	3	-	-	3	1	4
VGM Score	C	-	-	D	C	B
Market Cap	3.14 B	1.39 B	22.74 B	70.40 B	4.86 B	24.74 B
# of Analysts	7	3	14	11	3	2
Dividend Yield	0.00%	0.00%	1.81%	0.98%	0.00%	0.34%
Value Score	C	-	-	D	D	C
Cash/Price	0.41	0.06	0.06	0.07	0.02	0.04
EV/EBITDA	-4.13	14.45	13.19	24.19	23.58	16.37
PEG Ratio	1.68	2.36	3.05	3.97	3.02	NA
Price/Book (P/B)	0.79	2.66	3.14	16.16	3.98	5.34
Price/Cash Flow (P/CF)	2.54	19.05	12.31	27.87	19.05	20.20
P/E (F1)	11.36	39.92	22.34	37.87	19.71	83.72
Price/Sales (P/S)	0.40	2.04	2.40	4.56	2.77	2.48
Earnings Yield	8.74%	2.44%	4.27%	2.64%	5.07%	1.19%
Debt/Equity	2.42	0.31	0.75	1.60	0.30	0.32
Cash Flow (\$/share)	1.62	1.62	6.94	7.02	10.07	3.07
Growth Score	D	-	-	C	B	A
Hist. EPS Growth (3-5 yrs)	-15.60%	6.41%	10.82%	16.69%	8.72%	32.80%
Proj. EPS Growth (F1/F0)	72.11%	-17.81%	-9.08%	16.96%	4.66%	-56.98%
Curr. Cash Flow Growth	-2.37%	10.15%	5.51%	13.88%	13.99%	22.67%
Hist. Cash Flow Growth (3-5 yrs)	17.39%	8.81%	8.55%	9.29%	4.22%	57.54%
Current Ratio	1.19	1.48	1.30	1.63	2.07	1.33
Debt/Capital	71.00%	29.76%	44.41%	61.50%	22.95%	24.30%
Net Margin	-38.33%	5.07%	10.46%	8.43%	9.81%	3.82%
Return on Equity	7.26%	8.50%	15.29%	43.18%	20.17%	8.28%
Sales/Assets	0.45	0.94	0.54	0.95	0.94	0.93
Proj. Sales Growth (F1/F0)	-3.90%	-3.90%	-2.27%	6.03%	7.44%	-20.34%
Momentum Score	A	-	-	F	F	D
Daily Price Chg	0.00%	0.00%	0.60%	0.57%	0.50%	-1.45%
1 Week Price Chg	-0.47%	0.00%	3.82%	4.38%	-5.18%	0.51%
4 Week Price Chg	-4.85%	0.00%	7.55%	4.17%	5.88%	-4.84%
12 Week Price Chg	-24.54%	10.58%	7.51%	10.58%	18.60%	0.58%
52 Week Price Chg	-62.58%	-8.74%	-3.37%	3.23%	29.32%	-17.49%
20 Day Average Volume	11,971,645	26,686	2,037,153	1,089,161	221,138	17,168
(F1) EPS Est 1 week change	4.98%	0.00%	0.00%	-0.39%	0.00%	0.00%
(F1) EPS Est 4 week change	5.86%	0.00%	0.14%	-1.54%	12.47%	-24.87%
(F1) EPS Est 12 week change	-29.92%	-8.00%	-3.51%	3.73%	71.94%	-45.39%
(Q1) EPS Est Mthly Chg	20.00%	0.00%	0.00%	-11.06%	4.50%	0.00%

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	C
Growth Score	D
Momentum Score	A
VGM Score	C

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.

Disclosures

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