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NEU CP Instrument rating
Initiation report

GROUPE CLARINS

Rated Entity: **Clarins S.A.**
Sector: **Cosmetics**

Short-term rating: **SR1**
Credit outlook: **Stable**

Rating rationale

- **We initiate coverage on Clarins and assign our SR1 short-term rating, the second-highest grade in our rating scale, to its planned NEU CP instrument issuance for up to €200m. This reflects strong credit metrics and excellent liquidity**.
- Headquartered in Paris and founded by Jacques Courtin-Clarins in 1954, **Clarins is a manufacturer and distributor of cosmetics products worldwide. It is fully-owned and controlled by the Courtin family**. In 2016, sales and EBITDA amounted to €1.5bn and €0.2bn respectively (2017 financial statements have not yet been audited). Skincare and make-up are primarily sold under the Clarins brand while perfumes are marketed under the company-owned brands Mugler and Azzaro. Essentially all products are made in France at the group's two plants. We understand that there is no significant exposure to a specific supplier or raw materials. Clarins claims to be strongly committed to promote responsible beauty, and the company supports several social and environmental projects.
- The cosmetics industry is fairly concentrated, with the top fifteen players accounting for roughly two-thirds of the market. **Clarins has a narrower positioning than most which weighs on its global market share, but it benefits from a leading position in its core skincare segment, which represents 60% of its sales, and strong brand awareness in many countries**. This differentiates the group from most peers, which tend to have greater emphasis on other beauty and cosmetics sub-segments. Consumers value the quality of Clarins' product offering, which is generally positioned in the premium price points.
- **In spite of its relatively small scale compared to main peers, Clarins benefits from strong sales diversification both in terms of geographies and clients**. 90% of sales are generated outside France in about 130 countries, with emerging markets representing a fair share. The ten largest clients accounted for a moderate 33% of sales in 2017 (top 1: 6%). They are large beauty specialty retailers (such as Douglas, Sephora, Marionnaud, L'Etoile), department stores (such as Macys, Debenhams), travel retailers (Dufry, Gebr. Heinemann), and pharmacy chains (Boots, Shoppers Drug).
- **Operating margin is improving even though Clarins still lags most peers.** There is room to implement efficiency measures in the coming years, which provides grounds for expecting continued moderate margin enhancement.
- **We see skincare, and more generally the cosmetics industry, as a relatively attractive market with positive long-term trends** driven by rising middle classes in emerging markets and still favourable prospects for the top-performing brands in mature economies. **This offers growth prospects for Clarins, provided that the group manages well the ongoing structural changes in distribution, with the rise of e-commerce and omnichannel at the expense of traditional retail outlets such as department stores**, which have been important clients for Clarins in the US and the UK. As a result, we view positively the management's strategy to further develop its direct access to end-customers by expanding online sales while selectively growing its own retail network, although these activities remain small for the time being.
- **Our rating factors in the high level of consistent cash generation, which has driven deleveraging over recent years, along with earnings improvement. At YE17, net adjusted leverage stood at a very low 0.7x**. Looking ahead, we expect continued strong free cash flow and credit metrics, while we assess the financial policy of the group as relatively conservative.

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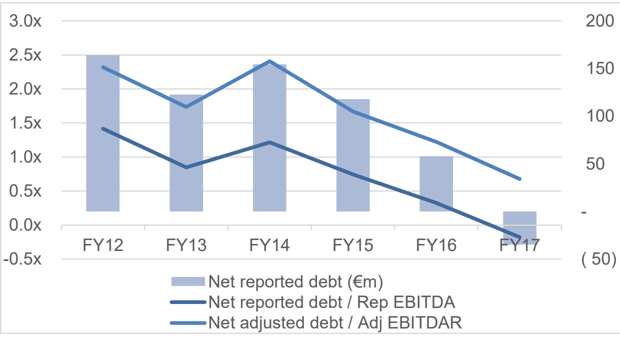
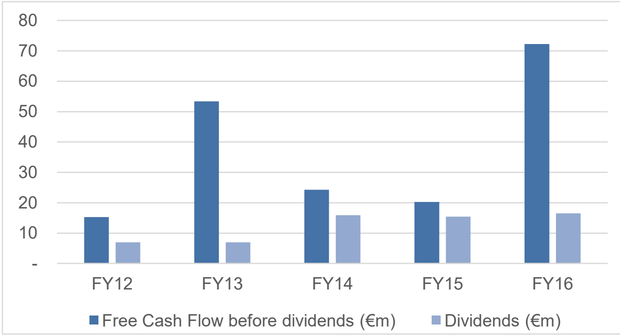
Capital structure - Net cash position

Clarins benefits from a net cash position, with more cash in hand than the reported debt of €120m. Debt primarily consists in short-term credit lines and bank loans issued by its Russian and Australian subsidiaries.

Clarins has also secured a €100m committed RCF due 2022, which is fully available. The RCF has one financial covenant providing for a maximum net leverage ratio, within which Clarins has substantial headroom.

Low leverage supported by consistent cash generation and conservative financial policy





Large liquidity headroom

Liquidity is excellent.

Existing cash on balance sheet more than covers reported debt, and is further supported by the €100m undrawn RCF due December 2022 along with our expectation of continued strong free cash flow.

Credit outlook: Stable

- Our Stable outlook reflects our expectation that credit metrics will slightly improve over the next twelve months on the back of moderate margin improvement and continued high free cash flow.

Rating sensitivity

- At this stage, an upgrade to SR0 is unlikely as it would require substantial improvement in the business risk profile, including greater scale and market share.
- Conversely, we could downgrade our rating to SR2 if Clarins' financial risk profile deteriorated significantly. This could result from increased leverage due to large debt-funded M&A and/or margins/free cash flow falling down, although this is not our base case.

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Initiation report on NEU CP Instrument rating

Rating nature: Solicited short-term public rating (the rating report was published after being reviewed by the issuer)

Limitation of the Rating action:
Spread Research believes the quality and quantity of information available on the rated entity is sufficient to provide a rating. Spread Research has no obligation to audit or verify the accuracy of data provided.

Principal methodology used in this research: Short-Term Ratings Methodology available at
http://www.spreadresearch.com/uploads/pdf/user/methodo/SRshorttermratingsmethodology-08jan16Public.pdf

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