



PARTHENON

Premium skin care market as an area for private equity investment

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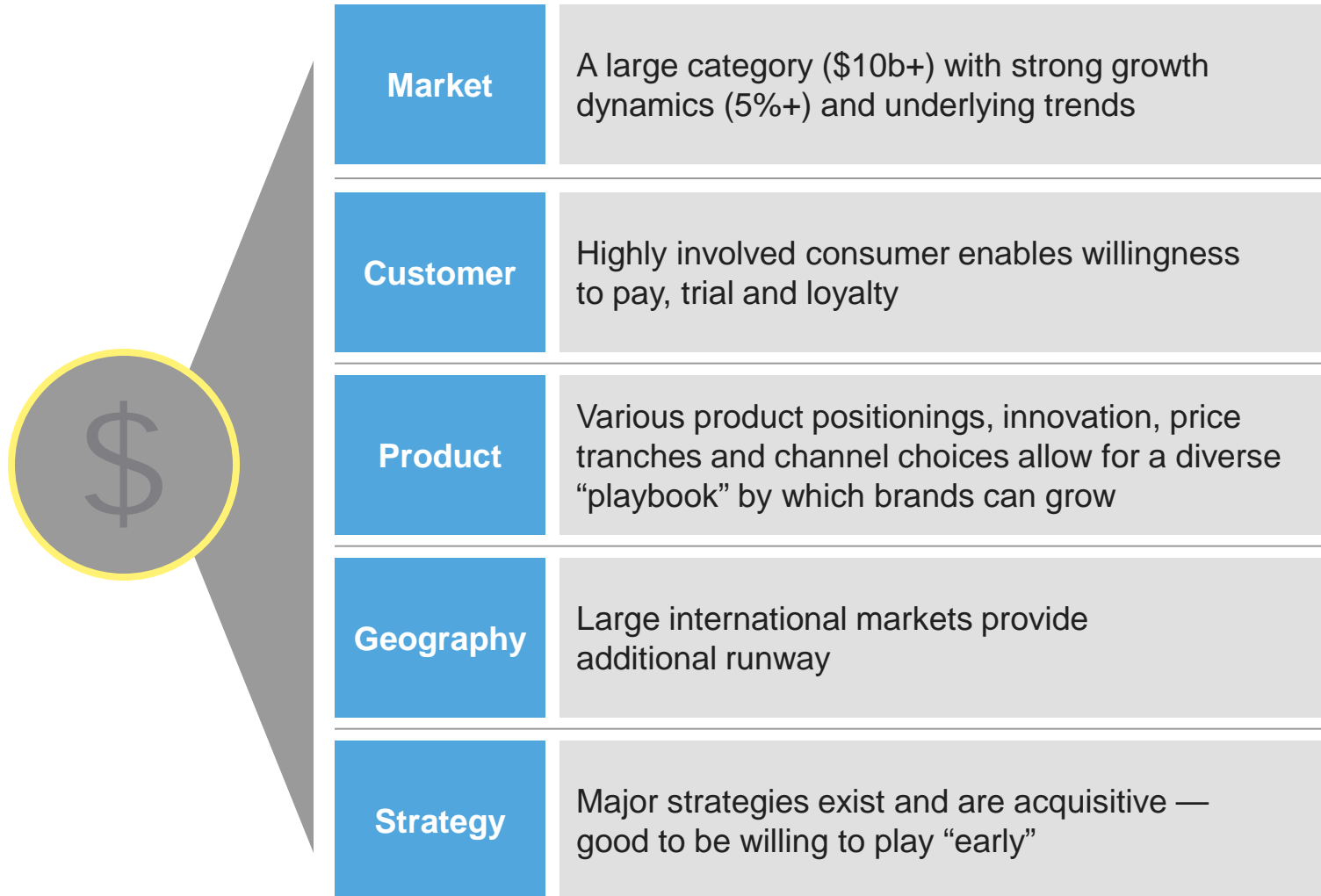


Agenda

- ▶ **Summary**
- ▶ **Market summary**
- ▶ **Growth drivers**
- ▶ **Bios**

Summary

Why do we like the premium skin care market as an area for PE investment?



Key findings for the premium skin care market in the US

Summary of premium skin care in the US

Market overview

- ▶ **Premium skin care represents ~30% of the skin care market;** “masstige,” prestige and ultra-prestige premium segments are defined by price, availability, customer service and marketing
- ▶ **Premium skin care has grown 5.5% annually** (compared with mass market decline by -0.5%), with prestige and masstige segments showing the strongest growth
- ▶ Premium skin care is **heavily focused on facial treatments and anti-aging products**, whereas the majority of mass sales are body care and cleansers
- ▶ Long-term growth is expected to continue to be driven primarily by sales of anti-agers and facial moisturizers; however, **a more clinical focus and scientific efficacy will be increasingly important**

Competitive landscape

- ▶ **L'Oréal, Shiseido and Estée Lauder comprise over 60%** of the premium market across their portfolios of brands
- ▶ Large skin care companies have used a **combination of acquisition and internal brand development** to play across skin care retailers and segments
- ▶ Premium skin care companies are **focused on scientific efficacy and “cosmeceuticals” to drive growth**, as increasingly savvy consumers seek key ingredients and scientific support for marketing claims
- ▶ **Few ultra-prestige brands have established a reputation for “clinical luxury,”** presenting opportunities for new entrants or emerging players

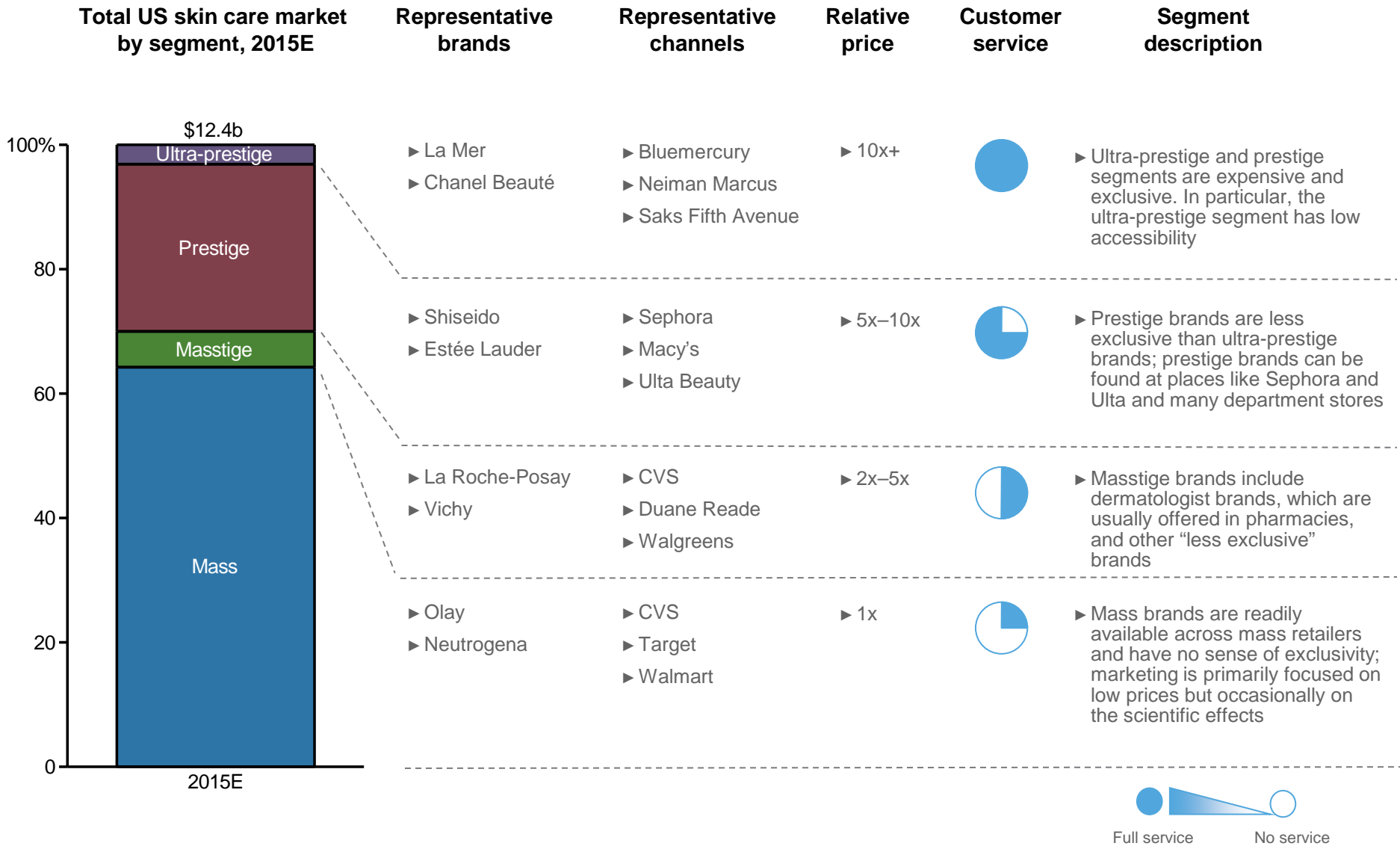
Win themes

- ▶ **New product innovations** — specifically, cosmeceuticals, and those with clinical evidence supporting their claims, and at-home electronic devices — will satisfy consumer demand for professional-quality treatment at home
- ▶ **Effective marketing** to (i) increase consumer recognition of key active ingredients and delivery mechanisms, and (ii) target consumers for up-selling is important for success in a market with so many players and options
- ▶ **Dermatologist support** of products will continue to be an important source of endorsement and sales for brands emphasizing scientific efficacy
- ▶ **Securing distribution channels into international markets**, particularly in Asia, will enable US companies to capitalize on the large skin care market (~\$50b) and the more comprehensive Asian beauty regimen

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Premium skin care represents ~30% of the market; masstige, prestige and ultra-prestige segments are defined by price, retail availability and marketing

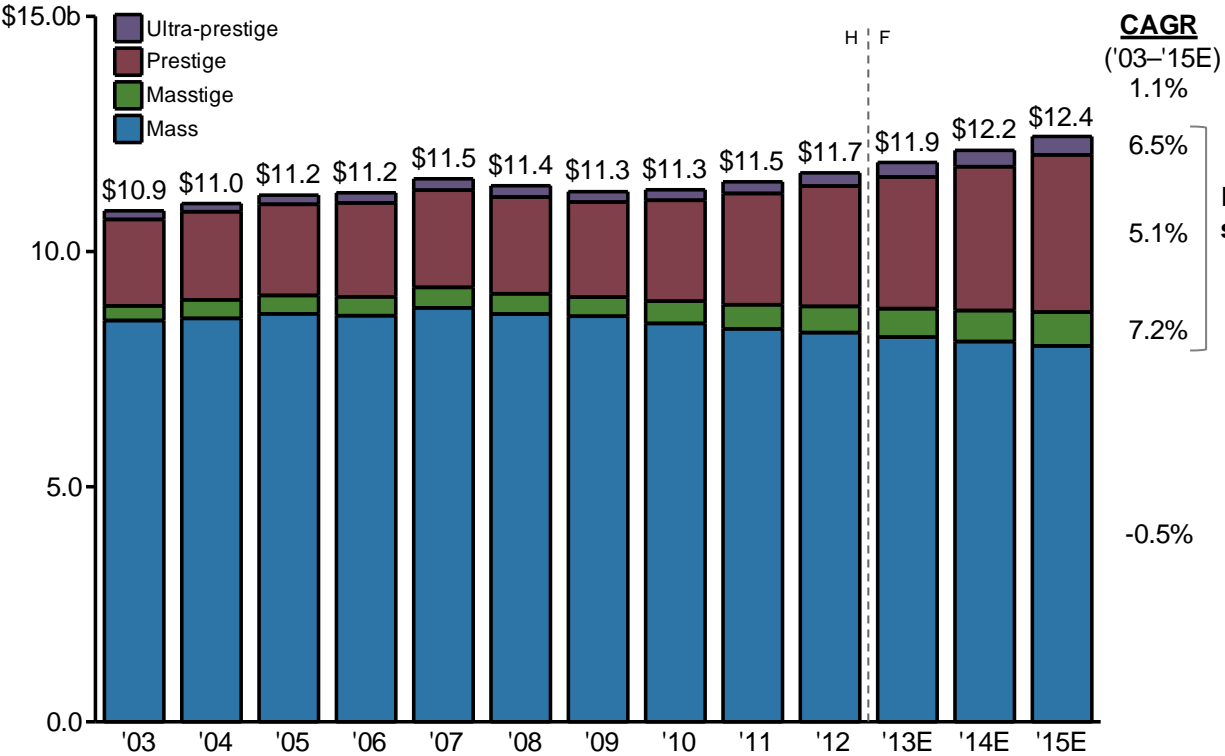


Note: Premium skin care relative price ranges are based on analysis of average \$/oz. for eye creams and moisturizers
 Source: Euromonitor, Parthenon-EY interviews, company websites, Parthenon-EY analysis

Premium skin care has grown ~5.5% annually since 2003, with prestige and masstige segments showing the strongest growth

Total skin care market segmented by ultra-prestige, prestige, masstige and mass, 2003–2015E

Commentary



- ▶ Consumers returned to premium products during the economic recovery and continue to do so after trading down for more affordable mass products during the recession; long-term growth will continue to be driven primarily by sales of anti-agers and facial moisturizers
- ▶ A larger pool of customers willing to invest more money into skin care and expanding skin care regimes is the primary driver of growth in the ultra-prestige and prestige segments
- ▶ Increased efforts from drugstores to offer and promote dermatologist brands at higher price points, and consumer willingness to trade up from mass, are driving the growth of masstige segment
- ▶ The mass segment, compared to all premium segments, is expected to experience negative growth as premium segments capture customers from the mass segment

Note: Subsegments under premium skin care are based on analysis of average \$/oz. for eye creams and moisturizers
 Source: Euromonitor, Parthenon-EY interviews, Parthenon-EY analysis

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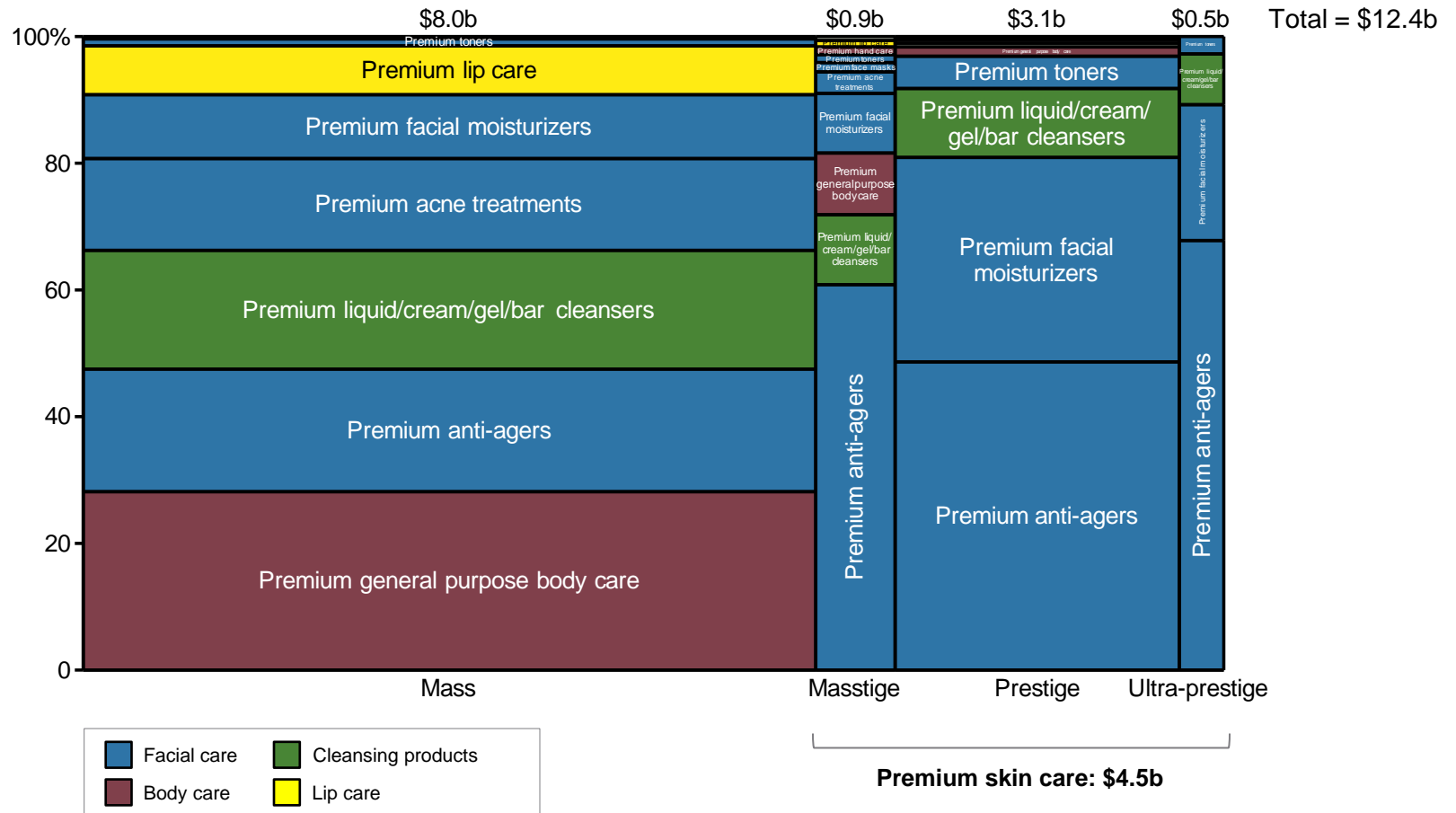
Growth drivers have positively impacted premium skin care segments and have been generally neutral to negative in the mass segment

Driver		Description	Commentary	Impact on segment growth			
				Mass	Masstige	Prestige	Ultra-prestige
1	Expanded regime	<ul style="list-style-type: none"> Premium brands have been marketing toward expanded skin care regimes; for example, serums and retinol creams have expanded typical skin care regimes from three to five steps 	<ul style="list-style-type: none"> "Asia has always had a lengthy and complex skin care regimen — it is much shorter in the US. So I think we are trying to make that shift — how do we get people to buy more? — Current director of product development, leading cosmetics company 	-	-	+	+
2	Product innovations	<ul style="list-style-type: none"> New product introductions have fueled skin care sales, such as at-home electronic devices; such innovations are expected to impact the market in the long term 	<ul style="list-style-type: none"> "Clarisonic has been ahead in this space. Born out of the dermatologist's office, Clarisonic sold its cleansing device for \$120–\$150, which has contributed a lot to their sales growth" — Former SVP of merchandising, US cosmetics chain 	-	+	+	+
3	Greater channel availability	<ul style="list-style-type: none"> Specialty stores, such as Ulta and Sephora, have increased masstige/prestige/ultra-prestige skin care availability; big pharmacies are committing more shelf space 	<ul style="list-style-type: none"> "Skin Care Sets' are available all year 'round. This is a great way to discount the premium end of the market without really discounting — this eventually brings more customers — Former SVP of merchandising, US cosmetics chain 	-	+	+	=
4	Increased efficacy	<ul style="list-style-type: none"> Customers are willing to pay a premium for products containing ingredients proven to work and with claims backed by scientific evidence 	<ul style="list-style-type: none"> "Customers are quite savvy — they know what [ingredients] to look out for and they know new ingredients are coming through. The science side is where we can offer more" — Former SVP of merchandising, US cosmetics chain 	=	+	+	+
5	Brand portfolios	<ul style="list-style-type: none"> Brands have identified white space in existing portfolios and aggressively addressed product gaps either through new product development or strategic acquisitions 	<ul style="list-style-type: none"> "We regularly evaluate opportunities in our product line to innovate and develop new product. As you know, we have also not been shy about acquiring new technology when we see promise" — Current director of product development, leading cosmetics company 	+	+	+	+
6	International growth	<ul style="list-style-type: none"> Brands have realized growth from international expansions; also, tourists to the US have increased purchases due to large price gaps of prestige and ultra-prestige brands across different geographies 	<ul style="list-style-type: none"> "Some of the more expensive brands are dramatically cheaper in the US than in China. Macy's has dedicated tour operators for tourists on shopping tours" — Current director of business development, global cosmetics chain 	=	=	+	+

Relative impact

Premium skin care has a heavy focus on facial treatments and anti-aging products, whereas the majority of mass sales are body care and cleansers

Skin care subcategories breakdown by segment, 2015E



The success of many premium brands is predicated on a “hero” product or line, which can drive brand equity and sales

Crème de la Mer *La Mer (Estée Lauder)*

As the company’s first offering, Crème de la Mer is an essential component of the company’s brand identity and its highest selling product

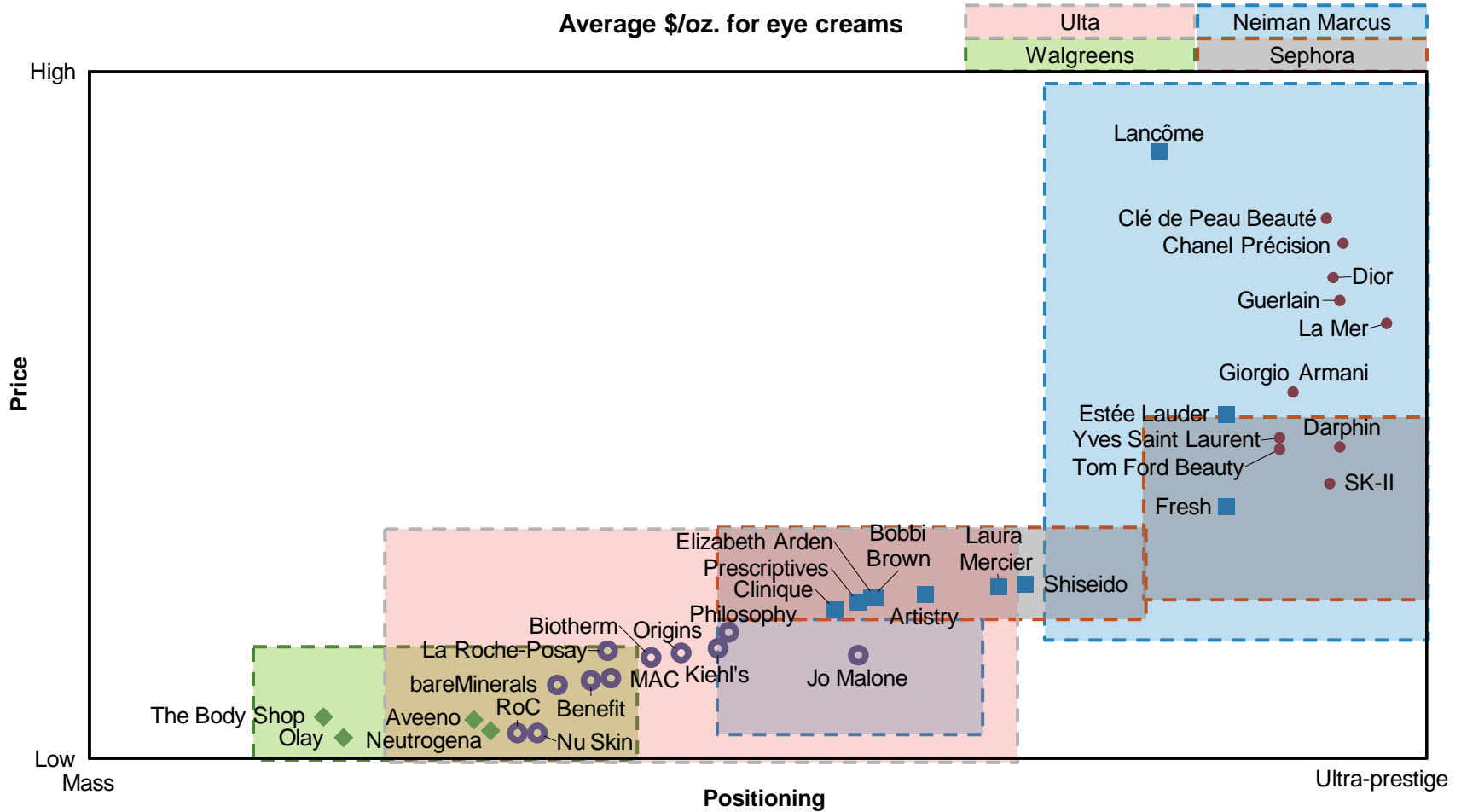
- ▶ La Mer draws extensively upon the history of developing Crème de la Mer in its marketing materials — when aerospace physicist Dr. Max Huber sustained burns from an accident, he developed the product from sea kelp
- ▶ Based on the popularity and brand equity of its hallmark product, La Mer has been able to expand into new beauty categories, including tonics, sun, skin color, masks and body

C E Ferulic Serum *SkinCeuticals (L'Oréal)*

C E Ferulic Serum has helped cement the scientific and clinical image that SkinCeuticals attempts to convey

- ▶ SkinCeuticals launched C E Ferulic Serum in 2005, the same year that the company was acquired by L'Oréal. The product was supported by Duke University research indicating a doubling in photoprotection from use of C E Ferulic Serum only
- ▶ In 2008, the *Journal of the American Academy of Dermatology* published a double-blind, peer-reviewed study that upheld the product’s claims
- ▶ Because of the reputation it enjoys, the product is able to sell for a premium of three to five times the price of other comparable ferulic acid-based beauty products

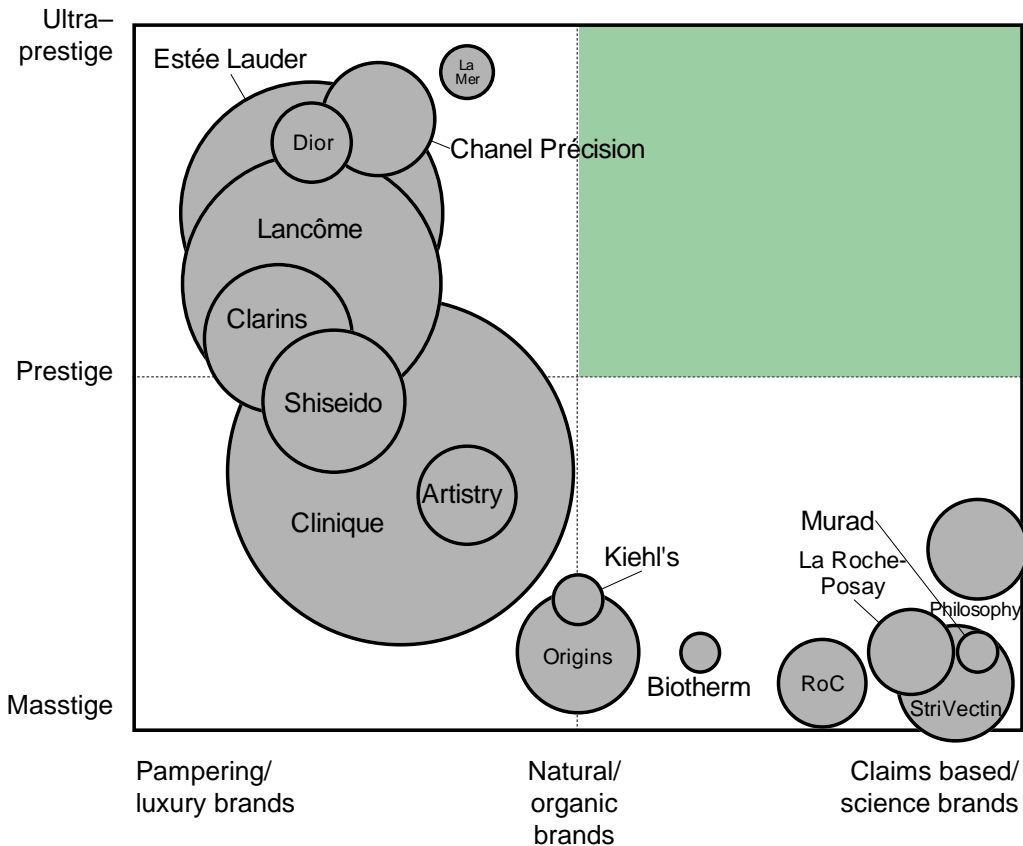
Skincare brands are expanding across retail channels, blurring price and distribution boundaries to fuel growth, but creating potential channel conflict



This dynamic has mixed impacts for premium brands: on one hand, there is greater freedom for brands at various price points under the same ownership to penetrate the same retail channels without diluting brand name; however, channel conflict could cause confusion among less savvy consumers

Premium skin care companies are increasingly focused on scientifically proven efficacy and cosmeceuticals, but white space exists in clinical ultra-prestige

Prestige skin care market segmentation

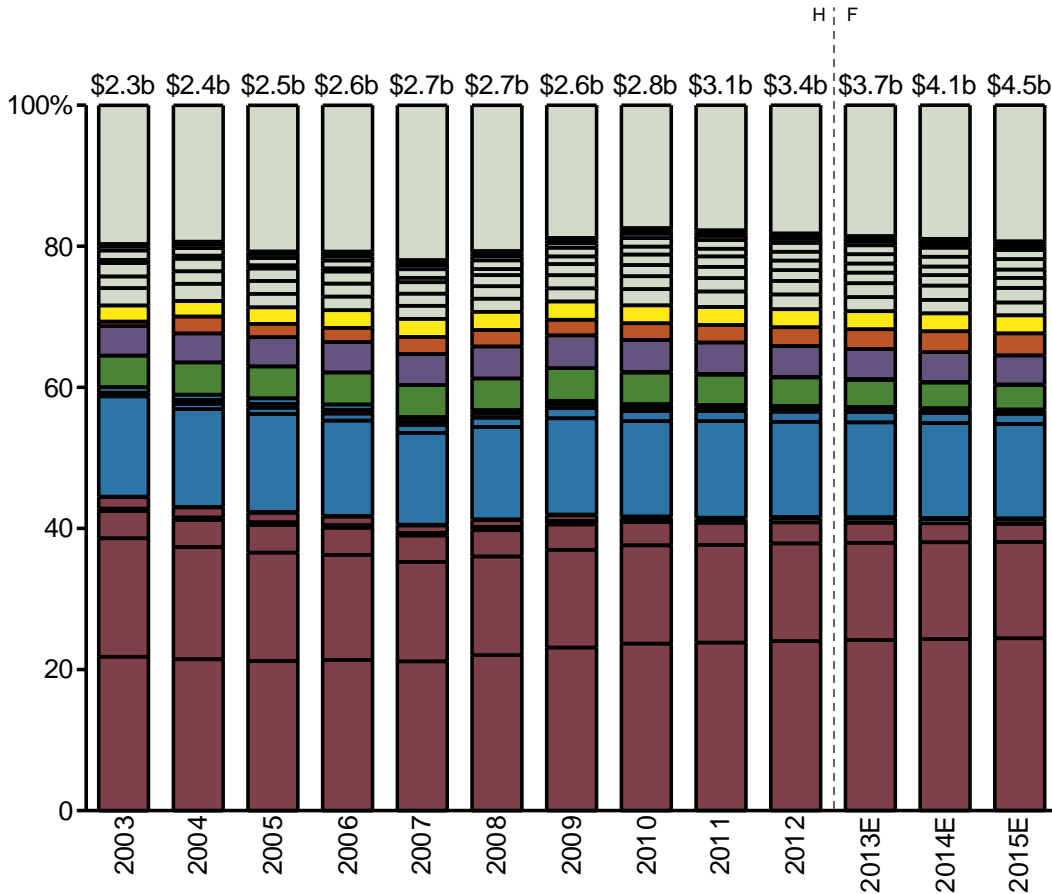


Increasingly savvy consumers are looking for key ingredients and scientific support for marketing claims in premium skin care

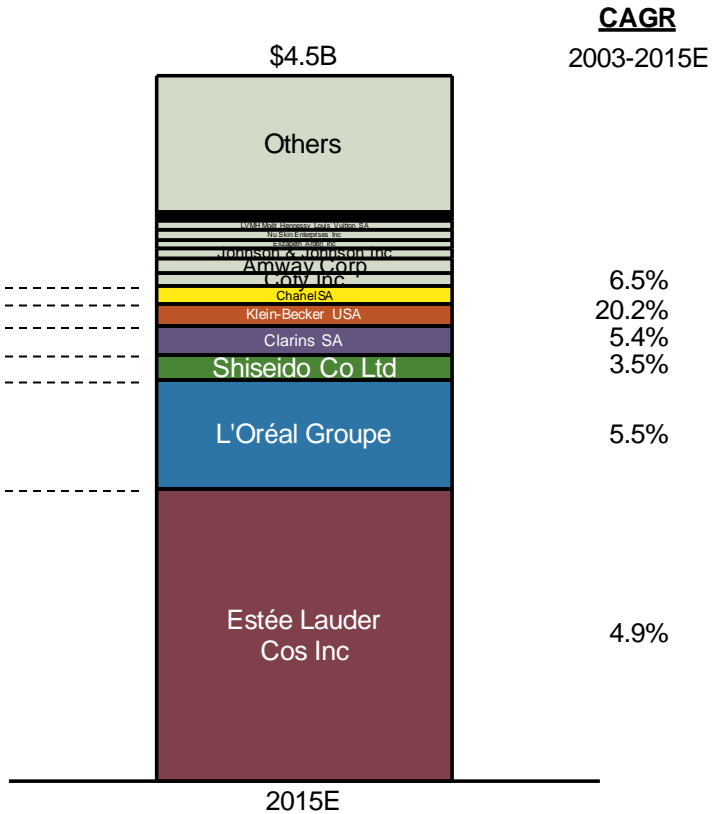
- ▶ For example, La Roche-Posay's sustained double-digit growth relies on recommendations from health professionals and little on advertising; the brand is reputed for robust clinical testing
- ▶ Both scientific efficacy and consumer recognition and demand for key ingredients are critical to product success
- ▶ Key ingredients with high consumer recognition include retinoids, hydroquinone, antioxidants (e.g., ALA, vitamin C, CoQ10, green tea), alpha hydroxy acids (e.g., glycolic acid), hyaluronic acid and neuropeptides
- ▶ The success of marketing cosmeceuticals is dependent upon avoiding claims requiring FDA approval but promoting consumer awareness of key ingredients and evidence of efficacy
- ▶ Few ultra-prestige brands have established a reputation for "clinical luxury," such as SK-II and Orlane, but consumers are demanding more robust trials to justify high price points and claims, presenting opportunities for new entrants or emerging players

L'Oréal, Shiseido and Estée Lauder comprise over 60% of the premium market across brands; growth is driven through creating and acquiring brands

Prestige skin care brands by market shares, 2003-2015E

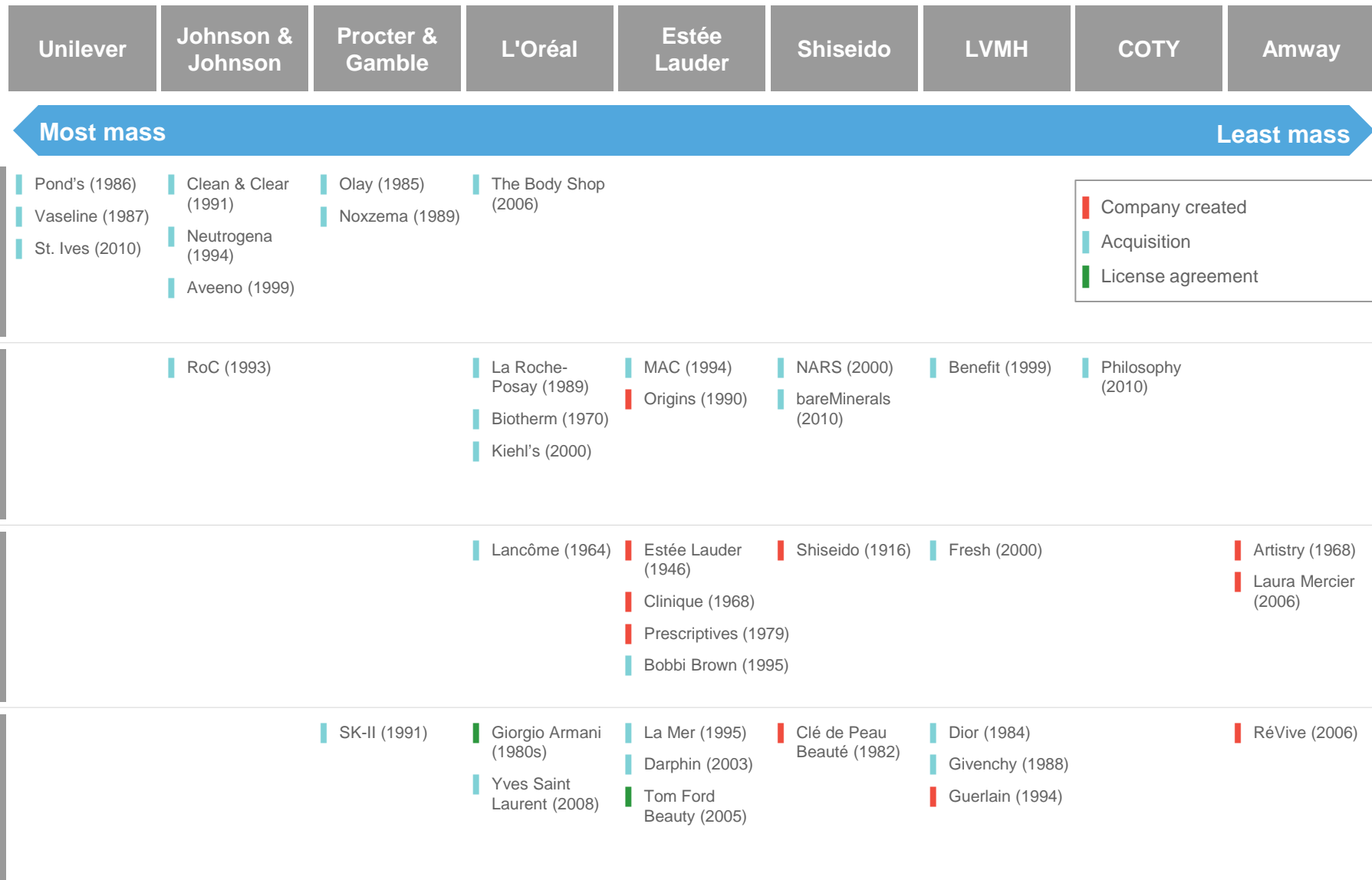


Parent ownership of premium brands, 2015E



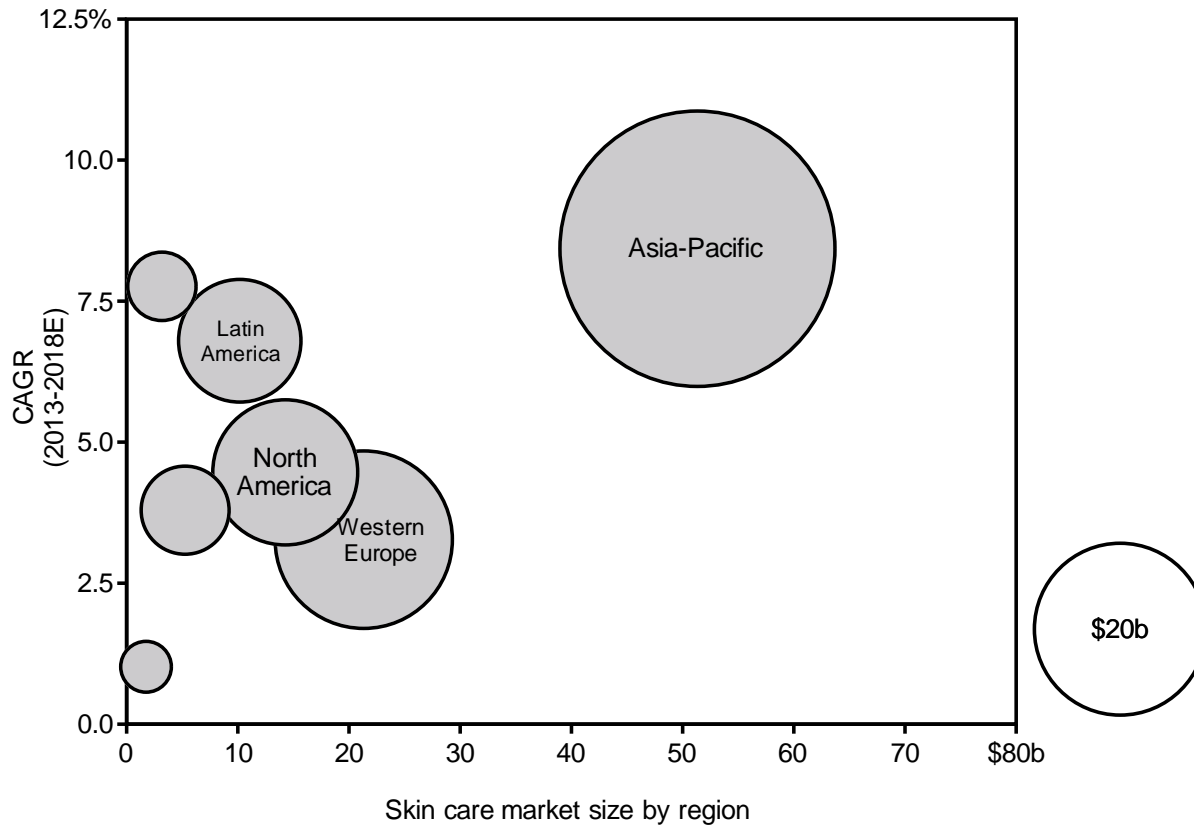
Note: CAGR represents total for skin care brands owned by parent (excludes non-skin care revenue)
 Source: Euromonitor, Parthenon-EY analysis

Large skin care companies have used a combination of acquisition and internal brand development to play across skin care retailers and segments



Securing distribution in international markets, particularly in Asia and Latin America, will enable US companies to capitalize on large growing markets

Global skin care market size, 2013



The global skin care market reached \$107.3b in sales in 2013

- ▶ Growth in global skin care was driven primarily by the Asia-Pacific region, but Latin America and Brazil have also emerged as key growth engines and have more than doubled skin care sales since 2006
- ▶ Anti-agers remain the fastest growing category in global skin care and will add \$6b in sales by 2017; the US, China, South Korea and Japan are the primary countries driving this trend
- ▶ Men's skin care has emerged as a significant growth category, and major international skin care providers have invested in the space

Indonesia, India and Thailand are the next big skin care markets

- ▶ Indonesia alone is expected to be the third biggest contributor to skin care growth with sales of \$1.2b by 2017

The continued expansion of global beauty retailers has driven market growth in certain Southeast Asian countries

- ▶ Sephora, through its 2014 partnership with Zalora, now has online distribution capabilities for Singaporean and Malaysian customers

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Andres Saenz

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Profile

- ▶ Andres is a managing director and co-head of Parthenon-EY's Private Equity practice
- ▶ Andres assists firms with due diligence, investment strategy and portfolio company projects
- ▶ Over the past thirteen years with Parthenon, he has worked in a wide variety of industries, including consumer products and services, retail and restaurants, business and financial services, industrial and health care
- ▶ His work has addressed a number of strategic issues including growth strategy, sales and marketing optimization, and operational improvement. Andres also leads the firm's recruiting efforts.

Education

- ▶ Andres received his undergraduate degree from Harvard University and his MBA from Harvard Business School

Enoch Minn

Managing Director, Private Equity practice (focused on consumer sector)



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Profile

- ▶ Enoch helps lead Parthenon-EY's Private Equity practice in Boston
- ▶ Enoch has over 12 years of experience and has led over 60 engagements in commercial due diligence, M&A advisory, growth strategy development, strategic brand assessments and brand strategy development
- ▶ Prior to joining Parthenon-EY, Enoch was a senior engagement manager with L.E.K. Consulting, focused on working with private equity firms in commercial due diligence and strategic growth opportunities
- ▶ In addition to extensive experience developing brand positioning and growth strategies, Enoch has also worked extensively in the retail and consumer products sectors, helping develop growth strategies and assessing brand strengths

Education

- ▶ Enoch received his JD and MBA from The University of Chicago, and his BA in Economics and Mathematics with honors from Northwestern University
- ▶ Enoch is a member of the California Bar Association

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