Shop or Drop: The Inevitable Path for Growth in Beauty

The beauty and personal care industry is at a tipping point where the ability to grow inorganically will separate the best from the rest.
Add Brands, Boost Business

The beauty and personal care (BPC) industry has seen a large number of mergers and acquisitions (M&A) over the past five years with key industry players building their businesses by adding brands—large and small—to their portfolios. The intensity of this inorganic growth activity is driven by two factors.

First is the stagnant or slow growth in core markets, including the United States and Western Europe. For example, the overall beauty and personal care market in the US grew by only 3 percent over the past five years, and not much more is expected in the next five years. Second is the highly concentrated nature of the industry: in both the mass and premium segments, the top three companies account for a 39 and 49 percent share respectively (see figure 1). This is also true at a category level—in three out of six categories, the top three companies have more than a 45 percent share of the market. Conversely, the other half of the market is extremely fragmented, with a plethora of brands.

Figure 1

US beauty and personal care market: share of top three companies

<table>
<thead>
<tr>
<th>Category</th>
<th>Total premium</th>
<th>Total mass</th>
<th>Deodorants</th>
<th>Hair care</th>
<th>Color cosmetics</th>
<th>Bath and shower</th>
<th>Fragrances</th>
<th>Skin care</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top three market share</td>
<td>49%</td>
<td>39%</td>
<td>75%</td>
<td>62%</td>
<td>51%</td>
<td>46%</td>
<td>38%</td>
<td>27%</td>
</tr>
<tr>
<td>Other</td>
<td>51%</td>
<td>61%</td>
<td>25%</td>
<td>38%</td>
<td>49%</td>
<td>54%</td>
<td>62%</td>
<td>73%</td>
</tr>
<tr>
<td>Market size ($ billion)</td>
<td>$19.9</td>
<td>$43.6</td>
<td>$4.2</td>
<td>$12.0</td>
<td>$14.4</td>
<td>$7.7</td>
<td>$7.8</td>
<td>$15.6</td>
</tr>
</tbody>
</table>

Sources: Euromonitor International; A.T. Kearney analysis

A.T. Kearney’s Merger End Game methodology, which is based on the analysis of hundreds of mergers across industries, shows that an industry is approaching a tipping point when the top three companies combined hold a 45 percent share of the market. At this point, the industry is ripe for consolidation, and survival likely depends on acquiring or being acquired. The beauty and personal care industry has reached this point. Already, industry leaders have been pursuing opportunities to reinvigorate performance across a variety of categories, geographies, and channels. The recent increase in M&A activity raises a series of questions: What is the right target? Are some segments better than others? And ultimately, does M&A create value for acquirers?

1 For more information, see The Merger Endgame Revisited at www.atkearney.com.
To answer these questions, our 2016 Beauty and Personal Care M&A Market Study analyzed more than 200 M&A transactions that took place across all categories and geographies between 2010 and 2016 (see figure 2). Here we take a look at the factors driving these transactions and explore how acquirers are using M&A to create value.

We segmented the transactions by primary driver (see figure 3 on page 3). The following section examines these drivers.

**Access to consumers.** This is the most widespread strategic M&A driver. BPC companies are looking to expand share of wallet of new consumer groups. The most attractive targets are those that better harnessed the ability to read the attitudes and preferences of evolving or emerging beauty consumer segments. Small specialized companies targeting rising demographics such as Asian, African American, and Hispanic consumers did so in a more effective and efficient manner than large corporations. By investing in niche ventures, large companies can expand their customer base without cannibalizing the revenue of their pre-existing brands (see sidebar: New Indies: The Next Frontier of Beauty M&A on page 4).

L’Oréal is a good example. In 2014, the company bought ethnic hair-care and skin-care brand Carol’s Daughter to target women of color by harnessing the demand for ethnic products.

Age is another demographic factor to consider. As Millennials get older, more companies are targeting the successive Generation Z. For example, in 2012, Elizabeth Arden acquired global licenses for the celebrity fragrance brands of Justin Bieber and Nicki Minaj to target young consumers, and PZ Cussons launched a beauty division by acquiring premium hair-care brand Fudge, targeting Gen Z with stylish products and an appealing website.

Polarization of consumer behaviors is another new trend driven by most demographic groups. Trading down to products that offer a good value has become the new normal. In 2011, Revlon entered the value side of the nail polish market by acquiring Mirage Cosmetics (Sinful Colors).
And in 2014, L’Oréal acquired NYX Cosmetics, a provider of high-quality, on-trend color cosmetics sold at value price point while TPG bought e.l.f. Cosmetics, a branded value-price color cosmetics company.

On the opposite end of the spectrum, aging Baby Boomers and high-earning Millennials are becoming more quality conscious and trading up to costlier premium brands. For example, in 2014, Estée Lauder Companies acquired premium luxury US skin-care company L Rodin, a manufacturer of Italian high-end oils, and bought exclusive, ultra-luxury fragrance house Editions de Parfums Frédéric Malle. The acquisition of Smashbox was another step toward bringing affluent younger consumers into the prestige market.

**Access to innovation.** With product life cycles shortening, the ability to scan the market for innovation becomes crucial. The BPC space is behaving more like the tech industry, where leaders capitalize on the market of rising companies in Silicon Valley as a “test lab.” The primary targets were companies with the ability to incorporate technological innovations into their products and processes. In 2014, for example, L’Oréal acquired Sayuki, a maker of skin-care scanning and color-matching technology.
New Indies: The Next Frontier of Beauty M&A

The beauty industry has been buzzing recently about the rise of indie brands, those that “came from nowhere” and almost overnight gained customer trust, market success, and perhaps most importantly, a “challenger” status for the established brands. Ownership structure by itself is not sufficient to describe the recent activity and excitement about indie brands. There are four additional factors that characterize the new generation of brands, which we call the “New Indies.”

Focus: catering to the specific needs of a niche audience and avoiding being “everything to everyone”

Engagement: reaching consumers in innovative and authentic ways—and allowing consumers to define the brand and be part of it

Purpose: placing emphasis on values from family or community to social and environmental impact

Channel to market: bypassing traditional channels—these brands either sell through stores such as Sephora or deliver their products through e-commerce channels

We categorize every brand making an art of one or more of these characteristics as a new indie. Of our sample of 214 transactions, 41 percent fall into this category.

It is important to note that indie brands are not entirely a new phenomenon. Indies have been around for decades. Urban Decay and Nars, for example, are indie beauty brands that rose in the ‘90s and became “mainstream” after being acquired by established corporations.

In our universe of 214 M&A transactions, about 80 percent of the brands acquired were independently owned. But

Access to distribution channels. Twelve percent of the transactions were motivated by the need to strengthen or build the acquirer’s sales infrastructure from the ground up. One example of downstream integration into retail is the 2013 acquisition of Lena White, the largest distributor of Coty’s leading color cosmetic brand OPI. This acquisition enabled Coty to strengthen control of its brand in the UK market, accelerating commercialization through retail and professional channels. Another example from the brick-and-mortar space is the expansion by Macy’s into a new retail beauty format with the 2015 acquisition of Bluemercury, a leading luxury beauty retailer. Not surprisingly, access to e-commerce distribution has also been fueling a significant portion of BPC M&A. Brick-and-mortar companies have been acquiring digital retailers to complement

Other interesting targets include companies that use scientific research to reach customers. In 2013, SkinMedica acquired leading science-based mineral makeup company Colorescience, demonstrating how scientific formulas can help convey health-related messages to consumers. At the end of 2014, Estée Lauder strengthened its prestige portfolio by acquiring GlamGlow, a UK-based prestige skin-care brand offering high-end facial mask products formulated with patented technologies. The brand, originally known as Hollywood’s Beauty Secret, is a testament to how a technological patent can be used to build a nascent brand’s credibility.

Finally, numerous targets in our study were innovators in tools and devices for medical or aesthetic applications. For example, in 2013, Valeant acquired Solta Medical, a manufacturer of energy-based medical device systems for aesthetic applications, and Syneron Medical and Unilever Ventures formed Iluminage Beauty, a joint venture to develop aesthetic medical devices and capitalize on the consumer trend of bringing professional-level aesthetic care to at-home use.

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their capabilities and reach consumers through multiple touch points. A good example of this trend was Target’s 2013 acquisition of online beauty e-retailer DermStore Beauty Group.

**Access to markets.** Expansion into new geographies is often a core driver of M&A moves. Acquiring or merging with local companies creates rapid access to local distribution channels, not only bypassing the time and capital needed to build distribution from the ground up but also avoiding import barriers. Acquiring local companies is also often a way to access information about a local market—local skin-care, color, and hair-care companies cater to the tastes and needs of consumers with different skin colors and types of hair and are a soft spot for global companies entering a new market.

Although market access was a primary driver for only 8 percent of the transactions we studied, we gathered interesting insights by analyzing the location of the acquirers and targets. In most cases, the transactions occurred between an acquirer and a target that were both based in mature markets. Despite high saturation and competition from incumbents, acquisitions of North American, European, and Japanese companies were very common. Notable examples include the expansion of Hein Celestial into Canada with the 2015 acquisition of Belvedere and Japan’s Kosé making a move on US prestige cosmetics by buying Tarte in 2014.

By investing in niche ventures, **large companies can expand their customer base** without cannibalizing the revenue of their pre-existing brands.

Less than 10 percent of the transactions in this category involved a company from a mature market acquiring a target in an emerging market, presumably driven by more limited acquisition options available in these geographies or the higher risks of overseas transactions. Over the past five years, companies from traditional markets have shown significant interest in South America and Asia, with a higher concentration of transactions in India, China, and South Korea. L’Oréal has been an M&A leader in emerging markets, acquiring Brazilian hair-color and hair-care company Niely Cosméticos in 2014, Brazilian retail chain Empório Body Store in 2013, Indian beauty and hair-care manufacturer Cheryl’s Cosmeceuticals in 2013, and Chinese cosmetics facial masks specialist Magic Holdings in 2013. L’Oréal also pushed into the up-and-coming African market in 2013 by acquiring Interconsumer Products, a Kenyan hair-care and skin-care company. That same year, Coty bought StarAsia, a beauty product distributor in Southeast Asia. And the list goes on.

Not surprisingly, acquisitions by companies from emerging geographies to access established markets were uncommon (less than 5 percent). More common were transactions initiated within an emerging market toward another emerging geography. For example, Delhi-based consumer goods company Dabur India Ltd. has been expanding its international presence in the Middle East and North Africa since before 2010, including the 2010 acquisition of Hobi Kozmetik, a leading Turkish personal care company. Similarly, Mumbai-based consumer product company Godrej entered Latin America to make two acquisitions within two weeks in 2010, snapping up local hair-care companies Argencos and Issue Group. Two years later, Godrej expanded its presence in the region by buying Chilean hair-care company Cosmética Nacional. By entering
smaller emerging markets through the acquisition of well-established local leaders, Dabur India and Godrej have become expert in identifying the big fish in a small pond.

Another noteworthy trend is the search for e-commerce pure players, a space that is heating up around the world, especially in the prestige market. Recognizing this trend back in 2010, LVMH bought an e-commerce site in Brazil. And Sack’s, a Brazilian online retailer of fragrances, cosmetics, and toiletries, played a significant role in Sephora’s expansion into Brazil.

Serial Acquirers Create More Value

After analyzing the strategic drivers of the 214 transactions in our study, we looked at the acquirers’ ability to create value through these transactions. Our research shows that frequent buyers—those that completed on average two transactions per year or more—increased value faster than infrequent buyers. Whether companies benefit directly from inorganic growth or use acquisitions to fuel organic growth, the enterprise value (EV) growth rate of the frequent buyers is 26 percent higher than for companies that did not engage in transactions as often during the same period (see figure 4).

We also analyzed the transactions to evaluate the impact of company size on the ability to create enterprise value, focusing on whether frequent M&A drives more or less value for large corporations (revenue of $1 billion or more). What we found is that frequent buyers (mostly large companies) grew 63 percent more enterprise value over a six-year period than infrequent buyers of comparable size. While M&A is generally beneficial, large beauty companies benefit from frequent M&A more than their smaller counterparts. In other words, large corporations cannot afford to sit on the sidelines in the acquisition game if they want to remain leaders.

Note: Study analyzes 214 transactions.
Sources: A.T. Kearney 2016 Beauty and Personal Care M&A Market Study; A.T. Kearney analysis

2 Our study classifies large corporations as those with $1 billion or more in revenue in 2015.
Finally, we compared EV/EBITDA multiples across the 214 acquisitions. Serial acquirers—both large and small—maintained 1.4 times EV/EBITDA compared to those who were not serial, confirming that Wall Street rewards frequent buyers with significantly higher market valuations.³

Where Do We Go from Here?

While the transactions in our study range from microcap acquisitions to billion-dollar ventures, a common thread remains: strategic buyers had more appetite to acquire in the BPC space than financial buyers. In particular, our study shows that strategic acquirers between 2013 and 2015 had the lion’s share in BPC acquisitions, with more than 80 percent of transactions being of a strategic nature.

At the beginning of 2016, tightening high-yield debt markets were constraining financial buyers’ ability and willingness to pursue M&A in the BPC space, especially for smaller, high-risk targets. As debt markets recover and M&A valuations become more balanced following markets’ return to more rational deal values than in recent years, financial acquirers could jump back in the game and make the BPC acquisition space more competitive. As a result, strategic acquirers could find themselves battling not only their peers but also financial buyers for a limited pool of available targets.

Whether or not the predictions on liquidity and valuations hold, the fast pace of acquisitions is bound to stay. Going forward, the main vehicle for growth and creating value in the BPC space will be acquisitions. Strategic buyers will need to be on their A game—acting fast to grab better-priced targets in this competitive arena. Making an art of the acquisition game will separate the best from the rest.

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³ EBITDA is earnings before interest, tax, depreciation, and amortization.
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