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# Bankruptcies, blind spots and M&A: Beauty’s 2023 outlook

Expect different kinds of M&A deals, breakthrough categories and a reassessment of influencer brands for beauty in the year ahead.

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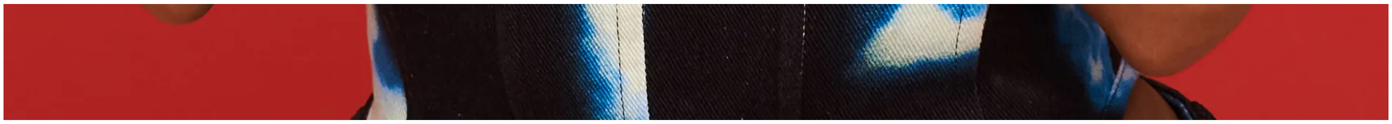

Photo: Topicals

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Beauty was back to business in 2022. This year, expect more deals, new breakthrough categories and a reckoning for the influencer era.

Factors such as ongoing supply chain disruption, mounting energy costs and changing consumer attitudes meant that, in beauty, there was feast and famine: Procter & Gamble acquired indie skincare line Tula; Famille C, the holding company which owns Clarins, acquired clean makeup brand Ilia; and Puig added disruptive fragrance brand Byredo to its portfolio. It was also a banner year for Estée Lauder Companies, which made an investment in British skincare brand Haeckels, and outbid Kering to acquire the entirety of Tom Ford for $2.3 billion, previously having held just the cosmetics licence. Meanwhile, Forma Brands, the parent company of the influencer favourite affordable line Morphe filed for bankruptcy, just three years after receiving a $2.2 billion valuation.

Celebrity-founded brands launched at a dizzying rate, with some breakout successes, such as Hailey Bieber's Rhode Beauty. Some stirred up discontent, with a number of beauty founders penning an open letter to Brad Pitt, dismayed with what they felt was a hollow and inauthentic launch with Le Domaine skincare. "2023 will be judgement day for any brands, celebrity or otherwise, that don't have a clear raison d'être," says Ransley Carpio, head of venture investments at Fortress Group.

## Different deals

Experts say they expect another active year in beauty M&A, though the financial climate may make for different kinds of deals being struck.

“I continue to be astonished at how many new brands are being introduced, both in terms of the pace and the positive reception,” says Carpio. “These brands are speaking to a new demographic, or finding unique ways to reach them.” While Carpio, along with other experts, noted that initial public offerings (IPO), special purpose acquisition companies (SPACs) and other non-traditional exit options may dry up, and capital markets may become too expensive for acquirers, he still expects to see a great deal of activity.

Nadia Pelaez, a director at investment bank RBC Capital Markets, who leads beauty and wellness in the consumer and retail group, expects deals to pick up in the second half of the year, thanks in part to the financial market, but also due to the selection of brands that will be ready for M&A. “A lot of scalable assets (brands at around $50 million or so mark) had investment or were acquired in 2022. Now, we’re waiting for that next class of assets to scale up,” she says. “While there are pockets of positivity, the financing market is still uncertain, and volatile.”

Pelaez adds that while it may be harder for private equity companies to do deals in the current climate as obtaining debt financing will be difficult, conglomerates such as L’Oréal, Coty and P&G are less likely to have these problems. “They likely have a good amount of cash on their balance sheets, and can afford the high multiples we’ve become used to seeing in the last two years when acquiring a beauty or personal care company,” she says.

Carpio echoed this statement, saying that he expects to see a handful of smaller acquisitions of $10-50 million from financial sponsors, especially in the second half of 2023 when the market hopefully stabilises. He suggests brands such as Necessaire, Summer Fridays, Pat McGrath Labs and The Inkey List as marquee names in top-tier private equity portfolios that could trade this year.

“I think we’re going to see very attractive valuations for some great companies,” says Rachel ten Brink, general partner at venture capital fund Red Bike Capital, adding that many conglomerates have cash to burn. “In fact, I think we might see strategic acquisitions of companies that might even be at an earlier stage than what we usually see from larger companies.”

Bill Detwiler, managing partner of Fernbrook Capital Management, which has invested in beauty companies such as Westman Atelier and Violet Grey, says that despite the economic conditions, there will be a number of strong companies looking for investment or to be acquired. “Private equity firms are likely to be more cautious in their approach, but there will be good companies with a strong core business that are just not properly capitalised and growing fast. They'll need a port in a storm,” he adds. There's all to play for, says Marko Horvat, managing director at Financo Raymond James consumer and retail investment banking division: “Given the leveraged finance market, large cap private equity deals that are heavily revenue driven are just not happening. But, that means people are going to find disruptive programmes and strategies to get to the next level.”

## New categories in the spotlight

Pelaez, ten Brink and Carpio all point to new and emerging categories as possible frontrunners for 2023. “I'm very interested in brands that are speaking to the needs of more melanin-rich skin, such as Topicals,” says ten Brink, adding that brands addressing pigmentation, uneven skin tone and other skin concerns more commonly found in Black, south Asian and Latinx communities will be in a good position. She also suggests menopause care and acne care as two other niche categories that could be levelling up. Recent success stories include Stripes, a line designed for menopausal skin backed by biotech firm Amyris and co-founded by the actress Naomi Watts.


Stripes
Resting Clean Face
Ectoine Nourishing & Calming Face Wash
Nettoyant pour le Visage Nourrissant et Calmant à l'Ectoine
Stripes
The Cool Factor
Ectoine Cooling & Calming Face Mist
Brume Visage Rafraîchissante et Apaisante à l'Ectoine
Stripes
Dew As I Do
Ectoine + Vitamin C Brightening & Hydrating Cream
Crème Éclaircissante et Hydratante à l'Ectoine et Vitamine C
Stripes
The Power Move
Ectoine Hydrating & Plumping Facial Serum
Sérum Visage Hydratant et Repulpant à l'Ectoine

“These categories that brands have avoided at all costs previously — such as dandruff care, thigh chafing or other slightly unsexy concerns — are going to be big,” says Carpio, noting that no one brand has yet to dominate the bottom-shelf beauty space. Pelaez suggests haircare will continue to grow, especially brands that focus on scalp care, while skincare will remain bullish.

Lisa Payne, head of beauty at trends forecasting agency Stylus, says wellness is still on the rise. “Now is the right time for consumers to understand a concept of wellness outside of just taking supplements.” She also notes that a handful of indie brands are doing great advocacy work to bolster the men’s and acne-care sectors, while she also expects more growth in doctor-led brands. “I’m also interested in what I call ‘sophisticated sustainability’,” she adds. “Companies that are investing in biotechnology or engineering, or otherwise moving the clean conversation along and offering new value propositions will be interesting. Consumers are still interested in naturals, but there’s growing interest in bio-design and cultivating those ingredients in a lab to better marry together efficacy and sustainability.”

Dandruff care is a category that brands have previously avoided. Photo: Ouai

Barrier health is Payne's other big bet for 2023. The concept of skin barrier care has been growing for the last 12 months or so, as consumers search for more protective products to counteract the damage done by over-use of exfoliants, or to minimise the symptoms of conditions such as eczema and psoriasis. "The barrier health trend might be demonstrated through probiotics, or really nourishing products, but there will be a great deal of care for dry and sensitive skin," adds Payne.

## Beauty's blind spots

As bricks-and-mortar bounced back in 2022, brands who had bet entirely on e-commerce found themselves at something of a loss. Moving into 2023, Pelaez and ten Brink say over-reliance on influencer marketing could also be something of a blind spot. Pelaez returns to the example of Morphe, an affordable cosmetics brand that made a splash with buzzy influencer partnerships.

Two influencers in particular, James Charles and Jeffree Star helped catapult the brand to mass popularity, however, Morphe later cut ties with both Charles and Star after they were both independently hit with allegations of inappropriate behaviour. Both Charles and Star had millions of followers, but as Pelaez notes, "We still can't say for sure how reliable influencers are in terms of converting followers to users long-term, and often, smaller influencers have a more loyal following," she says. "Likes or follows do not always translate to sales or recurring revenue."


Bricks-and-mortar bounced back in 2022. Photo: Space NK

2022 was also the year of the celebrity beauty brand, with a slew of A-Listers launching brands at a dizzying pace. Actors Scarlett Johansson, Brad Pitt and Jared Leto brought out skincare lines, while musicians such as Travis Barker and Gwen Stefani also debuted new brands. While some celebrity-backed lines such as Rihanna's Fenty Beauty and Selena Gomez's Rare Beauty have shown staying power and popularity with consumers, others have felt like a cash grab. "The problem with some celebrity brands is that while people might make an initial purchase because they're a fan, they won't come back when they realise the products are not efficacious, or didn't offer good value," explains Pelaez. "The celebrity aspect is going to die down a little bit, and some of the brands will likely just slowly disappear."

Companies betting big on TikTok in particular may be well-advised to spread their social spend across platforms. Ten Brink described TikTok as a "political hot potato", noting that at times, rumours had swirled that it could be banned in the US altogether over national security concerns about Bytedance, the Chinese parent company.

Crucially, brands must evolve, says Pelaez. She points to the example of Glossier, historically a staunchly direct-to-consumer brand, announcing it will enter Sephora in 2022. "They had a very of-the-moment aesthetic, with heavy use of what was often called 'millennial pink', a soft pastel pink," recalls Pelaez. "As that consumer has gotten older and the market has shifted, they've had to evolve to keep up, and that included entering into retailers."

Ultimately, Detwiler, Carpio, Horvat, ten Brink and Pelaez are all optimistic about founders' prospects for the year ahead. "Good companies can go to great companies during economic downturn," says Detwiler. "They become more efficient with capital and they tighten up. When you have to figure everything out yourself, you get pretty good at that. There can be great outcomes."

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