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BEAUTY

Where are beauty founders raising capital now?

As banks fail and private equity firms rein in their spending on beauty, brands are looking at new ways to generate cash.

BY DANIELA MOROSINI

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MADE WITH REPURPOSED
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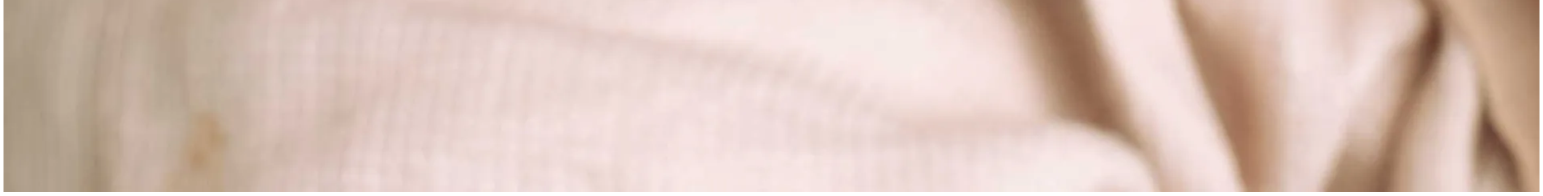

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It's a rough climate for founders looking to raise money. Capital markets have dried up and private equity funds are tightening their purse strings, while the fallout from a series of banking collapses, particularly the startup-friendly Silicon Valley Bank (SVB), has meant that even companies with adequate capital for growth are nervous about managing and maintaining that money. For the beauty industry, this could shape how brands navigate funding, exit strategies and acquisition plans.

Increased pressure in the sector isn't helping, says Rich Gersten, co-founder and managing partner of investment firm True Beauty Ventures. "Beauty is an intensely competitive, heavily saturated sector," says Gersten, adding that while the last five to 10 years have seen record valuations for beauty acquisitions, there is now a slowdown with price tags. "The leverage has swung from the founder to the investor in this market," he says.

Gersten says that makeup and hair brands are seeing a good post-lockdown rebound when it comes to funding, while skincare has become somewhat harder to fundraise for, due to oversaturation. In early 2023, True Beauty Ventures announced a minority investment in Caliray, a clean makeup brand founded by Wende Zomnir in 2021, as part of its Series A funding round. Terms of the deal were not disclosed. Zomnir previously founded Urban Decay, now owned by L'Oréal.

Founders should not be so focused on raising capital that they accept unfavourable terms, says Detwiler. While it's appealing to have a big-name investor on board for a seed or Series A round, if they choose not to invest in subsequent rounds, it could spook other investors, so longevity matters. "Also, founders should ensure they don't just leave things to lawyers without understanding the terms themselves. If someone offers investment but on the basis that the fund has the right to buy their company in five years, for example, the founder should think very carefully about that. Think about creating the best environment for a future exit."

Recent shockwaves in the market have changed investors' outlooks. "With the demise of SVB, we're going to see venture debt dry up, especially in the form that they delivered as a product," says Bill Detwiler, co-founder and managing partner of venture capital firm Fernbrook. A bear market affects funds, too, he says: "Even the best-known funds are having trouble fundraising, or getting to their target amount."

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While some strategics are continuing their shopping sprees, few early-to-mid-size companies meet the revenue thresholds to be attractive to them or if they do, founders may not be ready to sell. So, where can they raise and manage capital now? Angel investment, venture capital backed by strategics and even appearances on US business reality TV show *Shark Tank* are all becoming popular options, as well as a resurgence of the incubator model.

Taking on television

Fiona Co Chan, founder and CEO of makeup line Youthforia, took a hybrid approach to fundraising in early 2023. The company has recently closed a seed round of funding led by True Beauty Ventures with participation from Willow Growth Partners, and *Shark Tank* investor Mark Cuban. In March, Chan made an appearance on the TV show, securing a $400,000 investment from the celebrity in exchange for 8 per cent equity in the company.
"We were about to launch into Ulta when we filmed," says Chan (the episode was filmed in September 2022 and aired this year). "The company had grown very fast and we were getting interest from retailers. We needed cash to sustain growth," says Chan.

In her pitch, Chan says the brand generated $2 million in sales in their first 16 months of business, with half of that revenue coming from their direct-to-consumer channels. Chan says she was cognisant of a slowdown in the funding market, but a raise was non-negotiable.

"We were reaching an inflection point where it made sense for us to raise. We were moving into a big retailer, and we have big launches planned. We needed to ensure we could support both of those things." The brand is also stocked in Thirteen Lune in JCPenney, Credo, Revolve and Soko Glam. Other beauty companies, such as the shower filter brand Hello Klean and oral care line Pärla have appeared on *Dragons' Den*, the UK version of *Shark Tank*. In addition to helping secure potential fundraising, appearance on primetime TV gives brands a visibility and marketing boost

— Youthforia has already posted a breakdown on its Instagram of the products Chan was wearing for the appearance.

While high-profile raises are appealing to founders, friends, family and angel investors shouldn't be overlooked, says Detwiler. "People don't like to hear it, but these are good options," says True Beauty Ventures's Gersten, adding that if his fund passes on a company, it's often because it lacks a proof of concept or doesn't meet internal revenue criteria — not because it's not unique or interesting. "You have to look at every possible source of capital, be that from angels, incubators, accelerators or even crowdfunding," says Detwiler. He advises that founders don't fall into the trap of myopically pursuing only big-name funds with high public profiles, as they may miss good connections. "[Founders] may need to take a slightly more circuitous or less sexy path than getting that seed round with a boldface name."

Photo: Courtesy of UpCircle

Angel investors, especially those already in the beauty space, are becoming a popular funding route. British haircare line Sam McKnight has investment from the makeup artist and founder Charlotte Tilbury, while the new salon hair colour concept brand Yuv, founded by Francisco Gimenez, who previously co-launched Esalon, received investment from Hourglass founder Carisa Janes. Nam Vo, the makeup artist and influencer, invested in skincare line Matter of Fact, alongside the fashion designer and model Nicky Hilton.

British refillable skincare company Upcircle launched its second crowdfunding campaign in August 2022. The company raised nearly £440,000, 146 per cent of their goal, from 1,352 investors. The funding helped grow its team, launch new products and fuel its first out of home marketing campaign, says co-founder Anna Brightman.

Understanding corporate venture capital

A number of cosmetic conglomerates have added venture capital arms to their business in recent years, with the goal of identifying emerging brands and maximising their growth. The Estée Lauder Companies, through its New Incubation Ventures group launched in March 2021, has made minority investments in the British skincare company Haeckels, and the fragrance line Vyrao. L'Oréal's venture capital arm, Bold (Business opportunities for L'Oréal development) launched in 2018, invests in brands and beauty tech and science. In 2019, L'Oréal invested in Canadian company Functionalab Group, which has 15 aesthetic medicine clinics throughout Canada offering non-invasive treatments.

A middle ground also exists in an emerging batch of hybrid models, such as Beach House Ventures (BHV), the new investment arm from the founders of incubator Beach House Group, which created Pattern by Tracee Ellis Ross and Moon Oral Care with Kendall Jenner among other brands and expects to surpass $250 million in sales this year. "The day that our press release went out announcing the launch of Beach House Ventures, the news also broke that Silicon Valley Bank had gone under," recalls co-founder Shaun Neff, adding that the bank's closure has left founders in many sectors scrambling. "In the last couple of weeks, we've had over 200 inbound responses from founders," he says.

Instead of following the standard venture capital format of securing external funding, for example in the form of limited partners, BHV is taking a different approach. Near-term funding will come from internal sources, such as existing cash on its balance sheet or current shareholders. External family offices and investment funds will be reviewed if needed, says the company. Each deal will be different based on brand needs, though Neff and co-founder PJ Brice say that they're looking for brands in the nascent stages of growth. They expect the majority of the capital they're willing to commit to range between $2 million and 10 million per brand, but there is "no limit" for the right opportunity.

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Brice confirms that the company is not looking to make partial plays. Instead, they're looking to do a small number of investments, perhaps as few as one to three a year, taking a majority stake in each business and scaling them within the incubator's service platform. "We've got a unique model that the brands can tap into, including compliance, legal and accounting," says Neff of their USP. "It's a very reciprocal and collaborative process."

Running a tight ship

However funding is raised, founders and investors alike have two things on their mind: building a lean operation, and safeguarding funds. Fernbrook's Detwiler, who previously worked as a merchant banker and a mergers and acquisitions lawyer, says investing in treasury management will be hugely important, and that founders may wish to consider the use of sweep accounts, which are accounts that automatically transfer funds when the balance is above or below a preset minimum. Sexual wellness brand Maude was one of many who banked with SVB. "When we started out six years ago pre-launch, SVB was the only bank that would do business with us," recalls founder and CEO Éva Goicochea, although they've since worked with other startup-focused banking and debt providers. "After the collapse, we were able to diversify our capital among multiple institutions," she says, adding that the "shock" helped fortify her aim at profitability and solvency.

Personalised skincare company Skin + Me, founded by James Mishreki, found itself in a similar position as SVB had been its primary bank. "From a treasury management standpoint, my companies and likely many others, are likely never going to bank with just one institution again," says Mishreki.

True Beauty Venture's Gersten advises against falling into the valuation trap. "If you're going to raise, make sure it lasts 18 months or so, or longer, if you can. You don't want to have to raise again too soon without any good proof points. Youthforia's Chan agrees, adding that her focus is on being capital efficient following their raise. "It comes down to understanding your business fundamentals — knowing how business is growing, what drives it, and what are the levers for growth?”

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