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02/06/2023

L'Oréal Acquires Aēsop from Natura&Co for $2.5bn

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Division:

Consumer & Retail

M&A Analysts:

Daniel Ribeiro

Tyler Edwards

Market Analysts:

Aliyan Hussain

Ben Read

Ignacio Paz Garcia

Luca Salvatori

Mats Gadajev

Siya Goyal

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TABLE OF CONTENTS

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DEAL INTRODUCTION

DETAILS ABOUT THE DEAL

On April 3rd, L’Oréal announced it intends to expand its presence in the luxury beauty market by acquiring the Australian brand Aēsop from Natura &Co at an enterprise value of USD 2.525 billion, its largest brand acquisition to date. A day after, the group share price was up 1.3% , closing at $90. The transaction is expected to be completed in the third quarter of 2023, subject to regulatory approvals, and will be paid in full cash.

Aēsop currently operates 400 points of sale across the Americas, Europe, and Asia, with a small footprint in China. The brand posted sales of $537 million in 2022 ($1bn expected by 2027), up 21% from a year earlier, and is estimated that Aesop will add around 1.2% growth to the French giants’ organic sales in 2023.

The acquisition confirms L’Oréal's growth story, as the cosmetics group is known for buying emerging labels, and scaling them up through its global distribution network. L'Oreal CEO Nicolas Hieronimus tilted the deal as "massive growth potential" in Aesop, notably in China one of the fastest growing markets for cosmetics, leaving plenty of headway for future growth. Growth opportunities include travel retail, selling Aesop in airports and other transport hubs, and fragrance.

The French cosmetics group is known for buying emerging labels, and scaling them up through its global distribution network, Ian Simpson, analyst with Barclays, said, estimating Aesop will add around 1.2% to L'Oreal's organic sales this year.

Morgan Stanley served as the lead financial advisor in the L'Oréal-Aesop acquisition, with Bank of America as secondary financial advisor and Davis Polk & Wardwell as the main legal advisor.

REASONS FOR M&A

L'Oréal recognises the potential for growth in the Chinese market and sees Aesop as a strategic asset for further expansion. Aesop's successful entry into China, with strong performance and exceeding expectations, provides L'Oréal with a platform to leverage its global distribution network and capitalise on China's fast-growing beauty market. Put into numbers, Barclays' analysts suggest Aesop will add 1.2% to L'Oréal's.

Aesop's product line of hair, skin, and body-care formulations also strengthens L'Oréal's wide portfolio of products, specifically within the rapidly growing natural cosmetics market, a significant value of Aesop's brand identity. This is especially important as consumers are pivoting to more environmentally friendly products while also avoiding synthetic ingredients.

From Aesop's perspective, L'Oréal has had decades of success with organically growing and scaling emerging labels. L'Oréal's core growth strategy is centred around acquiring exciting brands, previously adding Skinbetter Science and Takami to their long list of subsidiaries. This acquisition offers the opportunity for synergies and operational improvements, especially with L'Oréal's expertise, resources, and global presence. This includes expanding the number of points of sale, particularly in travel retail, and enhancing operational productivity

Natura & Co, Aesop's former parent company, stated that the divestment of Aesop will reduce debt on their balance sheets and help focus on other avenues of growth, specifically with their flagship brand The Body Shop's presence in Latin America.

INDUSTRY OVERVIEW

COSMETICS INDUSTRY

The cosmetics industry is a vast and dynamic sector that encompasses various products and services related to beauty and personal care. It plays a significant role in society, reflecting cultural trends, individual preferences, and self-expression.

The cosmetics industry operates on a global scale and spans multiple product categories, including skincare, haircare, makeup, fragrances, and personal hygiene products. It caters to a diverse consumer base, encompassing individuals of different genders, age groups, and cultural backgrounds.

The market is driven by consumer demand for enhancing appearance, maintaining personal hygiene, and addressing specific beauty concerns.

MAIN PLAYERS/COMPETITORS

The cosmetics industry is home to numerous leading firms that have established themselves as key players in the global market. A few dominant firms in the industry are listed below:

1. L'Oréal: L'Oréal is the world's largest cosmetics company and operates in various segments, including skincare, haircare, makeup, and fragrances. It owns a wide range of brands such as L'Oréal Paris, Maybelline New York, Lancôme, Kiehl's, Garnier, and NYX Professional Makeup.

2. The Estée Lauder Companies: Estée Lauder is a multinational conglomerate that owns and operates a diverse portfolio of prestige beauty brands. Some of its well-known brands include Estée Lauder, Clinique, MAC Cosmetics, Bobbi Brown, La Mer, and Jo Malone London.

INDUSTRY OVERVIEW

3. Procter & Gamble (P&G): P&G is a global consumer goods company that encompasses various sectors, including cosmetics and personal care. It owns popular brands such as Olay, SK-II, Pantene, Head & Shoulders, Gillette, and Herbal Essences.

RECENT AND FUTURE TRENDS

Before the COVID-19 pandemic, the cosmetics industry experienced steady growth with increasing consumer awareness of personal grooming, beauty trends, and the rise of social media influencers.

Market research projects that revenue in the beauty and personal care industry will top $101 billion by 2027. Expected future trends:

1. Hyper-Personalisation with AI/AR: Research from McKinsey shows that 71% of consumers expect a personalised experience when shopping. More than 75% of shoppers get frustrated without it.

2. Biotech Innovations Focused On Sustainability: Science in the beauty industry is nothing new, but the current biotechnology trend is taking the science of beauty to a whole new level.

3. Natural And Organic Ingredients: More than 65% of consumers are looking for environmentally-friendly brands, and 55% are willing to pay more for sustainable products.

4. Brand Engagement On TikTok And Instagram: Nearly half of all social media users will make at least one purchase on a social platform this year. By 2024, the average shopper on social media will spend $800 on social commerce each year.

5. Demand For Men's Beauty Products: A study found that 56% of men reported buying more skincare products today than they did five years ago.

ACQUIRER OVERVIEW

L'ORÉAL PARIS

TICKER:OR

COMPANY OVERVIEW

Founded in 1909, L'Oréal S.A. is the largest cosmetics company in the world, employing 88,000 people worldwide as of 2023 and acting as one of the most dominant players in the sector of self-care and beauty products.

As one of the most well-reputed and widely acclaimed firms active in the beauty sector, L'Oréal has a significant presence in the various sub-sectors of the market, particularly specialising in skin care, perfume, and hair care. Beginning with the sale of in-house produced hair dye to hairdressers in Paris, the firm has diversified significantly in the century since its founding.

Among the most notable brands owned by the firm are The Body Shop, Sanofi-Aventis, NYX Cosmetics, IT Cosmetics, and, as of the most recent acquisition, Aesop.

KEY FINANCIALS

Revenue: $38.3 Billion

EBITDA: $8.2 Billion

EBIT: $7.9 Billion

Net income: $5.7 Billion

Market Cap: $232 Billion

P/E Ratio: 40.8

Share Price: $42.60 (May 20th)

BUSINESS MODEL

As the foremost cosmetics company operating today by capitalisation, L'Oréal has pursued a strategy of constant acquisition of promising new brands and patents.

It has consolidated its presence in established markets whilst developing a robust R&D pipeline geared towards innovative products such as Modiface, a tech company specialising in augmented reality as a means of allowing user testing of makeup styles and products.

Although certainly notable as the largest acquisition by the firm to date ($2.525B), L'Oréal's purchase of Aesop is consistent with its broad strategy of expansion and consolidation as a dominant player in the cosmetics market, as evident in its past acquisitions of significant brands such as IT Cosmetics for $1.2B in 2016 and the Cerave, AcneFree, and Ambi skincare brands for a collective $1.3B in cash in 2017.

ESG PRACTICES

L'Oréal has heavily invested in ensuring that its products are sourced and tested not only sustainably, but ethically.

To this end, one of the most promising R&D initiatives championed by the firm has been that of Episkin, a reconstructed human skin model developed from leftover skin cells from surgery which have been developed in laboratories to produce sheets of skin.

These "artificial skins" have been praised as an ethically sourced alternative to animal testing, allowing the firm to effectively test new products on skin without compromising its commitment to ethical standards.

TARGET OVERVIEW

Aēsop.

COMPANY OVERVIEW

Aesop is a renowned Australian brand that specialises in the production and distribution of high-quality skincare, haircare, and body care products.

The company is known for its focus on using natural ingredients and creating unique formulations that cater to specific skin and hair concerns.

Aesop offers a wide range of products, including cleansers, moisturisers, serums, masks, shampoos, conditioners, and aromatic formulations.

The brand has gained popularity for its minimalist packaging and distinctive store designs, often incorporating elements of art and architecture.

KEY FINANCIALS

Revenue: $537 Million

EBITDA: $108 Million

Net income: $387 Million

P/E Ratio: 20.96

Market Cap: $2 Billion

Market Share: 0.7%

Share Price: $5.34

BUSINESS MODEL

Aesop follows a selective distribution strategy, with its products available in Aesop-owned stores, selected department stores, and authorised retailers globally.

It prioritises using high-quality ingredients and crafting meticulous products, distinguishing itself from mass-market competitors.

The company offers a curated range of skincare, haircare, and body care products, showcasing its expertise in formulating effective and innovative solutions.

Aesop establishes a strong brand identity through storytelling and a commitment to sustainability, engaging customers on a deeper level with its values and ethos.

ESG PRACTICES

Leaping Bunny approved: Aesop's formulations, including home products, meet the internationally recognized gold standard for cruelty-free products.

Certified B Corporation®: Aesop is a Certified B Corporation®, showcasing its commitment to high standards of social and environmental performance.

ESG-focused plastic packaging strategy: Aesop aims to increase the use of recycled PET in their plastic bottles, with 89% already made from recycled material, aligning with their Sustainable Packaging Roadmap.

Enhanced social commitment: The Aesop Foundation is intensifying its efforts in 2022 by engaging employees and expanding collaborations with charitable partners worldwide to create a greater positive impact.

DEAL ANALYSIS

STRENGTHS

The acquisition of Aesop by L'Oréal will allow the firm to capitalise on Aesop's dominance in the natural luxury cosmetics market. Aesop meticulously innovates to provide high end products that are carefully crafted with organic and vegan friendly materials. Therefore, the merger will enhance L'Oréal's brand portfolio with the addition of such products .

Furthermore, Aesop's delivery of strong financials: yearly growth rates of 20%+, sales of over $500 million and gross profit margin of 87.1% in 2022; make the acquisition beneficial forL'Oréal as these numbers will simply amplify its financials. It is likely L'Oréal will see its share price and market capitalization increase significantly following this merger.

WEAKNESSES

The merger may face integration challenges, due to the size of both firms. L'Oréal already finds itself to be the largest company in the cosmetic industry (value $38.3 billion) hence integrating with another company increases the firm's likelihood of succumbing to issues such as diseconomies of scale and principal agents problems.

Furthermore, since the deal's value of $2.525 billion is L'Oréal's largest to date, some may argue that L'Oréal isn't capable of an acquisition to this scale since it hasn't been done before. This will not instil confidence in shareholders and employees of the company. Some critics also argue the company may have overpaid for this transaction which may hinder financial performance in the short and long term.

DEAL ANALYSIS

OPPORTUNITIES

Aesop's recent expansion into China will pave the way for further growth into the world's fastest growing economy. As L'Oréal is keen to stay at the infront of its competitors, merging with Aesop therefore allows L'Oréal to penetrate the Chinese market with greater ease and advantage.

The merger can create cross-selling opportunities between L'Oréal's and Aesop's product portfolios. This may generate increased sales and revenue as consumers have a greater range of products to encourage them to purchase more from the companies combined.

THREATS

The merger is subject to regulatory approvals, and any delay or rejection may affect L'Oréal share price and financials. If it takes time for the final outcome to be decided it will also leave the company in limbo which may cause time and money wastage.

Considering the competitive landscape that is the beauty industry L'Oréal will continue to face problems maintaining its position in the market. For example, its competitor Estée Lauder has just bought Tom Ford for $2.3 billion, and reports have highlighted how Kering, LVMH, and Hermès are all making significant strategic advances as well. Although acquiring Aesop seems to be a desirable move, it is unclear if the move is enough.

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VALUATION ANALYSIS

DISCOUNTED CASH FLOW (DCF) ANALYSIS

		Perpetuity Growth Rate				
	$ 4.53	1.5%	2.0%	**2.5%**	3.0%	3.5%
WACC	7.4%	4.69	5.13	5.67	6.32	7.14
	7.9%	4.25	4.61	5.04	5.57	6.21
	8.4%	3.86	4.17	**4.53**	4.96	5.47
	8.9%	3.54	3.80	4.10	4.45	4.87
	9.4%	3.25	3.48	3.73	4.03	4.38

Please click on the table to access full model.

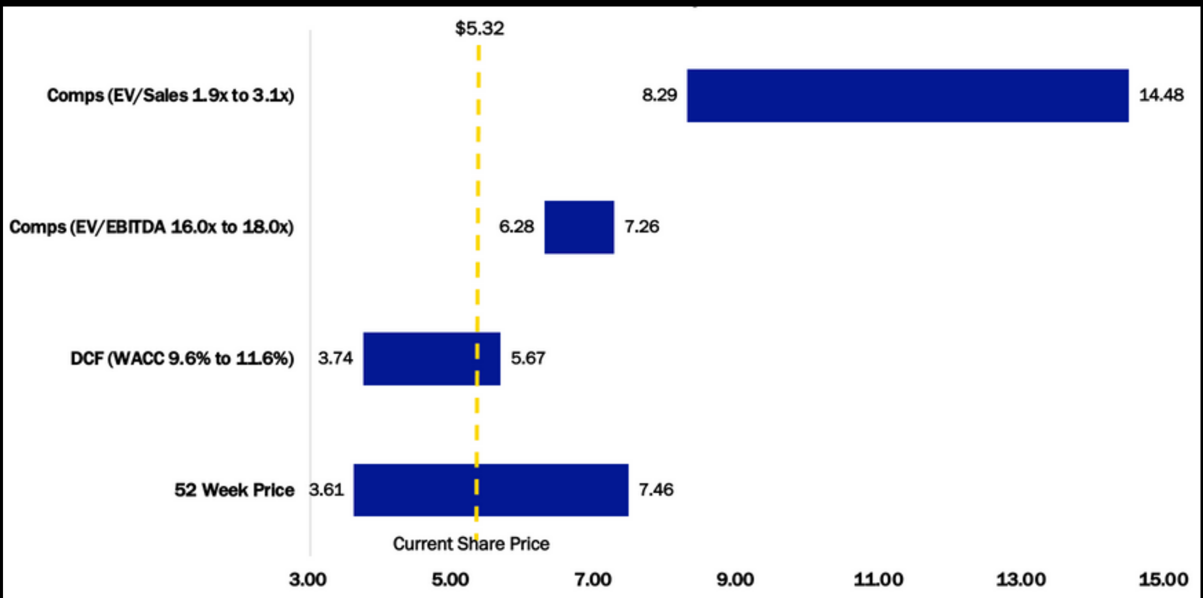
The Discounted Cash Flow (DCF) Analysis was used to calculate the value of Natura&Co's share price, Aēsop's parent company. This choice was made due to the lack of publicly available information on Aēsop's specific financial data.

With a terminal growth rate of 2.5% and WACC of 8.4%, the company's share price was found to be $4.53. This is below Natura&Co's trading share price of $5.32 at the time the analysis was conducted.

In the DCF, a sensitivity analysis was also conducted, in which the implied share price of Natura&Co can be seen with varying figures of the Terminal Growth Rate (TGR), and the Weighted Average Cost of Capital (WACC), as seen in the table above.

VALUATION ANALYSIS

FOOTBALL FIELD ANALYSIS



<u>**Please click on the table to access full model.**</u>

The graph above shows the football field analysis of Natura&Co, highlighting how its current share price compares to the valuation range obtained in different analyses.

Comparing the share price of $5.32 to the DCF and 52-week price, it seems that Natura&Co was fairly valued by the market at the time it sold Aēsop.

However, this is contradicted by two comparable metrics, namely, EV/Sales and EV/EBITDA, which suggest that the share price could be between $6.28 and $14.48. These were selected out of the CCA Model, which identified 7 comparable companies with similar performance to Natura&Co.

CONCLUSION

In conclusion, L'Oréal's acquisition of Aesop marks a significant move in the beauty industry and demonstrates L'Oréal's strategic focus on expanding its portfolio of subsidiaries within the luxury beauty market.

With Aesop's strong brand ethos, distinctive product offerings, and successful global growth, the acquisition aligns well with L'Oréal's growth strategy. The deal not only provides L'Oréal with a highly regarded brand but also offers opportunities to tap into Aesop's already recorded growth potential, particularly in China and within the travel retail market.

Additionally, Aesop's 5x turnover and 22x the EBITDA for 2023, recent y-o-y growth rates of 20-30%, and its exceptional gross profit margin of 87.1 per cent in 2022, made it a very attractive target for L'Oréal and could be worth the valuation.

While the acquisition price is considered high, L'Oréal's extensive experience in integrating and growing acquired brands positions it well to maximise the value and potential of Aesop.

Overall, the merger seems to be a necessary move for L'Oréal given the competitive nature of the cosmetics industry and it is no doubt Aesop is an advantageous firm to merge with. The only question is whether the firm can successfully operate as one entity, but given its successes to date with previous acquisitions, we have strong reason to believe it can and will.

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GLOSSARY

CAPM Model: *Capital Asset Pricing Model is a method to estimate the WACC of a company by taking into account the expected rate of return for an investment*

EBIT: *Earnings before Interest and Tax. A useful measure in measuring a company's ability to undertake its operations and pay off debt.*

EPS: *Earnings per share represents company's net profit divided by the number of shares outstanding. It is a useful ratio used to compare companies in the same industry to understand profitability.*

Gross Proceeds: *The term refers to all the expenses incurred in the transaction, including broker commissions or legal fees.*

P/E Ratio: *Price to earnings ratio represents the company's share price divided by its earnings per share, a useful tool to determine the analyse company's share price relative to other players in the same industry*

Synergies: *Improved conditions of the acquirer company as a result of the revenue and cost integrations after a transaction.*

Terminal Growth Rate (TGR): *A growth rate that a company is expected to grow at forever based on the market and industry conditions.*

Valuation Multiples: *Financial tool providing one metric as a ratio of another; often used to compare similar companies.*

WACC: *Cost of capital used to represent a firm's after-tax costs from all resources.*