5-9-2020

Beyond a Tube of Red Lipstick: An Economic Valuation of Estee Lauder and the Beauty Industry

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LMU|LA
University Honors Program

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A thesis submitted in partial satisfaction

of the requirements of the University Honors Program

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by

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March 2020

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ABSTRACT

The current valuation of the beauty industry is approximately $532 billion, yet this industry is not commonly suggested by investment professionals as a way to add diversification into their investors' portfolios. The current craze of the market is technology and fossil fuels, but the beauty industry has remained a major player in consumer spending patterns throughout time. Through examining the historical financial statements of the publicly-traded cosmetic conglomerate Estēe Lauder, as well as several of its competitors, I modeled the future valuation of Estēe Lauder using the Discounted Free Cash Flow and Comparable Firm Multiples models. This analysis demonstrated how large changes in the overall market impacted their value and key financial metrics, as well as their historical growth trends and potential for future expansion. I also explored where the beauty industry stands today and the kinds of changes that could disrupt the industry in the future. In order to explore these questions and create my models, I used financial databases such as Mergent Online and the SEC's EDGAR, different modeling techniques, expert articles, personal reflection, and financial statement analysis methods to ultimately develop a working Excel model and written thesis report. My work encapsulates the constant presence of the beauty industry within consumer spending habits, as it is only slightly impacted by changes in the larger market relative to many other industries considered to be "non-essentials." It also highlights the way in which investors ought to consider exploring the beauty and cosmetic industry as a way to diversify their portfolios to create lower unsystematic risk. The focus of this report could allow for greater exploration by investors into untraditional industries and companies, particularly within beauty, and encourage further education on how social media trends could impact industries beyond beauty.

INTRODUCTION

The beauty industry has been a part of the lives of people for centuries. It has taken many forms, but the most modern version has seen the capitalization and commercialization of beauty products. Every person participates in this industry and, despite fluctuations in trends, economic states, and interests, beauty products have remained constant components in the lives of people across the world. An article published by Business Insider in July of 2019 noted that the beauty industry is valued at $532 billion and only stands to gain value.[1] This valuation and projection are astounding for a category of products often labeled as “frivolous” and “excessive,” and, as such, worth dissecting to better understand where consumers are spending their money. Traditional investment strategies dictate that diversification is the way to eliminate some risk, particularly for risk-averse or newer investors. The beauty industry could represent an interesting addition to portfolios, and this examination will zoom in on one example of a largely successful, publicly-traded brand: Estēe Lauder.

Estēe Lauder is a more traditionally well-known brand itself, but what is not always known is that they own a conglomerate of popular brands in addition to their flagship products. However, despite their success, investors and enthusiasts might be curious to better understand how the company performs during differing stages of the economy and if the current trends will have any impact on their brands. This report will investigate further into the company, the beauty industry as a whole, and the potential disruptions heading its way.

<u>RESEARCH QUESTIONS</u>

In this report, the following questions will be explored:

[1] Bethany Biron, “Beauty has blown up to be a $532 billion industry - and analysts say that these 4 trends will make it even bigger,” Beauty Multibillion Industry, Business Insider, July 9, 2019, https://www.businessinsider.com/beauty-multibillion-industry-trends-future-2019-7.

1. What is the impact of different economic states on the financial health of the company, particularly when examining key financial ratios and metrics?
2. Where does the company's valuation on a price per share basis stand today given the historical trends reflected in the company's financial statements?
3. What kinds of industry changes could disrupt the growth of the company in the future of which potential investors should monitor and be aware?

LITERATURE REVIEW

In order to provide background context, understanding one of the most important theories in modern finance is critical: the Modern Portfolio Theory. This "theory was published by Harry Markowitz in the Journal of Finance in 1952" and while he was certainly not the first person to have explored the impact of diversification, he quantified and effectively labeled a formula for investors to use in their own analyses.[2] This article, by Wayne Duggan from U.S. News, outlines the basic concepts and history behind Modern Portfolio Theory. It serves as a strong introduction to this important concept, and points out the complexities of incorporating many factors beyond simply buying many different stocks. One of the key points brought up by the article is that diversification done efficiently by following the guidelines of the theory can minimize risk in portfolios. There has been substantial research on this theory and its effects, and while this has created key contributions to the field of financial research, it is not the ultimate focus of this report. Thus, this article serves as a clear basis to understand that diversification is a tried-and-

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[2] Wayne Dugga, "What Is Modern Portfolio Theory?," Buy and Hold Strategy, U.S. News, January 12, 2018, https://money.usnews.com/investing/buy-and-hold-strategy/articles/2018-01-12/what-is-modern-portfolio-theory.

tested tool that investors can use to change their risk levels. However, this report can branch out and look at how this mindset can be applied when looking at industries to invest in.

In conducting more research into previously published investigations into the beauty industry and investment, a 2016 thesis examined the impacts of various financial ratios on the stock returns of three well-known cosmetic companies in Indonesia.[3] Each of the companies had been experiencing positive sales growth each quarter but was also showing a declining return when it came to equity. The key finding from her report was that "ROE [Return on Equity] is the variable that has the strongest influence on the stock return of cosmetic companies." While this analysis was useful in better understanding how to read financial ratios with regard to cosmetic company returns, it focuses on a very different part of the world from this analysis and thus leaves room for more exploration into the major players of the U.S. beauty industry specifically.

A report completed by Saimanee Khotmanee in January of 2019 explored a CAPM analysis of whether or not to invest in the cosmetics industry.[4] It synthesizes several key sources and ultimately uses the Capital Asset Pricing Model to "analyze the expected return of each" of the four companies that were selected. The analysis covers Estēe Lauder, L'Oreal, Dior, and Revlon. While the report is thorough in its CAPM analysis and in providing background context to the beauty industry as a diversification tool, it doesn't dive deeper into the industry and relevant changes that are happening right now. It also only uses one methodology of identifying which of the four companies to invest in; there is more room for analysis into valuing companies,

[3] Sisca Suci Elyana, "The Influence of Debt and Profitability Ratios on the Stock Return of Cosmetic Companies," *President University Repository* (014201300142), http://repository.president.ac.id/handle/123456789/1702.
[4] Saimanee Khotmanee, "Does Cosmetic Market in the U.S. Worth to Invest?," Social Science Research Network (SSRN-id3323168), January 26, 2019, https://ssrn.com/abstract=3323168.

dissecting different financial ratios, and gaining a clearer understanding of the industry as a whole.

One of the sources the aforementioned report was an article published by TD Ameritrade as a beginning introduction for investors into getting a sense of what the beauty industry holds.[5] It synthesizes the main players in the industry and provides background numbers like a breakdown of the cosmetic market by geographic zone, but most importantly identifies a couple shifts that have taken place in terms of products and demand. Having this in literature is important and while the article mentions a couple of examples, it fails to address the impacts of social media, cult brands, and other current industry realities. It encourages readers to reach out to their investment staff to get more information, but this might not be an accessible route for those who are simply curious about the beauty industry from a finance perspective.

Beyond these sources, the literature available on this topic is highly limited, leaving lots of room for further investigation and discussion. Thus, this report is seemingly very unique in its incorporation of a detailed Excel model using two different valuation methods, as well as a further investigation into the industry itself by looking at economic market impacts and potential disruptions.

REPORT METHODS

The methodology behind this report is divided into two main sections for clarity: the written report and the model.

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[5] Ticker Tape Editors, "Beauty and Cosmetics Stocks: Diving Into A Multibillion Dollar Industry," Stocks & Stock Sectors, TD Ameritrade, August 27, 2018, https://tickertape.tdameritrade.com/investing/beauty-industry-stocks-16947.

The report was constructed after conducting the literature review as aforementioned. The discussion of the report explores the third research question and is broken into several sections to better analyze the related sources. It will begin by taking a closer look at Estēe Lauder itself, including its history, portfolio of brands, and organizational structure. It will also outline an analysis of its financial statements as are available through the Securities and Exchange Commission's EDGAR filing site. Next, it will zoom out to view the beauty industry as a whole and examine some of the major players. Estēe Lauder and other large beauty holding companies have accumulated a number of popular brands under their umbrellas and by better understanding these competitors, the model and analysis are given appropriate context.

After that point, it will dive into how YouTube and social media have elevated the launches and success of beauty gurus and various cult brands, such as Jeffree Star Cosmetics and Kylie Cosmetics. Finally, it will cover some key observations about the United States market currently as well as potential changes in the coming future. The purpose behind exploring these topics is to not only identify industry changes actively happening, but also to create a broader context of the financial health historically of the company. To finish off the discussion, the report will note some general assumptions surrounding the United States market in particular as it stands today and any key things to note in the future.

MODEL ASSUMPTIONS

The model created to answer the first two research questions represents two different valuation methods: (1) Discounted Free Cash Flows, and (2) Comparable Firm Multiples. Each was used to incorporate both an analysis of the individual company's financial statements while also taking a closer look at how its competitors might influence the way in which the company is valued. Each model stems from the same financial statement information taken from Mergent

Online, and thus the formatting remains consistent across each company's financial statements. Each sheet is appropriately labeled so as to create clarity and each model was conducted on a separate sheet with a summary page to showcase the two answers side-by-side. This was important to the methodology of the report as it creates clear distinctions between the valuation work being done in each situation. Additionally, the model was formulated using a number of assumptions, which are dictated below:

1. 15 years of annualized financial data was determined to be a good reflection of each company in order to include data from the 2008 Recession while still capturing the positive growth of the market in recent years.
2. The EBITDA margin, depreciation margin, net working capital as a percentage of sales, capital expenditures as a percentage of sales as calculated from the Statement of Cash Flows, and tax rate were calculated from the historical data and remained the same in both the forecast and terminal windows for simplicity.
3. The forecast window sales growth rate is projected to be slightly higher than the historical growth rate to accommodate for the estimated future state of the U.S. market as well as continued product expansion and brand advertising efforts.
4. The terminal sales growth rate is projected to be lower than the historical growth rate to more reasonably reflect future changes in the market and the company. It matches average growth rates of the market as a whole over time.
5. The equity beta was calculated using the adjusted closing prices on a weekly basis from both EL and S&P 500 Index for the past 15 years and can be found on the sheet "Beta_Calc".
6. The risk-free rate (Rf) was taken from data provided thanks to the U.S. Treasury.

7. The market risk premium (MRP) was taken from data provided thanks to KPMG.
8. The implied spread was taken from the data chart provided thanks to Damodaran Online.
9. The number of shares outstanding was taken from the income statement to reflect accurate comparisons with other financial data included.
10. The forecast window was calculated for the next ten years to reflect a healthier estimate of growth before calculating the terminal window values.
11. The comparable firm multiples were calculated to reflect two common measures of multiples: (1) EV / Revenues, and (2) EV / EBITDA. The formulas to calculate these stayed consistent for continuity.
12. All prices per share were taken from Yahoo Finance to reflect current data that was consistent from the same source.
13. All number of shares outstanding were taken from the income statements of each firm.
14. The financial ratios for Estēe Lauder were calculated to reflect accurately for each year in order to show general trends of data across the ratios year-to-year.

RESULTS

The following table synthesizes the impact on revenues and net income for Estēe Lauder dependent upon different states of the United States economy. The general categories pictured below encapsulate the overall market conditions that have been witnessed in the United States over the past 15 years, and the estimated values in coordination with each category have been averaged based on the data available in the financial statements of the company. All amounts are presented in thousands of USD.

U.S. Market State	Average Revenue	Average EBITDA	Average Net Income
Recession	$7,424,0333	$896,967	$247,133
Growth	$10,223,558	$1,792,075	$942,592

The following table demonstrates the range of financial ratios calculated using the past 15 years of financial statement data from Estēe Lauder. It shows the highest and lowest outputs, as well as the coordinating years and ranges for the data.

Ratio	Highest (Year)	Lowest (Year)	Range
Current Ratio	2.35 (2014)	1.49 (2007)	0.86
Quick Ratio	1.72 (2014)	0.92 (2007)	0.80
Debt to Equity (D/E)	0.96 (2007)	0.35 (2014)	0.61
Equity to Total Assets	0.49 (2014)	0.29 (2007)	0.20
Total Liabilities to Total Assets	0.70 (2007)	0.51 (2014)	0.19
Times Interest Earned Coverage	51.84 (2005)	5.53 (2009)	46.31
Inventory Turnover	2.26 (2010)	1.67 (2015)	0.59
Total Asset Turnover (TAT)	1.78 (2007)	1.13 (2018)	0.65
Net Profit Margin	12.07% (2019)	2.98% (2009)	9.09%
Return on Equity (ROE)	39.34% (2019)	13.26% (2009)	26.08%
Return on Assets (ROA)	16.11% (2014)	4.29% (2009)	11.82%
Return on Invested Capital (ROIC)	16.68% (2014)	4.97% (2009)	11.71%

The following table highlights the valuation conclusions of the Estēe Lauder model.

Method	Price
Discounted Free Cash Flows / Weighted Average Cost of Capital	$171.66

Comparable Firm Ratios: (1) EV / Revenues and (2) EV / EBITDA	$144.26
Current Market Price Per Share (as of February 2020)	$183.60

DISCUSSION

This section of the report will explore deeper into Estēe Lauder and the beauty industry to provide context for the valuation model while also highlighting disruptions in the industry.

A COMPANY PROFILE OF ESTĒE LAUDER

This portion of the report will provide context into Estēe Lauder itself and give background into why the model was set up in the way it was. Additionally, it creates a baseline from which comparable firms were pulled when conducting the comparable firms multiples model. It will discuss the history of the company and its founder, as well as its portfolio overview, before turning towards a financial statement analysis in conjunction with the model data.

THE WOMAN BEHIND THE NAME

Estēe Lauder was founded in 1946 by Josephine Esther (Estēe) Lauder and her husband, Joseph H Lauder. She had experience with making her own beauty creams after working with her uncle who was a chemist, and subsequently began exploring the world of beauty through her own product development and experimentation.[6] She started the company by introducing four original products that were packaged as a set to be used together; this package was sold in various Manhattan beauty salons as Lauder did demonstrations and makeovers for free to spread the word.[7] The packaged product set included a cleansing oil, cream pack, skin lotion, and an all-purpose skin cream - her reputation eventually gained her the first breakthrough as Saks Fifth

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[6] Biography.com Editors, "Estēe Lauder Biography," Biography.com, A&E Television Networks, August 22, 2019, https://www.biography.com/business-figure/Estēe-lauder.
[7] "Key Moments," Estēe Lauder Companies, https://www.elcompanies.com/en/who-we-are/key-moments.

Avenue ordered $810 of her products. Another early marketing tool that Lauder employed was the now-famous "Gift with Purchase," wherein Lauder would thank paying customers by including a sample or travel-sized version of new products the company was testing. Not only did this yield happy customers who felt special for receiving an additional product, but it also gave the company active market feedback on new products. Over time, the brand acquired other brands and also started the Aramis and Clinique brands to attract new target demographics.

From an organizational standpoint, Estēe Lauder represents a holding company of around 28 major brands including their originally-named brand. While publicly traded on the New York Stock Exchange (EL), the original Lauder family still controls much of the leadership and direction of the firm.[8] The current Chairman Emeritus is Leonard Lauder, one of two sons of Estēe and Joseph, and he has in his time formally at the company served as its President, Chief Executive Officer, and Chairman. Their other son Ronald Lauder is currently the Chairman of Clinique Laboratories and an Executive Officer of the Company; additionally, he is credited by the company for making the Clinique brand profitable and the household name it is today. William P. Lauder is the son of Leonard and the current Executive Chairman and Chairman of the Board of Directors. He started the with the firm in 1986 and was the leader in the creation of the Origins brand, after which he continued to serve as the Chief Operating Officer and Chief Executive Officer. Two of Ronald's daughters, Aerin Lauder and Jane Lauder, are also executive officers for the company, serving as brand representatives and leaders for Aerin and Clinique, respectively.

Investors might want to take note of this tight family control despite the firm being publicly traded. Much of the success of the company has been found from continued familial

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[8] "A Family in Business," Estēe Lauder Companies, https://www.elcompanies.com/en/who-we-are/the-lauder-family/a-family-in-business.

involvement and control over key leadership positions, and it is likely that this trend will continue. While they have demonstrated successful track records, disruptions in the beauty industry may require company changes and this could be a stumbling block for Estēe Lauder if the family is not willing to give up control or they are not able to find effective people to fill those gaps. Investors can take a look at this element more in their assessment of if this stock makes sense to invest in as a diversification method.

A BRAND PORTFOLIO REVIEW

The following chart illustrates the current portfolio of brands housed under the company.[9]

Company	Year Founded	Brand Description
Aerin Beauty	2012	Luxury lifestyle beauty brand 3 lines of feminine fragrance and body products
Aramis	1963	Prestige men's fragrance sold in department stores 20 products in men's grooming market
Aveda	1978	Lifestyle hair and skin care brand Leading high-performance, plant-based products 9000+ salons and spas worldwide
Becca	2001	Lifestyle complexion products World's best-selling highlighter, 50/50 shade focus
Bobbi Brown	1991	Prestige beauty brand with assortment of cosmetics 2 long-wear gel eyeliners sold globally every minute
Bumble and Bumble	1977	Prestige hair care brand started from an NYC salon Combination of product creation team and 2 salons
Clinique	1968	Lifestyle skin care brand that's allergy tested Custom-fit & fragrance-free with 22,000 consultants
Darphin	1958	Luxury botanical skincare brand Sold in 47 countries and territories
DKNY (licensee)	1985	Multifaceted prestige lifestyle fragrance brand Sells a "Be Delicious" apple every 16 seconds

[9] "Our Brands," Estēe Lauder Companies, https://www.elcompanies.com/en/our-brands.

DonnaKaran (licensee)	1994	Luxury fragrances and body product brand Variety of scent products that are highly popular
Editions De Parfums Frederic Malle	2000	Luxury perfume brand with an original concept 14 exclusive scents developed for the collection
Ermenegildo Zegna	1992	Luxury men's fragrance brand Underscored elegance and style based on Bergamot
Estēe Lauder	1946	Flagship skincare and makeup brand of the company Sold in 150 countries around the world
GlamGlow	2010	Premium professional treatment brand 6 mud treatments, sold in 52 countries and territories
Jo Malone	2011	Contemporary fragrance and lifestyle brand Sold in 67 markets, products for bath, body and home
Kilian	2007	Luxury fragrance brand with over 30 fragrances 5 different product categories available
Kiton	1995	Luxury men's fragrance brand 52 boutiques worldwide
La Mer	1995	Luxury, most top-rated skincare brand in the world 12 years of craftsmanship to discover base formula
Lab Series	1987	Premium men's only skincare brand Sold in over 30 countries and territories
Le Labo	2006	Premium unisex fragrance brand 18 different formulated fragrances and 10 soy candles
MAC	1984	Premium makeup brand supporting all people 19,000 makeup artists around the world
Michael Kors (licensee)	2000	Luxury fragrance brand with same luxury as brand Distinct personality for each fragrance
Origins	1990	Prestige natural skin care brand 1.3 million trees planted around the world
Rodin	2008	Luxury botanical skincare brand Oil-based product line with artisanal focus
Smashbox	1996	Premium makeup brand started from a photo studio Number 1 selling face primer in the U.S.
Tom Ford Beauty	2006	Luxury cosmetic and fragrance brand

(licensee)		Collections of unisex scents and a color collection
Tommy Hilfiger (licensee)	1969	Premium All-American fragrance brand Available in 120 countries and territories
Too Faced	1998	Premium cosmetic brand 1 Better Than Sex mascara sold every 7.5 seconds

15 YEARS LATER: THE FINANCIAL STATEMENTS

The financial statements, which includes the balance sheet, income statement, and statement of cash flows, were taken from the Mergent Online site for the past 15 years. Estēe Lauder's statements can be found on the appropriately labeled worksheets in the Excel workbook for further reference. A variety of financial ratios were calculated for each of the last 15 years in order to map out different trends for the company, which are particularly insightful when looking at times of severe economic decline like the 2008 Recession. The second table provided in the "Results" section of the paper also creates ranges presented by each ratio for clarity on the change that has happened over the course of 15 years.

One important ratio is the Current Ratio, which was at its lowest point in 2007 at 1.49 but was at its peak in 2014 at 2.35. This ratio measures current assets to current liabilities and it should be noted that even at its lowest point, the ratio stands at a healthy rate. When examining the Debt to Equity ratio, the data noted that while this ratio was at its highest and most balanced in 2007, 2006 saw a ratio of 0.36 which signals that the company took on more debt right before the financial crash of 2008. This likely set them up for greater protection as they received the benefit of the tax shield while simultaneously setting up a net for themselves when the market crashed. However, in 2009, they also faced their lowest amount of Times Interest Earned coverage, coming in 5.53, and this was due in part to their higher amount of debt. The next year, their TIE went up, the D/E went down, and the rest of the ratios stayed relatively constant as in years past. The company hasn't faced much ratio change on a larger scale over the past 15 years, even with a major recession globally. It begs the question that from a financial perspective, Estēe Lauder weathered the financial crisis quite well.

Several other ratios, including Net Profit Margin, Return on Assets, Return on Equity, and Return on Invested Capital, all have indicated general stability year-to-year. 2019 was a particularly successful year as each of these ratios increased from 2018, indicating stronger returns for investors and for the company as a whole. 2009 was the one year that saw lower ratios for each of these four categories relative to other years, which connects with the lowest TIE coverage ratio as well. Needless to say, the impact of the 2008 crisis did not wreak havoc on their books but it did create a lower end to their range of data to provide greater context into how the company is doing currently.

THE NOTABLE NAMES OF THE BEAUTY INDUSTRY

Through frequent merger and acquisition activity, many of the brands that are sold on the shelves of cosmetic shops, mass retailers like CVS and Walgreens, and at beauty counters across the world are owned by a very small number of holding companies. In 2017, "182 beauty companies are owned by seven major leaders"[10] and this has subsequently given substantial power for these companies to control the images, expectations, and standards of beauty. Each company also has a healthy blend of brands that fall into different price tiers, subsequently allowing all seven companies to continue targeting every tier of customer. This is a beneficial blend of brands to have because they can impact the way that all people see beauty, which subsequently keeps consistency across products and desired results, regardless of price tier. For a more detailed look at which companies own which brands, please reference Exhibit 1.

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[10] Megan Willett and Skye Gould, "These 7 Companies Control Almost Every Single Beauty Product You Buy," Insider, May 18, 2017, https://www.insider.com/companies-beauty-brands-connected-2017-5.

Within the context of this report, four of these companies were used as comparable firms to Estēe Lauder, but it also included Revlon, which is not among the top seven firms. The breakdown of the brand portfolio and basic information about each company can be found in the table below.

Company	**Year Founded**	**Share Price**	**Notable Brands**
Revlon[11]	1910	$17.31	Revlon, Elizabeth Arden, Almay, American Crew, CND, Cutex, Sinful Colors, Mitchum, AllSaints, John Varvatos, Juicy Couture
Coty[12]	1094	$9.23	Covergirl, Burberry, Wella, Adidas, Calvin Klein Fragrances, OPI, Clairol, Gucci, GHD, Rimmel London, Boss by Hugo Boss, Bourjois, Chloe, Nioxin, Sally Hansen, Tiffany & Co, Bottega Veneta, Marc Jacobs Fragrances, Miu Miu, Alexander McQueen, Balenciaga, Philosophy, Lacoste, Stella McCartney
Unilever[13]	1930	$53.93	Axe, Clear, Dove, Fair & Lovely, Lux, Clear, Citra, Pond's, Simple, St. Ives, Suave, TIGI
P&G[14]	1837	$113.23	Heads & Shoulders, Aussie, Herbal Essences, Old Spice, Pantene, Ivory, Olay, Secret, SK-II, Native, Snowberry
L'Oreal[15]	1909	$265.77	Lancome, Yves Saint Laurent Beaute, Kiehl's, Urban Decay, Giorgio Armani, Ralph Lauren, Clarisonic, Atelier Cologne, IT Cosmetics, L'Oreal Paris, Garnier, Maybelline New York, Essie, NYX Professional MakeUp, Redken, Pureology, Matrix, Biolage, CeraVe, Vichy, Sanoflore, Roger&Gallet, SkinCeuticals

11 "Our Brands," Revlon, https://www.revloninc.com/our-brands.
12 "Brands That Inspire," Coty, https://www.coty.com/brands.
13 "Our Brands," Unilever, https://www.unilever.com/brands/?Category=408114&page=1.
14 "Brands," P&G, https://us.pg.com/brands/#skin.
15 "Brands," L'Oreal, https://www.loreal.com/brand.

INDIE "CULT" BRANDS AND THE SOCIAL MEDIA REVOLUTION

This next section will delve deeper into the disruptions and changes that are currently impacting the beauty industry. It focuses on the ways in which social media, indie brands, beauty gurus, and influencers have changed how consumers are viewing beauty and interacting with creators.

SHANE X JEFFREE: THE DOCU-SERIES THAT BROKE THE INTERNET

On October 1, 2019, Shane Dawson released the first episode of his newest documentary series on YouTube titled "The Beautiful World of Jeffree Star." It promised a deep dive into the creative process, the drama, and the adventure behind creating a makeup collaboration with Jeffree Star Cosmetics. The running time for the first episode was one hour and eleven seconds and to date it has 26,761,937 views on YouTube.[16] 144 million views, 7 episodes, and 1 record-breaking makeup collection later, this docu-series broke the internet. For an image of the series from YouTube, see Exhibit Two. Due to the excitement generated from the docu-series, Shopify, the largest online ecommerce platform in the world, actually broke from the millions of people logging onto the Jeffree Star Cosmetics website to try and buy an item from the highly anticipated makeup collection on its launch day. However, the traffic did not just break the website itself; it broke the entirety of the Shopify platform, which had not happened in history.[17] Panic ensued across social media sites, and nearly three hours later, people began checking out with the products.

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[16] Shane Dawson, "The Beautiful World of Jeffree Star," YouTube video, 1:00:11, October 1, 2019, https://www.youtube.com/watch?v=JWukx3HGBKI&list=PLDs0tNoNYTz05R0xo7PCVc-RgL2fsJnGg&index=2&t=0s.

[17] Paige Leskin, "The Frenzy Around YouTubers Jeffree Star and Shane Dawson's Makeup Collection Crashed the Website, and People are Freaking Out," Business Insider, November 1, 2019, https://www.businessinsider.com/youtube-jeffree-star-shane-dawson-cosmetics-makeup-palette-website-crash-2019-11.

Jeffree Star Cosmetics had manufactured 1.1 million eyeshadow palettes, which sold out within the first day of the launch. This number did not include the two makeup bags, exclusive sweatshirts and joggers, six liquid lip products, clear lip gloss, lip balm, two hand mirrors, and two side bags.[18] All of these products also sold out within the first day. It was an unprecedented level of production for an newer indie makeup brand, and an unprecedented level of sales in an unprecedented amount of time.

The combination of the docu-series and the Internet-breaking launch demonstrated the incredible power behind harnessing an audience through social media. This was, at its core, an ad campaign for the collaboration taken to a whole new level. Traditional ad campaigns often include billboards, tv advertisements, website banners, social media hashtags and interactive ads, or even paying influencers to post content with the products. However, the Shane X Jeffree collaboration set a new level of transparency and initiated a month-long process of in-depth advertising that has not been seen on this scale before. The major names of beauty including Estēe Lauder certainly would have the resources to be able to engage with a new audience in this type of way; the question is if they would do so. As indie brands like Jeffree Star Cosmetics gain notoriety and popularity with younger generations based on its active social media and YouTube presence, these major brands ought to be aware of the potential for industry disruption.

KEEPING UP WITH KYLIE COSMETICS

Kylie Jenner recently splashed across headlines once again, but with an interesting update about her cosmetics company: she sold 51% of ownership to the brand Coty for $600 million in

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[18] "Shane X Jeffree Conspiracy Collection," Jeffree Star Cosmetics, https://jeffreestarcosmetics.com/collections/shane-x-jeffree-conspiracy-collection.

November 2019.[19] While her brand is private and does not release full financials to the general public, basic math put the purchase price into context and demonstrated that her company was valued at $1.2 billion in total, just four years after she started her brand. Coty has not yet fully released their reasoning behind the acquisition and the extremely high valuation, as the deal is set to close in the latter part of 2020, but it does show the impact and desirability of brands coming from social media influencers. This move would likely bring a younger, trendier audience to Coty and potentially open up their other brands to new target demographics.

Regardless of whether or not she is "self-made," the development of her brand and its notable success in such a short time is unique to the industry. Kylie Jenner is fortunate enough to have had exposure to the world from an early age due to the reality show starring her family, "Keeping Up With the Kardashians." With the advent of instagram and snapchat at the same time, Kylie harnessed her platform and gained a substantial following, allowing her to begin her company through her own funding and keep 100% control over the brand. The major players aforementioned in the industry took decades to get to the level of market share and financials that they are currently reporting, as well as taking advantage of merger and acquisition opportunities. Kim Kardashian has had similar success in creating and promoting her own brands, like KKW Beauty and Skims. This type of brand and company development that highlights aggressive growth and social media presence is a disruption to the current beauty industry as it follows untraditional growth patterns. Brands like Estēe Lauder should be aware of the impact this has on their younger audiences, especially as the consumers become more educated and require the

[19] Mallika Mitra, "Coty buys majority stake in Kylie Cosmetics, hoping to expand the brand globally and into new categories," Retail, CNBC, November 18, 2019, https://www.cnbc.com/2019/11/18/coty-buys-majority-stake-in-kylie-cosmetics-shares-jump.html.

transparency, social media engagement, and exclusive feeling provided by these indie brands. Investors should also take note of these changes, particularly if they are interested in investing.

THE BEAUTY GURUS

Through the development of social media and YouTube, the "beauty guru" has appeared. These individuals commonly have YouTube channels where they discuss various makeup products, new launches, tutorials, and trends; with growing viewers and subscriber counts, they have been able to secure brand deals, their own collaborations, and can impact the way in which young people view the beauty industry. While it can be a more inclusive community by allowing non-traditionally beautiful people to experiment and gain an audience, it also has become toxic at times, with the rise of "cancel culture" and potentially unrealistic expectations. One thing to note within this community is the fact that while all kinds of people are demonstrating how to use makeup and reviewing products, it does not necessarily shatter traditional beauty ideals in a large way. This community certainly has social influence but has not yet managed to undertake the major players like Estēe Lauder in the industry.

It is worth watching how these beauty gurus evolve their personal brands, especially as they partner with makeup brands to create limited edition product lines. Key beauty gurus include NikkieTutorials, James Charles, Tati Westbrook, and and RCLBeauty101. These individuals have a combined 54.35 million subscribers on YouTube and post impactful content relating to beauty. Each have had their share of scandals and "apology" videos, yet each has also made a comeback in terms of subscribers and view counts. They have significant sway into how people, particularly their subscribers, view the industry. The future interactions of these individuals and those that will follow with the major players could define the changes to come.

THE UNITED STATES ECONOMY: TODAY AND TOMORROW

Since the 2016 election, the economy has had a steady upward projection and relatively healthy gains. The model has demonstrated that even through recessions, the major beauty models like Estēe Lauder have maintained growth patterns in terms of sales. As the economy ebbs and flows on minor changes, the beauty industry will not likely face an impact. However, as of March 2020, the world economy has been shaken by a health pandemic, COVID-19. Investors ought to explore deeper into how these kinds of economic changes that do not reflect common recessions would alter consumer spending.

CONCLUSION

1. What is the impact of different economic states on the financial health of the company, particularly when examining key financial ratios and metrics?

   The results have shown that Estēe Lauder has grown each year in terms of net sales despite major economic changes, i.e. the 2008 financial crisis. The current ratio has not dropped below 1.49, showing a healthy level of current assets to current liabilities. Additionally, they have relatively strong Times Interest Earned coverage year-to-year, signifying that they likely are able to receive better rates on any debt acquired. Net profit margin dipped during the recession but remained positive and did not fall lower than 2.98% in 2009. The table illustrating the range of ratios and their highest and lowest points simplifies the data presented by the calculations made on the "Summary" worksheet of the model. Essentially, regular economic fluctuations do not have a drastic impact on Estēe Lauder and its liquidity, solvency, or profitability. This is a key point for investors if they are looking for a relatively stable stock that might yield more constant returns.

2. Where does the company's valuation on a price per share basis stand today given the historical trends reflected in the company's financial statements?

   The current stock price as of February 2020 was $183.60, and the valuation model showed that this is currently a premium compared to what it generated to be a fair price of $171.66 when looking at the FCF / WACC model or $144.26 when looking at the Comps model. The disparity in terms of price currently and the current value is likely due to a desire to acquire stock of this well-regarded firm. Adjustments to the model can be made with additional financial data, but overall Estēe Lauder's equity represents a slightly overpriced investment based on conservative growth models.

3. What kinds of industry changes could disrupt the growth of the company in the future of which potential investors should monitor and be aware?

    The growing presence and influence of social media is one change that could impact the general expectations consumers have of the major names in the beauty industry. Beauty gurus and exceedingly successful indie brands have captive, malleable audiences with the power to turn hundreds of thousands of people toward and away from certain brands. Additionally, by leveraging the power of video documentation, certain influencers are setting records and drawing younger audiences into the space of beauty. While traditionally mothers and grandmothers would take their daughters to department stores to outfit them with a basic kit of products from Estēe Lauder or L'Oreal, younger users are now being pulled towards indie brands of people they interact with on social media. This ultimately might draw sales away from traditional brands, and the industry should be ready to embrace change.

All in all, investors ought to explore further into the beauty industry as a solid investment opportunity to add diversity into their portfolios. Companies like Estēe Lauder have a well-known and respected reputation with solid financials to back up their claims. Further research into this industry from the financial perspective is critical, and subsequent studies relating to other industries conducted in a similar manner would greatly broaden the resources available to the common investor. While some may continue to scoff at makeup as a want rather than a need, there is a whole lot more to this industry besides tubes of red lipstick.

EXHIBITS

<u>EXHIBIT ONE</u>

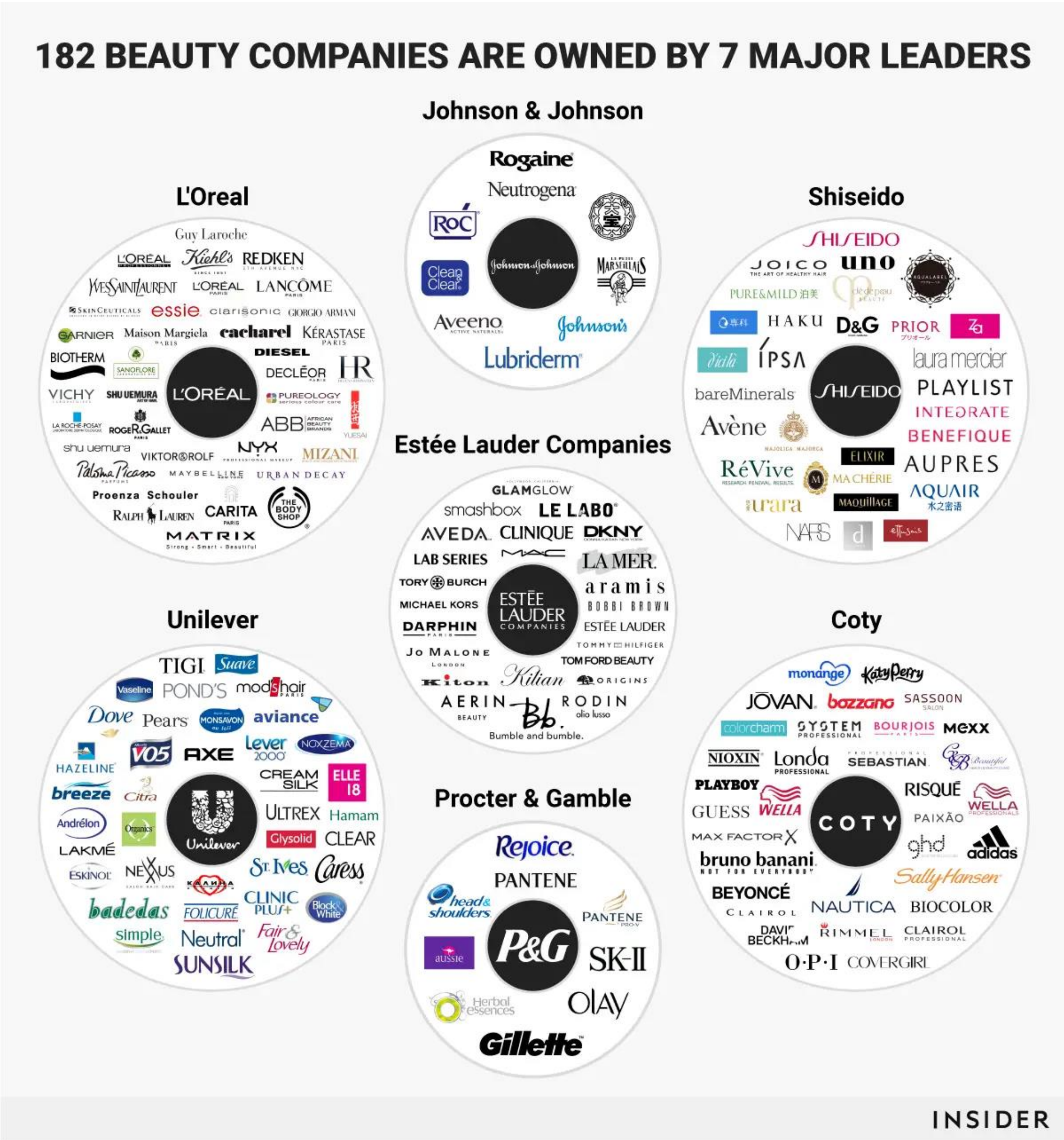
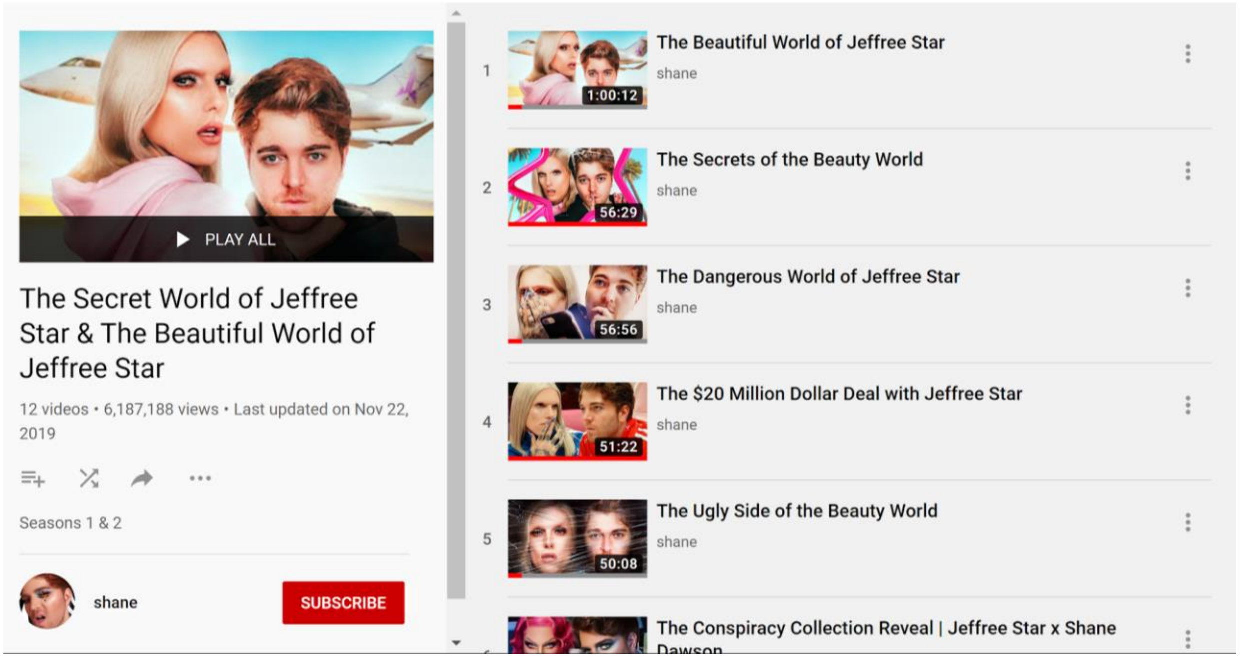


EXHIBIT TWO


PLAY ALL
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12 videos • 6,187,188 views • Last updated on Nov 22, 2019
Seasons 1 & 2
shane
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1
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The Beautiful World of Jeffree Star
shane
2
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The Secrets of the Beauty World
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3
56:56
The Dangerous World of Jeffree Star
shane
4
51:22
The $20 Million Dollar Deal with Jeffree Star
shane
5
50:08
The Ugly Side of the Beauty World
shane
The Conspiracy Collection Reveal | Jeffree Star x Shane