

BAIRD

DERMATOLOGICAL
BEAUTY CONNECT

BAIRD'S TAKEAWAYS

March 2024

BAIRD'S TAKEAWAYS FROM DERMATOLOGICAL BEAUTY CONNECT

We recently attended the inaugural Dermatological Beauty Connect conference in Miami, where we heard from a diverse array of speakers, including board-certified dermatologists, beauty service company founders, representatives from major retailers and private equity investors. The topic of the conference was the explosion of growth that we are seeing currently in the beauty services marketplace, with more consumers focusing on treatments and consultation to enhance their beauty regimens and with more capital being put to work funding different concepts. To be sure, it feels as if the convergence of beauty & wellness products with services is here to stay for a while, with the current \$20B marketplace for cosmetology services expected to grow at a double-digit pace over the next decade.

1. What's the Appeal of a Chemical Peel (or a Filler or an IV Drip)?
2. Beauty Services Can Offer the Utmost Personalization
3. Services and Products: Offering Both Seems to be a Winning Combination
4. Investing in Beauty Services: Lots to be Attracted to, but Also Lots to Be Wary of
5. Turning a Trend into an Enduring and Effective Offering Through Technology and Information Sharing
6. Marketing Beauty Services Has Its Own Unique Challenges, but the Consumer is Thirsty for Knowledge

WHAT'S THE APPEAL OF A CHEMICAL PEEL (OR A FILLER OR AN IV DRIP)?

- **“Wellness” is a priority for 80%+ of consumers.** While wellness can certainly be defined broadly, the concept of marrying products with services has taken off and an **increasing number of consumers are considering a wide range of beauty and wellness services to be a critical part of a healthy lifestyle.** Specifically, the co-founder of Restore Hyper Wellness shared that when the business started, they assumed that their core customer would be athletes looking for post-workout recovery treatments. However, it turns out that only 20% of their customer base is in fact athletes, with the majority being regular people who are focused on reducing everyday aches and pains to enable them to have more vitality and energy in life
- **The broad demographic appeal of beauty services is a compelling growth factor.** While in years past, the target customer base for medical aesthetics tended to be more affluent and older women looking for tummy tucks or traditional face lifts, **the development of newer, scientifically supported and generally more affordable procedures has led to a broadening of the consumer base interested in treatments. Consumers are increasingly focused on longevity, aiming not just for a longer life but also for overall health and wellness throughout their lifespan. And, for better or worse, the focus on that longevity seems to be resonating with younger generations** - with even Gen Z consumers expressing a genuine desire to take care of their skin and make healthy choices about their lifestyles
- Several speakers discussed the **headwinds to growth in the beauty services market.** First and foremost is the high **cost of certain treatments and the lack of insurance coverage** for most of them (e.g., most insurance companies consider aesthetic treatments to be optional, unless a doctor prescribes Botox to treat migraines, for example). Secondarily, while some consumers clearly prefer visiting a service provider in-person given the higher level of individual and private service they hope to receive, there is a **strong preference among certain cohorts for at-home treatments** (can I use an ingestible as opposed to an injectable and will supplements make me feel as healthy as an IV drip?). Lastly, but perhaps most importantly, **only ~17% of people in the U.S. have access to a dermatologist**, and with this in mind, larger retailers such as Ulta and CVS are committed to making highly effective products more accessible to a broader range of consumers and to offering education that might be helpful in lieu of access to a dermatologist or skilled aesthetician

BEAUTY SERVICES CAN OFFER THE UTMOST PERSONALIZATION

- For years, there has been discussion around the need for more personalized products when it comes to color cosmetics, skincare and haircare - ones that meet the needs of individual consumers regardless of their skin color, hair texture or personal preferences. Not surprisingly, then, **one contributing factor to the rise in popularity of beauty services is the degree of personalized attention a consumer can receive from a cosmetologist or dermatologist, whether it be with regard to a specific service or sometimes even the customization of a product formulation**
- Interestingly, **60% of women say that their health care provider does not listen to them.** Many of the speakers cited the **importance of developing a trusting relationship between the customer and their dermatologist or treatment provider** as a critical factor in growing a successful beauty services business. Indeed, **what makes a beauty services business lucrative is the recurring nature of the treatments** (e.g., injectables once a quarter, facials once a month, manicures every two weeks) and not surprisingly, **consumers only return for repeat (or additional) services when they believe the treatment they have had has been effective.** As such, **ensuring the highest levels of personal engagement with customers seems to be one of the most important features of a successful beauty service business**
- One challenge in providing personalized beauty services is that service providers may not fully understand the specific needs or goals of consumers due to differences in ethnic backgrounds and the subjective nature of beauty preferences. Indeed, **only 3% of dermatologists in the U.S. today are black and only 4% are Hispanic,** and as such, **consumers have complained in the past about the lack of representation as it affects their ability to find a professional that understands their needs.** We learned that there is a real **push in medical dermatology programs to ensure that not only more training is offered so providers are better equipped to offer the right advice to each consumer, but also to bring more culturally diverse people into dermatology practices**

SERVICES AND PRODUCTS: OFFERING BOTH SEEMS TO BE A WINNING COMBINATION

- The focus of the conference was on building successful beauty services businesses, but many of the speakers agreed that **offering own-branded products for the consumer to purchase as an adjunct to their services was a key enabler of their success**. Not only does **selling product in-store boost revenues for the service provider, but if done well, this strategy can also help build brand loyalty for the business**
- First, by offering a product whose brand is the same as the service provider, the customer is **repeatedly reminded of their experience**, and as such, **develops brand affinity** (assuming both the experience and the product are effective and meet their needs). In many cases, the **service provider makes their product available only in-store (not online or in broader retail), so when the customer wants a refill of the product, they generally return to the service provider for a repeat purchase**. That said, there are examples of where the product line actually grew to be even more successful than the services business (e.g., Drybar) such that it made sense for the brand to broaden distribution of the products
- Second, **by selling a product that is specifically formulated to complement a particular beauty service** (e.g., a gel to reduce swelling post fillers), **the service provider can bolster the efficacy of the treatment**. Jane Iredale, which has been in market for 30+ years, is a great example of a brand that has been particularly successful with this strategy. In this instance, the first “hero” product was a powder that worked especially well after certain treatments in a dermatologist’s office, and since then, the brand has remained one of the leading products sold in the professional channel

INVESTING IN BEAUTY SERVICES: LOTS TO BE ATTRACTED TO, BUT ALSO LOTS TO BE WARY OF

- In the past year, conversations with private equity investor rarely go by without a mention of beauty services and investor interest in the field. That said, the aggregate dollar volume of transactions in beauty services remains relatively low, especially compared to beauty products
- **Proven, large-scale winners in beauty services are limited**, beyond some successful waxing (think European Wax Center), laser (think LaserAway), or massage (think MassageEnvy) concepts. For more differentiated medical aesthetics (e.g., fillers, injectables, body sculpting), scalable brands across markets are even scarcer. Attractive unit economics in one region often fail to translate during expansion, as we've heard from many businesses
- One factor that makes **scaling a beauty services business challenging is the different types of regulatory approval needed by service providers**, which in many cases varies by state. Given the expense and importance of ensuring high quality operations, **many providers choose to maintain a relatively narrow focus - either in terms of the services they offer or the locations in which they operate**
- **Consistency of service is another challenge.** While there is a commodity aspect to certain services (you can get the same Botox injections anywhere, and nearly every spa seems to offer a HydraFacial), **the aesthetician or dermatologist performing the procedure makes the difference.** While appointment booking, check-in experience, and product offerings matter, a positive experience with the practitioner is paramount for customer retention. Therefore, **a consistent, high-quality workforce is crucial**
- All in, given that the level of unit growth in the industry has outpaced industry dollar growth for some time, it feels to us as if **there will likely be a degree of consolidation in the beauty services industry in coming years.** That said, how this consolidation occurs is a big question. **Deflation risk exists as some operators opt to become more promotional** in their efforts to win market share (come get your Botox and have a foot massage for free). There is also clearly a **risk that the beauty services industry is disrupted by more at-home innovations** (my quarterly Botox bill is more than \$1,000, could I replace that with an almost-as-effective "Botox-in-a-bottle" home treatment?)

TURNING A TREND INTO AN ENDURING AND EFFECTIVE OFFERING THROUGH TECHNOLOGY AND INFORMATION SHARING

- Given the importance of safety when it comes to many cosmetic procedures, we heard a fair amount of caution when it comes to “chasing trends” in the beauty services business. Clearly there are **high startup costs when it comes to beauty services** - in terms of training aestheticians and purchasing equipment - and therefore **while service providers seem to be keen to offer the “latest and best” treatment alternatives, concerns exist about rushing into (or trying to innovate and to create) trends too quickly**
- We did hear about the prevalence of “Ozempic face” as driving significant demand for solutions to sagging skin, insofar as when you lose considerable amounts of fat on your body, you tend to also lose elasticity and firmness in your face
- **Consumers are savvier than ever**, and the **crowded market makes it difficult to distinguish between treatments**, even though significant differences exist (e.g., not all injectables are fillers, and there are important distinctions between Botox and Restylane). As a result, some **service providers are investing heavily in clinical studies - and then in marketing to convey the results of those studies** - that support the effectiveness of the specific treatments they offer and which ones they recommend to particular customers.
- Another approach that we heard about involves **partnerships to enhance the effect of diagnostics**. Specifically, Restore Hyper Wellness shared that they have a partnership with Oura ring, and that they are leveraging the data from consumers who wear an Oura ring to optimize and target the treatment selection at Restore. On the other end of the spectrum, we heard that sometimes, **simply the emphasis of more traditional products and remedies can be very effective, albeit with a new marketing message attached** (e.g., while most people think a glass of orange juice is the most effective way to ingest Vitamin C, but the reality is that there are far more effective topical treatments to apply when using Vitamin C as a beauty product)

MARKETING BEAUTY SERVICES HAS ITS OWN UNIQUE CHALLENGES, BUT THE CONSUMER IS THIRSTY FOR KNOWLEDGE

- McKinsey reports a staggering **700% increase in consumer searches for "efficacy"** related to skincare products and services in recent years. This highlights a **significant shift towards evidence-based results in the beauty industry**. "Clean" had historically been a key buzzword when it comes to beauty, with consumer preferring products with fewer chemical and artificial additives; now, there seems to be a swing back to a preference for a **balance of "clinical and clean-ical"**. That said, we heard that there are some challenges that brands and marketers face when it comes to promoting beauty services specifically, as for example, TikTok does not allow brands to show needles or lasers in their messaging. While it is possible that certain social media restrictions will relax over time, for now, brands are working to be creative in getting their messages across to consumers.
- Not surprisingly, **influencers continue to be very effective at helping brands convey their points of differentiation** to consumers, so long as those influencers are perceived to be authentic in their messaging. **When it comes to beauty services, dermatologists tend to be among the most effective group of influencers**, and we heard from one board-certified dermatologist that he stopped seeing patients on Fridays so that he could devote that day to posting videos and blogging about the services and brands that he considers to be most effective (and which pay him a fee)
- One **unique angle that we heard about during the conference was from more traditional retailers such as Ulta and CVS**, who both benefit from the dynamic of consumers focusing more on their health and well-being, but who are also at risk of losing sales if those same consumers choose to purchase their products at their dermatologist's office or at their local day spa. To address this, both CVS and Ulta are **prioritizing a positive in-store experience**. They're **increasing the number of knowledgeable beauty consultants available and offering more educational materials in open-sell formats (brochures, graphics, etc.)**. Ulta specifically told us that while their average customer comes into their stores roughly 4x per year, they see huge opportunity to convert more shoppers to being "enthusiasts", who in fact tend to come into the store sometimes as often as 20x per year

BAIRD'S DIFFERENTIATED APPROACH TO BEAUTY & WELLNESS

BAIRD

- Dedicated senior team covering multiple sectors, from services to branded products and contract manufacturing
- Unmatched reputation for thought leadership in the category
- Track record of positioning businesses focused on the female consumer, with a deep understanding of business models
- Active dialogue across the spectrum of beauty, health & wellness brands – from early-stage brands to the large beauty consolidators
- Longstanding relationships with the strategic buyer universe
- World-class process execution



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kao

Kimberly-Clark

knix

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BRANDS

NU SKIN

prAna



Johnson

THYMES

WARBY
PARKER



The logo consists of the word "BAIRD" in a dark green, serif font, centered within a white trapezoidal shape that is wider at the top and tapers towards the bottom. The background of the entire page is a dense pattern of overlapping green leaves of various shades, from light to dark green, creating a textured, natural feel.

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