

Beauty is in the eye of the investor!

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Insync invested into Estée Lauder 3 years ago. Why did we, how is this investment progressing and what are its prospects?

To begin, Estée Lauder meets Insync's 3 key criteria;

1. It was (and still is) on the **right side of global disruption**, benefitting from global megatrends.
2. Is consistently highly profitable based on its ROIC (Return On Invested Capital)
3. Strong management that's future focused with its business well positioned

In aggregate these factors have once again combined to produce compounding growth in earnings and cash flows. Here's the Insync scoreboard on this count so far;

From \$87 per share to \$185.70 today. Equating to an annual compound rate of 28.7% p.a. (USD). Compare this to the MSCI (ex Aus) that returned just 12% p.a. over the same period.

We agree with its founder Estée; Yes, *"Everyone can be beautiful"*, and so are the returns for investors too. Insync's approach identifies great performers early into their sustained growth in profitability, whereas many of our peers come in well after.

Why we invested in Estee Lauder. The Lipstick Effect.

Today, the global beauty industry is a \$532 billion (USD) business. The world's largest beauty market is the USA, with about 20% share followed by China (13%) and Japan (8%). While projections for growth vary, most data points we are monitoring indicate that it will continue to advance at a 5% to 7% compound-annual-growth-rate (CAGR) to reach around \$800 billion by 2025. The beauty industry is a resilient one and is handling retail disruption with relative ease. With record retail store closures in all sectors globally, half the growth in beauty is online. This may be unsurprising, but it implies that the other half of the growth is from stores. It's hard to find another market segment where that's true. Should the world economy dip, the beauty business is more likely than other discretionary categories to hold its own. Its resilient, and this in Insync's opinion, is due to the "Lipstick Effect".

The Lipstick Effect: Professor Juliet Shor 'The Over-Spent American'

Asserts that consumers still spend money on small indulgences during recessions, economic downturns, or when they have little cash. They do not have enough to spend on big-ticket luxury items; however, most still find the cash for the purchase for small luxury items, such as premium lipstick. For this reason, companies that benefit from the lipstick effect tend to be resilient even during economic downturns. Another hallmark of Insync's investments, is that they endure through economic downturns.



How Disruption Impacts Beauty?

Low growth - low inflation is probably with us for a while yet. Combined with tectonic shifts in consumerism taking place at a time when technological advances are also occurring at breath taking pace, this creates a very challenging operating environment for most businesses and industries. This profoundly impacts the beauty industry and is one of the few 'consumer staples' where the incumbent behemoths are using their R&D (research and development) muscle to pivot, at any scale they wish, to take advantage of underlying disruptive trends in beauty. Interestingly, established prestige beauty brands remain the preferred choice. Despite consumers looking to try new beauty products, most consumers are satisfied with the products they use today. A recent survey showed that over 80% agreed with the statement "My personal beauty and grooming needs are met by products I can buy today." 55% are likely to "choose a trusted brand that I know over a new brand that I haven't used before." The same percentage (55%) saying "I am loyal to the face, body, hair or beauty care items I use." For the likely economic environment in the years ahead this is very good news for Estee Lauder investors.



What is Coming in Global Beauty?

Understanding consumer habits is critical to staying ahead in the beauty industry. Insync's rigorous research and studies identifies certain longer-term patterns and trends. Here are some;

- **Gen Z consumers** (aged 18 – 25) are really driving the beauty industry. The generation spending an average 5 hours a day on social media. In China, for example, appearance is

important as it ties in with their confidence and how people see them (much like here). They also look at their skin critically – using a magnifying mirror to really analyse it thoroughly!

- **Customisation and personalisation** are increasing fast. Consumers are constantly looking for products that are created to specifically address their problems.
- **A rapidly aging population** with societies obsessed with youthfulness. Men and women increasingly want to retain youthful appearances (groomed and nurtured by the cosmetics industry worldwide). Aging demographics has led to a robust demand for anti-aging products in order to prevent wrinkles, age spots, dry skin, uneven skin tone, and even hair damage, creating room for innovation in cosmetics. This boosts industry growth.
- **Women in the middle class** aspire to prestige beauty brands. It has been estimated that the global middle class will grow by 600 million people. This equates to more than \$5 trillion in added global spending power by 2028, an increase of 50%. Beauty regimens are becoming more sophisticated and consumers are spending more on prestige beauty products. For example;
 - Women in China aged between 15 and 65 spend \$23 annually on prestige beauty compared to \$255 in the US on average.
 - Korea, which was an emerging market in prestige beauty only 20 years ago, now spend \$276.
 - Brazilian women spend \$21 per year, in India, just \$2 –huge growth opportunities.



Selfies rule! The single biggest overarching trend is the ‘selfie’ culture. It looks like it’s here to stay and has resulted in consumers (male and female) paying more attention to how they look.

Why Estée Lauder in Particular?

When one considers innovation, most think of a technology company. Insync’s portfolio of companies includes innovative companies outside the technology sector. Innovation is key to delivering sustainable earnings growth in a low growth and low inflation environment. Simply investing in innovation however is not enough. The whole company must possess an innovative mindset and strong capital allocation processes to ensure the business is continuously generating high levels of profitability for every dollar that is invested in the business (ROIC).

“We want to deliver breakthrough products that benefit the consumer and continue to invent the unexpected.”

Carl Haney

Executive Vice President, Global Research and Development, Corporate Product Innovation, Package Development

Estée Lauder views itself as a brand-led innovation company. One creating a multiyear pipeline of transformative products across its brand portfolio. From upstream discovery to downstream R&D execution, their aim is to deliver noticeable, meaningful benefits to consumers. Beauty



is one of the fastest-moving industries in the world with a constant stream of innovation, be it in the form of delivery systems, raw materials, packaging, product textures, trends, or buzzy ingredients. As Estée launch new products into markets, they are acutely aware of very specific local trends to be able to respond well to consumer tastes. Examples include:

- Japan has a very defined standard of beauty – flawless skin; and there are many skincare steps (sales) before applying foundation.
- In Korea, they see more colour in this market, leading the way in creating lip trends.
- In China, consumers are more focused on the look of the face and the finish of their products. This is a market where consumers really care about their foundation and their lip products.

A Long-term Insync Holding with a bright future



AWARD WINNERS

Estée Lauder is an example of a company on the right side of global disruption, benefitting from global megatrends and sustaining very high levels of compounding profitable growth. Its business is well positioned for the future. It is an innovative leader in its industry and fits well into our diversified portfolio of companies of innovative leaders.

Our highly experienced global equity team vigilantly analyses trends and data for signs either supporting our holding, or what would lead us to a sale. This global house of prestige beauty passes our proprietary processes, thus continues to earn our investment in the company.

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