

## China Consumer

## Beauty expert call takeaway: demand and pricing risks the key to watch

Industry Overview

**Expert call takeaway: navigating a tough market**

We hosted a call with a cosmetics distributor Mr. Hu. His distribution business is based out of Northern China and generates RMB400-500 annual turnover. It covers a wide range of international and local brands and splits between roughly 60% online/40% offline (including traditional eCommerce, livestreaming, and offline cosmetics stores). Hu was cautious on the industry outlook and highlighted risks in demand and competition. Local consumers got more practical/value conscious. Inventory in the unauthorized B2B2C channels could continue to pose challenges to pricing in the industry. Despite a tough market, there are still opportunities: he expected that derma could still enjoy solid growth and that international brands with deeper local consumer insights and faster product innovation could stand a better chance at market share gain.

**Moderate demand growth and preference for value**

The expert expected beauty industry growth in 2024 to be largely similar to 2023 (mid-single digit). Growth would mainly come from volume while average pricing remain under pressure on challenging mix. Local consumers turned more value-conscious on their beauty purchase over the past year, with more people seeking value-for-money options. By channel, offline recovery was sluggish. Traffic continues to switch from offline to online and from traditional eCommerce to livestreaming and social eCommerce (Douyin and RED). Though, livestreaming might experience traffic growth normalization as well after years of fast growth. By category, derma and ingredient-focused products still generate outperformance, while more generic premium offerings can find it increasingly difficult to justify their price premium.

**Inventory came down from the peak but still see risks**

Overall industry inventory level came down from the peak but remain under risks, according to the expert. He has no direct exposure to travel retail but noted lingering pricing pressure from travel retail and non-authorized B2B2C channels. For leading international brands, inventory at beauty counters in department stores/shopping malls stayed relatively healthy at around 30 days. For unauthorized channels, distributor inventory was around 60-90 days at the peak (in 2Q-3Q23) and came down to around 60 days in early Jan (but still higher than the 30-45 days level before COVID). Some leading Japanese brands still have 90 days of inventory. For major eCommerce operators, inventory could remain as high as four months. Despite the sell-out pressure, most brands that the expert partners with have not lowered their sales target for the channel, which could prolong the process of further destocking.

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## Pricing pressure remains

Promotions intensified over the past year, with deeper discount and value offers, as the expert observed. Most leading international brands did not lower their price tags but some provided consumers with more gift samples (with a few offering essentially a buy-1-get-1-free). The largest risk factor for industry pricing still lies in the unauthorized B2B2C channels, which were used for destocking. These channels tend to offer deeper discount and can drag down price level in other channels. In the channels that the expert covers, effective discount (counting in promotional discount and samples) were around 48-55% off for leading Western brands (vs. 32-45% off pre-COVID) and can stretch to 62% off for some leading Japanese brands. However, leading luxury brands like Chanel and Dior have lower inventory pressure and see more moderate discount (35-40% off). These unauthorized channels could account for as high as 50% of total sales for some international brands, creating pricing uncertainties, according to the expert. Although Estee Lauder attempted to raise prices last year, the expert believes it was challenging to implement, given over-supply in the market and intense competition. Should brands raise prices, it will likely be reversed later with compensation for the channel with more samples/rebate.

## Local brands and L'Oreal taking share

Western brands still take the lion share of the market, especially in premium. Japanese brands remains sluggish, while leading local brands continued to take share in the mid-end segment. The expert saw Proya, Winona (Botanee), and Chando benefiting from the shift. Among western brands, L'Oreal appears to be better at leveraging local consumer trends and gaining market share, while Estee Lauder was perceived as relatively slower moving in product innovation. Within L'Oreal's product portfolio, SkinCeutical and CeraVe were successful in capturing rising consumer interest in derma/functional beauty.

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