MOR 565: Alliances and Cooperative Strategy – Final Paper

L'Oréal's Acquisition of Aēsop

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L'Oréal Group

L'Oréal has a 110-year legacy and is the world's leading beauty player. The group has a broad portfolio of 37 international brands which are supported by 87,400 employees and a global sales footprint across all channels (e-commerce, mass market, department stores, pharmacies, hair salons, branded and travel retail). In 2022 L'Oréal generated $41 billion in sales.

Natura & Co

Natura &Co is a multi-brand cosmetics group which includes Avon, Natura, and The Body Shop. Natura was the home to Aēsop until its sale to L'Oréal. Natura acquired a 65% stake in Aēsop for $45 million in 2012 and bought the rest in 2016. Aēsop was a profitable asset for Natura and contributed 7.5% to Natura's $7 billion revenue and 25% to EBITDA in 2022.

Aēsop

Aēsop is an aspirational, luxury brand, that provides products across hair, body, skin, home, and fragrance categories. Aēsop started out humbly in 1987 in Melbourne and grew slowly until 2003, when a change in direction under new CEO Michael O'Keeffe vastly accelerated the brand's growth. Aēsop is renowned for its sustainable, vegan formulations, bespoke customer service, and signature amber-colored, sustainable packaging. Aēsop has a global presence of 400 stores with a growing footprint in China. In just eight years, the brand's sales skyrocketed from $28 million to $537 million.

The Acquisition

L'Oréal acquired Aēsop from Natura & Co for $2.53B in cash in August 2023. The acquisition provides L'Oréal with an opportunity to unlock Aēsop's growth potential, particularly in China and travel retail, and strengthen its leadership in natural cosmetics. The deal was expected to contribute 1.2% to L'Oréal's organic sales in 2023.

For Natura, the sale allows them to enhance their financial structure and focus on their investment in Latin America, optimization of Avon, and improvement of The Body Shop's business. Aēsop was Natura's most profitable brand and L'Oréal largest target to date, surpassing its $1.7B purchase of YSL in 2008.

The $2.5 billion was approximately five times the turnover and 22 times EBITDA for Aēsop in 2023. These comparables are the upper end of analyst estimates at the time.

L’Oréal’s Why

L'Oréal seeks to leverage Aēsop's brand equity to further expand its reach in the luxury natural cosmetics market. Consumer products and luxury (‘luxe’) each account for a third of L’Oréal’s revenue today. A decade ago, the split was 50% consumer and 25% luxe. L’Oréal has undergone a strategic shift to add high margin luxury products to its portfolio. This is an industry trend where luxury companies (LVMH, Kering, Richemont) have a house of brands strategy since they can **diversify** with a strong brand moat. L’Oréal’s Luxe was overweight in fashion and fragrance. Acquiring a brand like Aēsop lets them diversify Luxe with more cosmetics.

L’Oréal stated that Aēsop would remain independent and focus on global expansion – particularly in China.

Other Alliance Options

A third of L’Oréal’s and 60% of Natura’s assets of intangibles! This demonstrates the value of the “brand” in products like Aēsop. Thus, **strategic partnerships** to share technology and know-how licensing would not have bought the same value. L’Oréal has an impressive R&D setup across 20 research centers in 11 countries with over 4,000 scientists and 5,500 tech professionals. If they wanted to create products like Aēsop’s they probably could have, but building brands is risky and time consuming. Afterall, Aēsop has been around for 37 years!

Aēsop could have been spun out as a **joint venture** co-owned by Natura and L’Oréal. But Natura wanted to focus on LatAm and had been pulling out of international markets. In fact, a few months later Natura sold The Body Shop too since it was a global brand. Of its two remaining brands, Avon was underperforming expectations. Culturally too, L’Oréal is a century old, proudly French company that has built global brands form the ground up. Natura on the other hand is much younger, built mostly through M&A and has a strong LatAm focus. Natura announced that their focus was on cash generation and improving the company's capital structure for the immediate future. Thus, the two companies did not have the same financial means, culture fit, and strategic interests to partner in a JV.

However, when it comes to acquisitions, L'Oréal is a seasoned player. In the last five years the group has made 18 deals. They had a low net debt ($3.8 billion) to equity of 11% and FCF of over $7.5 billion which made M&A much more feasible.

Aēsop's PoV

L'Oréal declared in a press release that they'd let Aēsop operate independently and support its international growth. But beyond public statements, Aēsop's CEO Michael O'Keeffe who has been running the brand since 2003 is going to continue leading the company and is a prominent voice in L'Oréal communications since then. Apart from the cultural shift of going from one parent to the other, Aēsop does not have much to lose. All the advantages it had of a parent organization are now increased many fold. L'Oréal will be able to provide Aēsop sales and marketing channels to expand globally, economies of scale for cosmetics raw materials, and R&D teams for product expansion.

Success (?)

Achieving RoI when Aēsop already offers an 87% gross margin is challenging but L'Oréal could raise the brand's operational productivity. L'Oréal expects they can even double last year's sales. This would largely be through building up stores, especially in China and in the travel retail channel. The delicate balance is going to be retaining Aēsop's brand identity. Aēsop's stores are distinctively designed and a cookie-cutter approach that would make a brick-and-mortar expansion faster and cheaper would dilute its identity. For L'Oréal, the group will need to incorporate and manage a brand with a vast retail network. This will be a new challenge for the group that largely distributes its merchandise and has indirect sales.

From a category standpoint, L’Oréal is a leader in fragrances and could use that expertise to increase Aēsop’s fragrance portfolio. Time to market and costs for new skin care products that meet the FDA requirements of each country can also be significantly reduced by leveraging L’Oréal’s R&D network.

Beauty and cosmetics is a dynamic industry that needs a lot of R&D investment. I was surprised to discover that L’Oréal’s R&D costs are 3% of revenue which is probably reflective of the fast-moving consumer demands. Thus, I believe that L’Oréal will be able to realize cost synergies like R&D, negotiate cosmetics raw materials costs at scale and use L’Oréal’s sales and distributions channels.

L’Oréal reported a strong performance in Mainland China in Q1 2024. L’Oréal Luxe continued to outgrow its market in mainland China, with momentum particularly strong for premium skincare and the Couture brands. However, travel retail, a key channel for Aēsop’s expansion, weighed on L’Oréal’s regional growth. Aēsop had recently stepped foot into China with two stores in 2022. Part of Aēsop’s appeal is its positioning in the clean beauty space — the brand uses vegan and organic ingredients only and is cruelty-free. Chinese customers like its gender-neutral premium products that appeal to a broad age range. Analysts believe Aēsop could double its sales under L’Oréal and that one-fourth ($250 million) of that could come from China.

L’Oréal will also have to ensure that Aēsop complements the Luxe portfolio and doesn’t cannibalize its apothecary Kiehl’s brand which has a similar positioning in the premium segment.

Conclusion

L'Oréal's acquisition of Aēsop represents a strategic move to strengthen its position in the rapidly growing luxury natural cosmetics market. While the $2.53 billion price tag is substantial, Aēsop's impressive growth trajectory and brand equity make it a valuable addition to L'Oréal's portfolio. The key for L'Oréal will be striking the right balance between leveraging scale to accelerate Aēsop's expansion while preserving the brand's distinctive identity and values that have resonated so strongly with consumers. The deal underscores the importance of strategic acquisitions in the dynamic and competitive beauty industry, where companies must continually evolve their brand portfolios to capture emerging consumer trends and maintain a competitive edge.

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