**Long SKIN - Price Target: $5/share (from $2/share, 200%)[[1]](#footnote-1)**

*Even when confronting the worst (if it takes 4 quarters to regain trust and get Syndeo 3.0 fully functional) strong unit economics, high margins, and sticky consumables products support a recovery.*

**Thesis:** SKIN will be able to eventually recover from operational challenges imposed by Syndeo’s botched roll-out. (1) Even if we assume it takes 4 quarters to fully convert from Syndeo 1.0 & 2.0 to 3.0, no new sales of ex-Syndeo machines (and consumable sales fall by ~18% q/q as SKIN gives 1 quarter of free products to users who experienced malfunctions), SKIN can still have EBIT just below 0 so that it can survive until operational difficulties are resolved. (2) After 3.0 issues are resolved, SKIN’s large install base, high margins, and sticky consumables will drive strong EBITDA to 98M by ’25 (vs. St. at 51).

**What Happened**: SKIN collapsed ~65% on 3Q earnings as a result of a botched Syndeo rollout and the news that mgmt. had suspended their LT ’25 guide (formerly 600-700 vs ’22 at 366). Syndeo is SKIN’s digitally connected delivery system which was originally released in the US in March ’22 and in APAC and EMEA in March ‘23. The first signs of operational trouble came in April ’23 when Brad Hauser, former CEO of Soliton (maker of RESONIC, a machine to remove cellulite) joined SKIN as COO. The stock began to move much lower (see Annotated Stock Chart). On the 8/9/23 (2Q) call, SKIN, for the first time, alluded to investors some technical difficulties. Mgmt. (CEO was Andrew Stanleick at the time) said “improvement starts first and foremost with resolving our Syndeo teething issues by the end of the year, developed at speed during the pandemic, this high-tech delivery system launched just 28 days into my tenure”. Yet, SKIN was still not being fully honest with investors about the scale of the calamity. On the 11/13/23 (3Q) call, mgmt. finally came clean: “There was an issue with low flow and clogs in the [1.0] …. [SKIN] made several enhancements to Syndeo to address and remediate these issues, releasing Syndeo 2.0 into the field … despite these efforts, many of the issues continue to persist … We believe we have addressed the Syndeo issues with our current Syndeo 3.0 … implemented in July.” Accordingly, Stanleick was removed as CEO and Marla Beck (founder of Blue Mercury) was made interim CEO, and LT ’25 topline guidance of 600-700M was suspended.

**Possible Outcomes:** Either (**Bull**) SKIN can stick the landing with Syndeo 3.0, remain a popular choice among estheticians and move forward from this debacle, or (**Bear**) the 3.0 machine released (similarly to the 2.0 machine) will continue to misfunction costing further loses as SKIN replaces malfunctioning products and further eroding trust. SKIN is unable to pay its outstanding convertible debt (750M due in Oct ’26) and the company is acquired or enters bankruptcy.

**Our Base Case:**

**Delivery Systems:** SKIN takes 4 quarters to fully recover from the 3.0 disaster. We trust mgmt.’s claim that 3.0 has resolved all clogging issues given (1) their report that “3.0 devices coming off the production line … have a return rate in line with HydraFacial’s low historical benchmark” and (2) the product was released to estheticians in July ’23 and there has been a noticeable decline in commentary on social media about issues with SKIN’s delivery systems. **To directly address the very palpable risk of further malfunctions**: we can (1) monitor social media channels to learn from the esthetician community[[2]](#footnote-2) and (2) model extremely conservatively (see Scratch Model of Disaster Scenario). [[3]](#footnote-3) SKIN had 7,350 Syndeo 1.0 and 2.0 devices in the field at peak of which 2,850 have been replaced. Thus, 4,500 still need to be replaced. We model a replacement rate of 1,425 machines per quarter (half of what SKIN was able to do in 3Q). We then model ~300 new system sales as a penalty to SKIN’s brand and reputation (down from 1,778 last quarter, but at the same level as peak COVID). We keep this as the status quo until 4Q’24 where we then begin to start new machine sales benchmarked to FY’19 levels (as a way of excluding COVID noise and Syndeo malfunction / upgrade cycle issues) (see Delivery System Build).

**Consumables:** There remain ~24,000 ex-Syndeo machines active in the field and currently 1,425 functional Syndeo machines in the field, using these, we build our consumables sales. We assume that consumables sales will take an 18% hit as mgmt. upgrades customers to 3.0 devices (see Consumables Build). Despite all these aggressively modeled headwinds, given high consumables margins (estimated at 80% from historical back-testing), we arrive at 238 adj. gross profit for the year. Holding fixed operating expenses flat and letting variable operating expenses fall by 200 bps (mgmt. working already to cut marketing, down 1,300 bps last quarter, and will continue to do so), we arrive at an adj. operating income of -27 for the year. Bringing these assumptions forward through FY’24 we arrive at an adj. operating income -27. By 4Q’24, we expect an install base of 30,812 machines (7,470 Syndeo and 22,742 ex-Syndeo), a full lapping of any promotional headwinds, and recurring revenue / installed active machine at 2,028 (a conservative 3.7% above FY’19’s levels). This gets us to 62.5 M in consumable revenue for 4Q (see Consumables Build). By FY’25, we believe there will be an active install base of 32,781 machines at 8,310 in revenue per machine getting 272M from consumables, on a 364 topline (~75% of revenue from consumables, in line with mgmt.’s LT objective).

**Valuation:** We triangulate valuation using:

1. **EV/EBITDA:** we apply a 12x multiple on FY’25 EBITDA 98 (vs. st. at 51), current EV/NTM EBITDA multiple is 22.2x to get WPT of $5.36.
   1. ULTA at 11.2x, ABBV at 11.6x.
2. **EV/Sales:** we use 3.4x on FY’25 sales of 364 (vs. street at 440), current EV/NTM Sales multiple is 1.3x gets WPT of $5.10.
   1. Elf Beauty at 7.2x, ABBV at 5.4x.
3. **DCF:** we assume 0% terminal growth rate, EBIT margins of 8.2% (based on FY’19 historicals) to get PT of $5.59.

**How We Get Paid / Event Path**: Investors need to reestablish trust with mgmt. They need concrete evidence that (1) the issues with Syndeo 1.0 & 2.0 have been resolved and (2) that there are no further unforeseen ways in which mgmt. is obfuscating the truth. We believe that this will come from first management being able to meet their 4Q implied guide of 84-99 restoring trust between them and the investor community (see Future Guides). From here, we believe that mgmt. will be very transparent in setting its FY’24 guide in such a way which fully accounts for any additional costs of the Syndeo 3.0 upgrade, the costs of promotional packages in consumables, and is very conservative when modeling new system sales / upgrades. We believe that if they guide, it will be towards 200-300 (see Guidance). We have confidence that as subsequent quarters unfold, mgmt. will continue to communicate with investors the progress on the roll out and any subsequent issues given Beck’s approach on the last call. By 2HFY’24, we expect almost all Syndeo 1.0&2.0 remaining in the field to have been upgraded to 3.0, the effects of the promotional consumables spend to have lapped, and HydraFacial to have maintained its relationship with estheticians. The market will come around and appreciate this view once mgmt. has made clear that operational issues are behind them by presenting further metrics on the stability of 3.0 (such as return rates, NPS, machines left to be replaced, etc.) – ***we expect this to happen during the next earnings call if not sooner***.

**How this View is Variant**:

This view takes a much longer-term approach than the market is currently. It is based on the fundamental assumption that (1) SKIN can eventually produce a Syndeo product without issues, and (2) subsequently postulates that in the absence of such a product, SKIN’s revenue, and economics in the ex-Syndeo products will be enough to support expenses and keep the company afloat (we diverge from the market, bond trading and stock performance imply that buy-side community doubts if SKIN can even exist by next year). From there, we interrogate the street’s implied DCF assumptions to conclude that even at its worst, SKIN is worth considerably closer to $5 / share than it is to $2 / share (see DCFs).

**Our Trade is Wrong… Why? (Risks):**

1. The risk: spending on luxury skincare products will collapse in an economic downcycle adding further pressure on SKIN’s top and bottom line. *Mitigant: Spending on Personal Care services has been gaining a larger share of the consumer wallet over time and this accelerated in 2008-2009 see (Relative PCE Spending).*
2. The risk: BeautyHealth faces increasing competition in the space from DiamondSpa (ABBV), SKIN loses share and investors lose confidence in mgmt’s ability to maintain topline. *Mitigant: recent share loss is due to operational issues rather than changes in consumer preferences. SKIN has a stronger brand than ABBV with higher NPS for its products comparatively. We expect share reversal to return towards normalized trends once operational issues are sorted (see Relative Share Loss).*
3. The market takes longer than anticipated to replace trust in mgmt., the stock sinks lower in the meantime. *Mitigant: using a reverse DCF with street’s numbers topline, NOPAT numbers, and the current stock price, we arrive at a perpetuity growth rate of -15.3%. This gives us confidence that the stock has been overly penalized and makes us comfortable buying at this price (see DCFs).*

**Conclusion:** SKIN broke investor’s trust. Stanleick did not make the short comings of his highly anticipated Syndeo product clear. His ambitions grew too large as he forecasted FY’25 revenue at a CAGR of ~25%. Marla Beck has made clear on the 3Q call that a new day has come at SKIN. She was extremely transparent about the economic impact of SKIN’s mistakes (70M total), laid out a clear, executable plan, and put her stakeholders first – actively managing the reputational damage done to estheticians. The underlying product remains strong. In subsequent quarters, investors will reestablish trust in SKIN through its new mgmt., and until then, strong unit economics and a large ex-Syndeo install base will keep the company afloat.

**Notes:**

For reference: [r/Esthetics](https://www.reddit.com/r/Esthetics/comments/13ftm7a/hydrafacial_syndeo_issues/) has 12 comments on the tread *HydraFacial Syndeo Issues*: “Hey, just wondering if anyone has found a solution to the poor suction on the Syndeo models, we cannot get consistent suction”. Of these 12 comments, 10 of them are 5 months or older, with the most recent comment posted on 11/16/23 reading “is the new machine Syndeo 3.0 better now?” and a reply stating “my newest machine arrived end of October. Knock [on] wood, haven’t had issues YET”. **We recommend active tracking of this channel and other social channels.**

Notably, the esthetician community stays very loyal to HydraFacial despite some users reporting that they are on their 8th replacement machine in one practice. They cite being able to contact customer support, the money they can generate from having a working machine, and the fact that their clients ask for the product by brand name. None of these strengths have changed nor do we anticipate that they will permanently change. (See Unit Economics) for benefits for the Esthetician.

1. Any comment which reads see (x) can be found in the accompanying slides. [↑](#footnote-ref-1)
2. Social media sentiment on TikTok, Reddit, and Esthetician Facebook groups would have revealed shortly after the release of Syndeo 1.0 issues with clogging and drainage. After the July 3.0 upgrades, there has been a noticeable decline in commentary. Further research / formalization recommended. [↑](#footnote-ref-2)
3. We let the reputational damage to SKIN’s brand persist for 4 quarters. We believe that this is overly conservative given that their NPS remains best in class at 40 (notably above Botox). SKIN has offered product upgrades/replacements to version 3.0 free of charge to their esthetician community, and in line with traditional practice, we believe they have offered their estheticians one quarter’s worth of consumables as they upgrade. See notes. [↑](#footnote-ref-3)