Discussion document:

Growth in the Personal Care in China

Hong Kong / Shanghai / Munich, January 2014
Preliminary Remarks

- This paper intends to share the most recent shopping trend and market structure of personal care market in China and our main perspectives on the opportunities present in this sector.

- The data shown in this paper is for reference only to understand the general trend and competitive environment, whereas some of the numbers being best estimates. Examples given here are selected for illustrative purpose and should not be considered as an exhaustive list.

- MelchersRaffel would be glad to discuss strategic impacts and strategic options with interested management of personal care companies.
China is the third largest market for personal care products globally and is expected to have strong growth in the next 15 – 20 years.

Global market size of personal care by country, 2013
% of total market value

- Take the development path of Japan as an example, the personal care has grown by 7 times from 1973 to 1995, once the GDP per capita was above the threshold level of USD 3,000.
- GDP per capita of China has exceeded USD 3,000 in 2009.
- The next 15 - 20 years is believed to be the golden age for personal care products business in China.

Source: Industry association; MelchersRaffel analysis
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China is growing much faster than the global average in personal care segment

Global and China market size of personal care products, 2007 – 2013
Bn USD

Source: Industry association; MelchersRaffel analysis
China personal care market is expected to continue to grow driven by the rising purchasing power of the people, increasing urbanization and life-style standard requirement.

Key drivers of China personal care market growth:

- **Increasing disposable income per capita**
- **Increasing urbanisation of the population**
- **Premium-ization and Upgrade of life-style**

**Underlying population growth is expected to be relatively low**

**China disposable income per household, 2004-2030F, k RMB**

- CAGR: 13%
- 2004: 9, 2012: 25
- 2030F: 60

**China urban population share of total, 2004-2030F, % of people**

- 2004: 39%, 2012: 54%
- 2030F: 65-70%

**Growth of luxury goods purchased by Chinese as proxy**

Chinese % of global luxury market sales value

- 1995: 1%
- 2012: 25%

**Source:** National Bureau of Statistics, China, MelchersRaffel analysis

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Skincare is the largest segment within personal care and consumers are growing to be more brand consciousness. Foreign brands are quite dominant in the market

Key characteristics of competitive landscape in personal care sectors in China

- **Skincare** is the largest segment among all
  - Market share by product segment:
    - Skincare: 38%
    - Hair-care: 12%
    - Oral-care: 12%
    - Personal wash: 10%
    - Other: 13%
    - Cosmetics: 9%
    - Cosmetics: 9%

- **Increasing dominance of foreign brands**
  - Market share of foreign brands:
    - 2001: 45%
    - 2009: 64%
    - +19%

- **Brand is important in consumers**
  - Market split by branded vs. un-branded products:
    - Branded: 75%
    - Un-branded: 25%

- **Increasing market concentration**
  - Market share of top 5 companies:
    - 2001: 28%
    - 2009: 41%
    - +13%

Source: MelchersRaffel analysis

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Supermarket/ CVS, grocery stores and hypermarkets are still the major channels for buying personal care products, while online shopping is emerging with strong growth.

### Major channels for personal care products in China

<table>
<thead>
<tr>
<th>Channel</th>
<th>Penetration rate</th>
<th>Purchase amount per household per trip (RMB)</th>
<th>Channel growth rate in sales revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supermarket / convenience stores</td>
<td>74%</td>
<td>261</td>
<td>12%</td>
</tr>
<tr>
<td>Small grocery store</td>
<td>65%</td>
<td>150</td>
<td>7%</td>
</tr>
<tr>
<td>Hypermarket</td>
<td>64%</td>
<td>304</td>
<td>9%</td>
</tr>
<tr>
<td>Specialty store</td>
<td>36%</td>
<td>216</td>
<td>12%</td>
</tr>
<tr>
<td>Online shopping</td>
<td>18%</td>
<td>271</td>
<td>33%</td>
</tr>
<tr>
<td>Department store</td>
<td>15%</td>
<td>236</td>
<td>-1%</td>
</tr>
<tr>
<td>Other channels, e.g. drug-store</td>
<td>68%</td>
<td>371</td>
<td>4%</td>
</tr>
</tbody>
</table>

Source: MelchersRaffel analysis
Herbacin, a 100-year history German skin-care brand, has seen quite some success in China, its sales channels have been expanded rapidly in China since its entry in 2007

Example of successful German personal care brand in China – Herbacin

Herbacin’s official site in China

Herbacin’s weibo site (Chinese Twitter)

Source: MelchersRaffel research
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Lavera, an organic skin-care German brand, has seen quite some success in Hong Kong, then started to expand to mainland China via dept. stores and online platform.

Example of successful German personal care brand in China - Lavera

- Established in Germany since 1987
- Entered Chinese market since 2010, started e-commerce in 2012
- Key products: Natural and organic skincare products
- Main Price range: c. RMB 100 – 200 per unit
- Target segment: Mid to high-end
- USP: Organic, Made in Germany, Gluten and Cruelty-free
- Multi-channel strategy:
  - Department stores such as New World Dept. stores in Beijing
  - Online stores such as LRLZ tmall
- Sales performance:
  - Number 1 organic cosmetic brands sold in health and beauty chain store – Watsons in Hong Kong during 2006 – 2009

Source: MelchersRaffel research
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Western big groups have shown strong interest to further expand in the personal care sector in, as demonstrated in the recent acquisition deals (1/2)

### Major cross-border M&A deals in Personal Care Products in China (1/2)

<table>
<thead>
<tr>
<th>Date</th>
<th>Acquirer</th>
<th>Target</th>
<th>Deal value</th>
<th>Details of the deal</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>L’Oreal Group</td>
<td>Magic Holding</td>
<td>850 mn US$</td>
<td>Magic Holding is a leading Chinese facial mask brand with the largest market share in Chinese facial mask market. The acquisition provides L’Oreal further penetration into the Chinese beauty care market and a valuable product extension in the facial mask category.</td>
</tr>
<tr>
<td>2013</td>
<td>Johnson &amp; Johnson</td>
<td>Elsker for Mother &amp; Baby Co. Ltd.</td>
<td>104 mn US$</td>
<td>Elsker is a leading Chinese baby product brand and local competitor of Johnson &amp; Johnson in the high-end segment of the Chinese baby care product market. With the acquisition of a local rival J&amp;J consolidated its dominance in China.</td>
</tr>
<tr>
<td>2013</td>
<td>LVMH Group</td>
<td>Marubi Holding</td>
<td>49% share 100 mn US$</td>
<td>Marubi is a rising brand in the Chinese high-end cosmetic market with significant market share and growth potential. The strategic cooperation provides LVMH further access to the Chinese beauty care market.</td>
</tr>
</tbody>
</table>

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Western big groups have shown strong interest to further expand in the personal care sector in, as demonstrated in the recent acquisition deals (1/2)

Major cross-border M&A deals in Personal Care Products in China (2/2)

<table>
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<tr>
<th>Date</th>
<th>Acquirer</th>
<th>Target</th>
<th>Deal value</th>
<th>Details of the deal</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>Coty Inc</td>
<td>Tjoy Holding Ltd.</td>
<td>400 mn US$</td>
<td>TJoy is a leading Chinese cosmetic company with top market positions in the sunscreen market, facial cleanser market and men’s cosmetic market. Objective of the acquisition was to gain access to the Chinese market and strengthen its market position through TJoy’s established sales channels.</td>
</tr>
<tr>
<td>2008</td>
<td>Johnson &amp; Johnson</td>
<td>Dabao Beijing Dabao Cosmetics Co. Ltd.</td>
<td>337 mn US$</td>
<td>One of the most influential Chinese cosmetic brands with strong brand image and No. 1 market share in Chinese daily basic beauty care market. J&amp;J expanded its presence in the Chinese market and gained further access to the market.</td>
</tr>
<tr>
<td>2007</td>
<td>Beiersdorf AG</td>
<td>C-BONS Group</td>
<td>850 mn US$</td>
<td>The largest Chinese hair care group with a series of well-known brands in the market. Through the acquisition of C-Bons hair care business unit, Beiersdorf consolidated its dominance in China and strengthened its position against Procter &amp; Gamble and Unilever.</td>
</tr>
<tr>
<td>2004</td>
<td>L’Oréal Group</td>
<td>YUE-SAI</td>
<td>90 mn US$</td>
<td>Created in 1992 by Yue-sai Kan, a Chinese American, to produce make-up and skin care products for the Chinese market. The acquisition also includes a manufacturing plant in Shanghai. This factory will increase production capacities, ensuring rapid growth in Asia.</td>
</tr>
</tbody>
</table>
The market in China is huge – how to go ahead as a foreign company?

For foreign companies, besides the overall growth rates and volumes the identification of the relevant channels and target consumer groups is of utmost importance.

Key questions to be answered for an accelerated growth strategy China are:

- What are the right growth strategy – lower-tier cities expansion? E-commerce? etc
- Which Chinese cities to target? How may the consumers different among different cities and regions and what are their respective key buying factors?
- How to make the brand work? How the investment plan will look like?
- Will M&A be an option for accelerating business growth?

With a well structured and systematic approach, the accelerated and profitable growth in China is realistic.
Overview: “Network Capital” can be a co-operation option for smaller European players to gain market presence in China

A separate discussion paper „Network Capital“ is available from MelchersRaffel.
MelchersRaffel is the company for successful Euro-Asia endeavours

- Founded: 1806 in Bremen, Germany
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