

THE FUTURE OF BEAUTY

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THE FUTURE IS BEING REWRITTEN

More than nearly any other fast-moving consumer goods (FMCG) sector, the beauty industry is guided by trends. And over the last few years, multiple trends have emerged with the promise that they will redefine the future of beauty. From balayage to activated charcoal, it seems like the next big thing can come from just about anywhere. And while that's more true than ever, how are you supposed to know when something really is a *thing*, and when it's just a flash in the pan?

The secret is finding a connection between the micro-trend and macro consumer needs, which are readily shifting. Because, while we're in the midst of a great proliferation of brands, products, services and, yes, trends, the new shifts creating sustained growth opportunities for brands and retailers are really nothing new at all.

More than ever, trends are starting small and growing into something far more mainstream. Over the last three years, distribution of beauty and personal care items with charcoal have nearly quadrupled. And as the trends grow, they constantly evolve, take new forms and help new products and categories find connections with consumers.

So, the real question becomes, how do you justify investing in understanding something that represents just 1% of your category or market? Well, if in fact that micro trend is connected to a more systemic shift in the market and you're *not* along for that journey, you'll spend more time catching up than adapting to the evolving shifts.

Today, there are three big systemic shifts that will redefine the future of the beauty industry. While they represent the future, these shifts should come as no surprise. But, the breadth of forms they're taking are creating micro-trends that represent serious opportunity.



NATURAL

As with organic food and household supplies, more consumers are becoming interested in natural beauty products. That's because a focus on health today isn't confined to what consumers put in their bodies. Now, we're just as aware of what we put *on* our bodies. But, how shoppers are looking for more natural beauty products is already evolving. And what "natural" means to one shopper might be very different from what it means to another.



PERSONAL

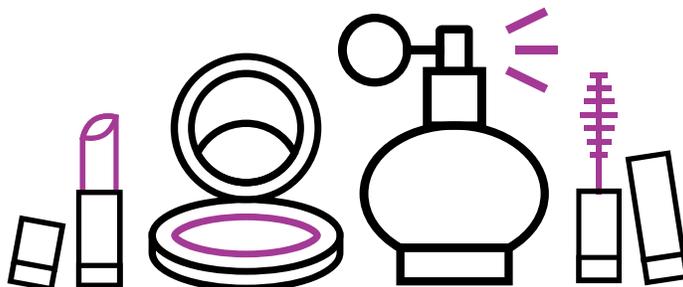
The same shoppers who are redefining what healthier, natural beauty products look like are themselves younger, more racially, culturally and ethnically diverse and cosmopolitan consumers. While it's arguable that Millennials are "killing" the beauty industry (along with every other one), they clearly represent a more diverse shopper base. But, it's not about appealing to the new beauty shopper. There is no one beauty shopper.



CONNECTED

As more buyers grow increasingly comfortable with incorporating online channels in their paths to purchase, the opportunity for manufacturers and retailers to connect with them is increasing as well. But, connecting with digitally engaged shoppers isn't as easy as encouraging them to visit a website or dropping promoted posts in their social media feeds. As more people shop via digital assistants without ever stepping up to a shelf (digital or otherwise), it goes without saying that the playbook for building and sustaining brand loyalty has changed.

How are these shifts playing out today, and what does that mean for the future of beauty? Let's dive in.



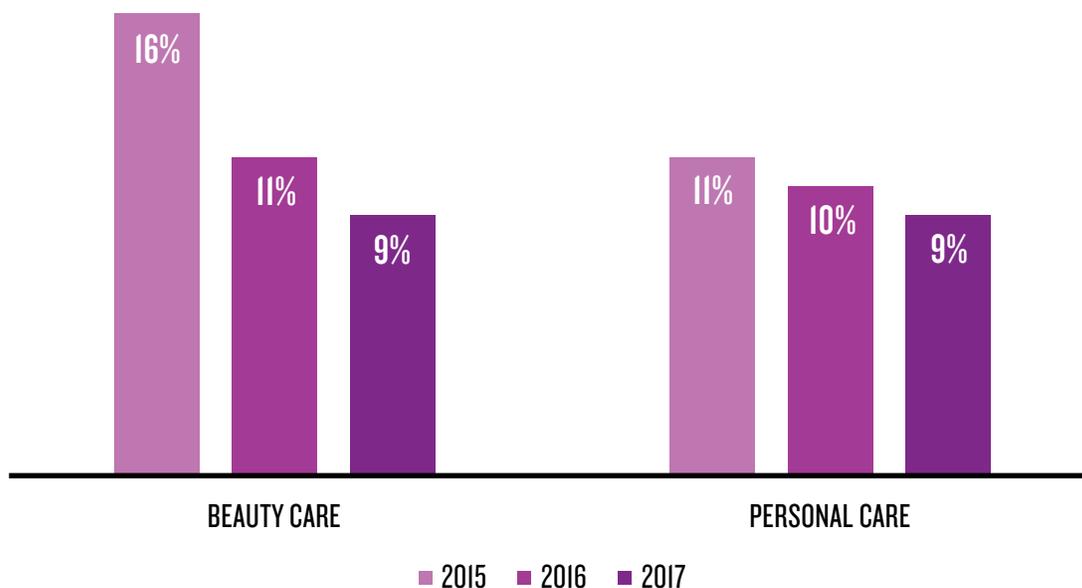
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BEAUTY IS GOING NATURAL

Natural beauty has been outperforming “conventional” beauty for some time, taking market share in the process. And the dollars are really starting to add up on the natural side of the fence. In 2017, products featuring natural claims represented 3.1% of the U.S. personal care market, generating \$1.3 billion in annual sales last year. That’s up from 2.1% of the market in 2013 (representing sales of \$230 million). Comparatively, beauty has been slower to go natural (natural products currently make up 1.4% of the market), but sales are growing quicker than in personal care.

U.S. SALES GROWTH OF NATURAL BEAUTY & PERSONAL CARE PRODUCTS STARTING TO SLOW

NATURAL SALES GROWTH VS. YEAR-AGO



Source: Nielsen Wellness Track, data ended Dec.30, 2017 vs. year-ago. “Natural cosmetics” are those with natural product claims.

But while natural product growth still outpaces conventional product growth in personal care and beauty, growth based simply on natural product claims is starting to slow. While consumers still increasingly seek more natural beauty products, how they decided what’s natural is changing.

LIVING WITHOUT IS BEAUTIFUL

Let's look at sales trends in cosmetics. Through traditional retail outlets, sales of cosmetics as a whole actually declined just shy of 1% over the last year. Looking at natural cosmetics—at least those claiming to be natural—we see a similar trajectory. Sales of those products have declined 1.2% on the year, underperforming the category as a whole. That's not the case, however, when we look at products made without certain ingredients, like parabens.

This is just one example of a big shift in what consumers expect from the products they buy. It's no longer enough for brands to simply say they're natural; they have to authentically prove it. And in looking at recent sales trends, the absence of certain ingredients is one proven way to achieve this.

As with many other sectors across FMCG, natural beauty is increasingly about what's *not* in the product. In fact, 53% of FMCG consumers say the absence of undesirable ingredients is more important than the inclusion of beneficial ones.

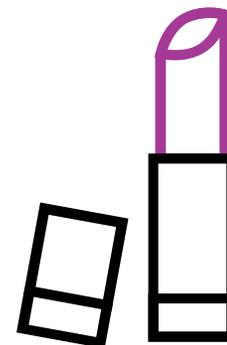
While most beauty and personal care categories still lag edible categories in this consideration, hair care, skin care and cosmetics consumers are all more likely than the average beauty and personal care shopper to look for products without artificial ingredients.

PARABEN FREE IS THE WAY TO BE

In recent years, beauty shoppers have become more focused on parabens as an ingredient to avoid than just about any other. For many consumers, synthetic compounds like propylparaben and butylparaben are hard to pronounce and hard to view as a safe ingredient. And beauty manufacturers have been responsive to these concerns. In fact, just 35% of beauty products contain parabens, down nearly 7 points over the last two years.

Relative to other packaged goods categories, beauty and skin care manufacturers have been quite responsive to shifting consumer preferences. Just a quarter of dairy products and a third of packaged food sold in 2017 were "clean label," meaning they were devoid of any undesirable ingredients. In edible categories, undesirable ingredients include things like high fructose corn syrup or MSG.

But for the beauty industry, there's still work to be done. Many categories still derive a significant share of sales from products with parabens and likely many other undesirable ingredients. The good news? Those categories still heavily focused on parabens are some of the fastest shifting to paraben-free. Over the last two years, facial cosmetics have gone from just 43% paraben-free to 54%.



CONSUMERS FLOCKING TO BEAUTY PRODUCTS WITH SIMPLER INGREDIENTS

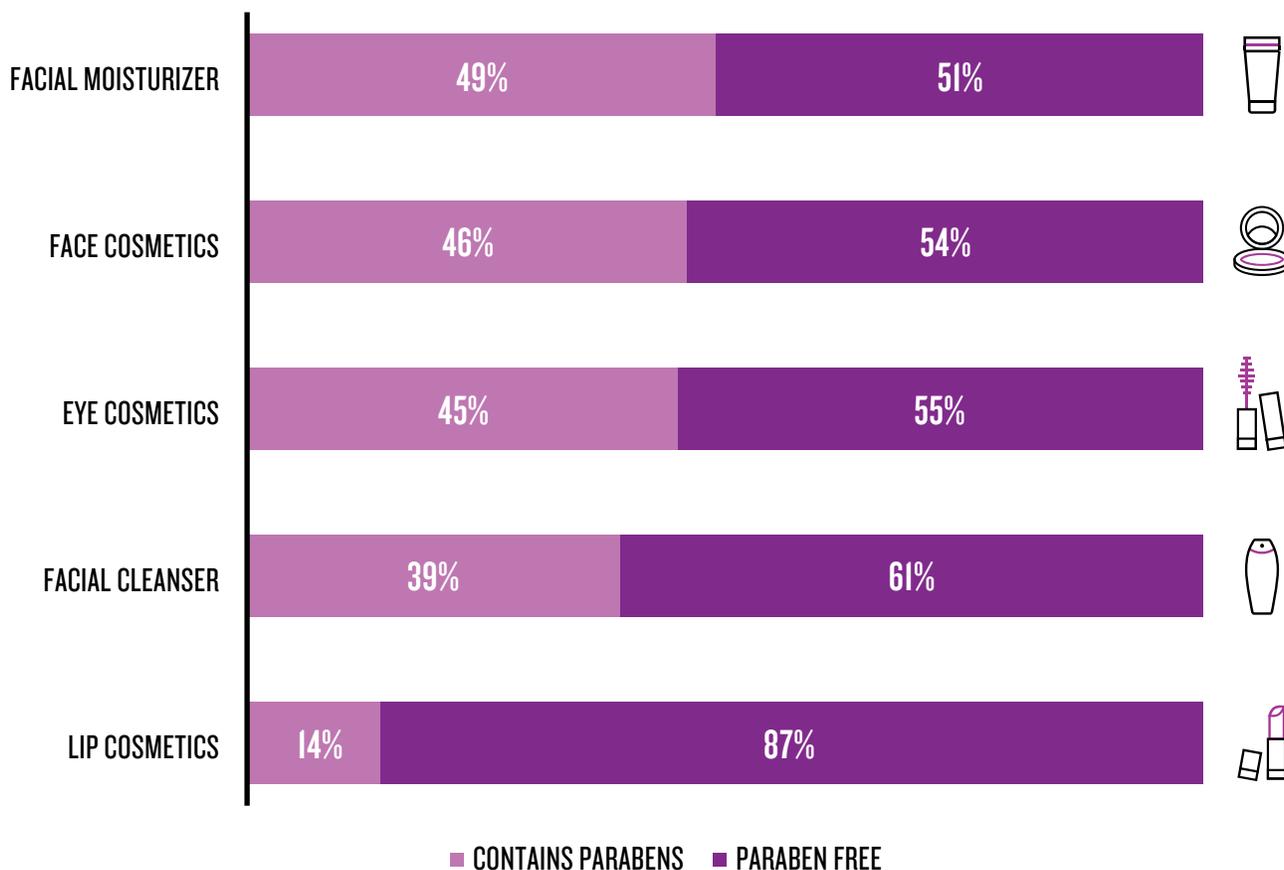
COSMETICS SALES GROWTH VS. YEAR-AGO



Source: Nielsen Wellness Track & Product Insider, powered by Label Insight, data ended Dec. 30, 2017 vs. year-ago. "Natural cosmetics" are those with natural product claims.

SOME BEAUTY CATEGORIES SEE MORE THAN HALF OF SALES FROM PARABEN FREE PRODUCTS

PARABEN FREE CATEGORY SHARE



Source: Nielsen Product Insider, powered by Label Insight, data ended Jul. 29, 2017.

But there's more to beauty and personal care trends than parabens. In fact, there is a wide array of specifications driving incredibly strong growth across beauty and personal care. These include products free from phthalates, artificial fragrances, sulfates and more. Across each of these, products without these ingredients are selling faster than those that include the same ingredients. But when products are free of some or all of these ingredients *and* include a natural claim, sales really take off. In fact, while sales of cosmetics free from parabens have grown around 2% over the past year, sales of those that also claim to be natural grew 12%.

So, to truly deliver natural beauty, you have to first satisfy that natural appeal at a functional, granular level. Only then can you bolster that with a natural claim. Do that well, and the growth opportunities are staggering.

WHAT ABOUT THE GOOD STUFF?

You can remove all the ingredients that you want, but the product does still need to deliver *something*. And while simplifying the ingredients that a product includes is a good first step towards truly natural beauty, there are a range of ingredients that can be included that live up to the cleaner, healthier and at least perceivably natural appeal.

With more consumers thinking about their food as medicine, it should come as no surprise that many of the ingredients consumers are looking for in natural beauty come from emerging food trends. Superfoods like coconut oil and quinoa, which first emerged as food trends, are now starting to show up in beauty and personal care items. But it seems like the time between when a trend emerges in food and jumps over to beauty is condensing tremendously.

Avocado oil is an interesting example of such a trend. Over the last two years and across consumer goods, spending on products with avocado oil has increased 31%. Over the same period, the number of U.S. households buying these products has nearly doubled, growing from 6% to 11%. And of the 31 different categories that now contain this ingredient, hair care and lotions are growing the fastest. On the food front, more people are turning to avocados as a source of a more healthful fat, and that more healthful trade-out is creating an opportunity for beauty brands to tap the same appeal.

Over the last year, we've seen similarly natural trade-outs drive ingredient trends forward. Sales of health and beauty products including honey, charcoal and micellar, for example, are growing rapidly—even exponentially in some cases. So what's the next charcoal or avocado oil? It may well be seaberry or sea buckthorn oil, herbal oils believed for centuries to have anti-aging properties. Sales of beauty products including these ingredients are growing over 200% annually, primarily in skin care, but in hair care and cosmetics as well.



HOW TO CAPITALIZE ON NATURAL BEAUTY

Natural beauty means something different to each of your customers. And consumers will increasingly take their own paths toward a more natural beauty experience. These transparency-minded consumers seek authentic brands and products, and each will likely seek different natural appeals on their path toward a more natural beauty regimen. So, what's *your* path toward natural beauty?



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BEAUTY IS PERSONAL

THE NEW BEAUTY SHOPPER

Finding your path to truly natural beauty starts with an understanding of your consumer. As consumers are increasingly focused on narrower, more personal definitions of natural beauty, we've seen rampant fragmentation of consumer segments. Even across this single dimension, it's clear there's no *one* natural beauty consumer. As you're thinking about tapping emerging trends like natural beauty, the shoppers that delivered growth in years past will likely *not* be the ones to get you through to tomorrow. But, while it might be easy to blame Millennials for any struggles you're having, that view of consumer diversity is far too simplistic.

For example, buyers of hair care products without artificial fragrances are far more likely to be ethnically diverse, younger and cosmopolitan. To truly understand the needs of your shopper, we have to look at more nuanced, personal consumer segments.

Having both the empathy to understand consumer needs and the diligence to engage, not en masse but in a more nuanced, personal way will be table stakes. For beauty brands in particular, the stakes have never been higher. Consumers want to identify with brands—and they want brands to identify with them as well. And nowhere is that more true than with cosmetics brands. In fact, nearly a quarter of cosmetics consumers demand to be able to identify with the brands they buy, more than any other category of packaged goods. Your products are truly the most *personal* products that consumers can buy.

NUDE IS NO LONGER JUST BEIGE

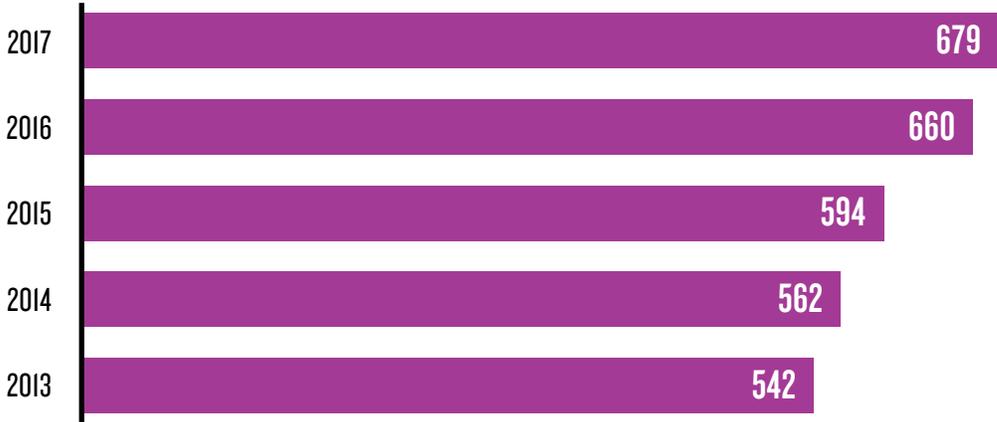
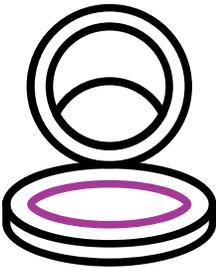
Just as the meaning of natural has become fragmented, so too has our view of the average or generic beauty product. As with natural beauty, shoppers are flocking to products that provide more individually relevant experiences. Across most cosmetics categories, “nude” colors are underperforming the category as a whole, a trend that has emerged over the last two years. With a more diverse consumer base, what was once generic has now become less relevant.

Consumers have always wanted their beauty products to reflect their individuality. What’s shifted over the last few years is that shoppers have immense options when they step up to the beauty counter. Over the last five years, the number of unique facial cosmetic colors available on shelves has grown 22%, outpacing the general pace of new product development in facial cosmetics by 7 times.

With 679 unique colors of foundation from which to choose, consumers were able to self-select their own version of beauty. And in the process, brands that haven’t adapted have lost share.

COSMETIC COLOR OPTIONS CONTINUE TO GROW

NUMBER OF UNIQUE FOUNDATION COLORS SOLD



Source: Nielsen Retail Measurement Services, Core syndicated hierarchy, Total U.S., 52 weeks ended Dec. 30, 2017 vs. prior periods.

CATEGORIES ARE BECOMING FEATURES

Consumers' focus on transparency and ingredients has implications beyond making beauty more natural. In much the same way that smartphones have all but made dedicated point-and-shoot cameras obsolete, entire categories are becoming folded into other products' feature set. That's because consumers no longer shop categories. They shop their needs. And increasingly, an "all-in-one" product is the best solution for those needs.

We can see evidence of this shift in the decline in sales of sunscreen as a discrete product, and the growth of products with sunscreen as an ingredient. In fact, sales in the sunscreen category have declined over the last year as consumers opt to cover their sunscreen needs by buying products that feature sunscreen as an ingredient, ranging from hand and body lotion to shampoo.

The delineation between categories has all but broken down and consumers now shop fluidly between categories. Now, brands and retailers will have to more deeply understand shopper needs and appeal to those needs on a more personal level. It's no longer enough to simply grow a category. It's more about solving problems in creative ways.

ANYONE CAN BE A BEAUTY BRAND

As consumer needs fragment and shift, an ever-widening range of brands and products are popping up to fill those needs. Indie beauty brands—free of massive corporate infrastructures and worldwide supply chains—have certainly risen to fit some of these needs, and the industry has rightly been focused on understanding their appeal with consumers. While indie, small and niche brands continue to expand their reach and take share, they're delivering consumers with endless choice. They're also rewarding seemingly odd entrants to the beauty brand landscape.

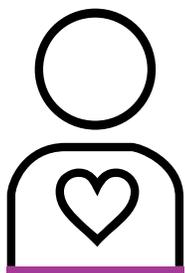
Over the last five years, retailers' store brands have grown cosmetic sales nearly 3X faster than entire cosmetics category, gaining a full percentage point of share in the process. This shift toward store brands isn't unique to beauty. It's happening across packaged goods and around the world. At the close of 2016, the average FMCG national brand saw 1%-3% growth and store brands' sales were declining. A year later, fortunes reversed, with store brands growing 2% amid flat or declining growth for national brands.

DIGITAL TOOLS ARE BECOMING PERSONAL ADVISORS

While brands and retailers have granted consumers a seemingly endless range of range, digital tools, devices and platforms have empowered shoppers to find the precise products for them. And in the short period of time that digital has become ubiquitous for many of us, our relationships with technology is already changing how we use it. Rapidly.

Over the last five years, Google searches for “foundation for me” have more than doubled. Mobile devices give us the answer to any request at the tap (or swipe) of a finger. But as these devices have gotten smarter, we now expect them to understand our unique, individual needs and so a search for “best foundation” becomes “best foundation for me” over time.

While we might have previously asked a friend or retail associate for help in making this choice, we’re now entrusting our devices to meet our needs. This enables brands and retailers new points at which to engage. But, as always, relevance is critical.



HOW TO CAPITALIZE ON PERSONAL BEAUTY

Today, anyone can be a relevant beauty brand. While the beauty industry has been heavily focused on the growth of indie brands—and they will certainly continue to drive innovation in the market—the premise of what it means to be a brand is being redefined. In fact, many direct-to-consumer brands actively communicate that they give consumers value by stripping away the wasteful overhead that big brands bring.

But what they’re getting at is the inefficiency of a mass market strategy, the antidote to which is a more targeted, personalized and ultimately relevant method of building brand loyalty. The path toward building a relevant brand is being authentically relevant to individuals, at scale.

3

BEAUTY IS CONNECTED

THE BEAUTY OF E-COMMERCE

The mobile internet is undeniably one of the greatest tools ever created for reaching individuals at scale. Constant connectivity means shoppers can research and buy whenever and wherever they like. Mobile phones are some of the most personal devices we own.

Given widespread mobile connectivity, it might come as no surprise that consumer spending on beauty products has shifted online faster and greater than nearly every other packaged goods category. In fact, nearly one in three dollars spent on beauty products in the U.S. today is spent online.

This critical mass, at such an early stage of online development, is impressive. Americans spent over \$12 billion on beauty and personal care products online over the last year. What's truly staggering is how rapidly this sizable business is growing and how quickly share is moving to online channels. Notably, that \$12 billion in spending represents 30% of dollars flowing through online channels, up from just 24% a year ago.

Beauty and personal care products are particularly ripe for online development, given consumers' combined interest in both exploring new products and replenishing the ones they already own and love. These two shopper modes—discovery and replenishment—are some of the strongest drivers of online penetration across FMCG. While beauty shoppers are ahead of the FMCG curve in online shopping, we're still very early in the development of truly connected beauty.

To understand where things are headed, Nielsen conducted an analysis of online share today, and included an index of factors that indicate whether shoppers might be willing to shop online in the future. We considered the impact that value, convenience, variety and experience have on shoppers' willingness to buy a category online and scored each accordingly. While fragrance, hand and body lotion and cosmetics have amassed the most significant online share of sales to date, our analysis indicates that hair care, and hair coloring in particular, presents the biggest online growth opportunity across beauty and personal care.

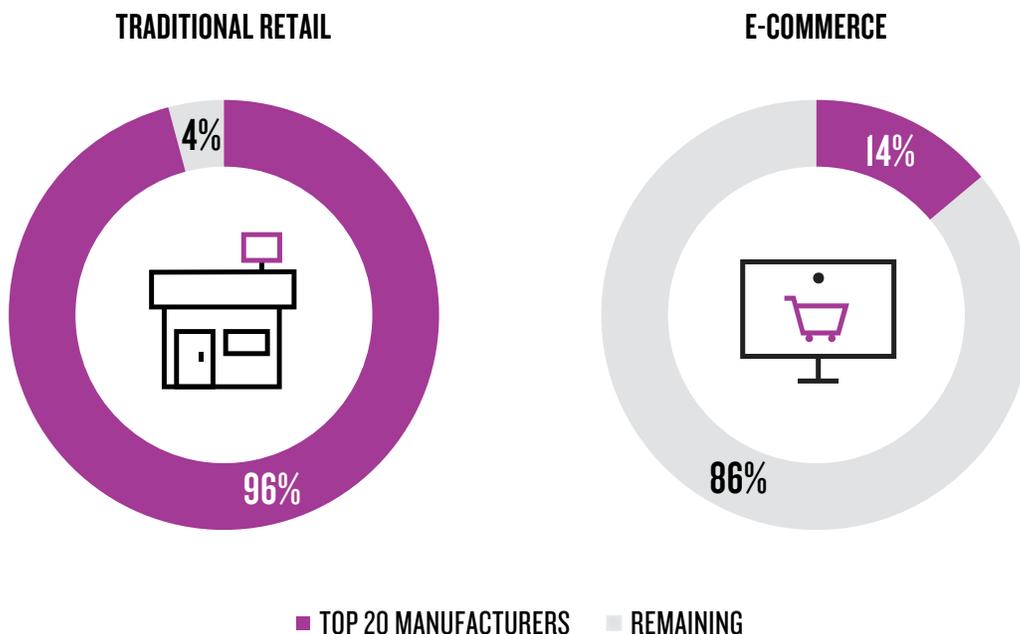
THE ONLINE BRAND LANDSCAPE

So you want to capture a piece of this rampant online demand for beauty products? You'll find an entirely different brand landscape online than in traditional brick and mortar retail. From new brands and retailers ranging from direct-to-consumer pureplay brands and subscription (many of which are increasingly investing in their own store brand-like offerings), you'll be up against business models that simply don't exist offline.

As a result, the balance of power between large beauty brands and smaller ones looks completely different online than they do in a brick-and-mortar environment. In fact, while the top 20 cosmetics brands capture 90% of the dollars going to brick-and-mortar retailers, those same companies capture just 14% share online.

THE ONLINE BRAND LANDSCAPE IS VAST AND REWARDS A DIFFERENT TYPE OF BRAND

CATEGORY SHARE BY RETAIL CHANNEL
TOTAL COSMETICS



Source: Nielsen Retail Measurement Services, Core syndicated hierarchy All Outlets Combined + Convenience, and Nielsen E-commerce measurement, Total U.S., 52 weeks ended Nov. 4, 2017.

PLATFORMS TIE DISCOVERY TO PURCHASE

Compared with other packaged goods sectors and much of retail, online giant Amazon has not driven the bulk of online beauty growth. Rather, the strength of specialty and prestige retailers like Sephora and Ulta have powered much of the early online beauty development.

But the online beauty landscape surely isn't constrained to activity on retailers' sites and apps. As more research has moved online, facilitating new product and brand discovery, much of that activity has concentrated on social networks. This is particularly true for cosmetics, in which social media garners more influence on the path-to-purchase than just about any other category across non-edible packaged goods (except shaving).

The effect of the growth of social media and mobile platforms should come as no surprise. As consumers spend more of their time on mobile devices, it was only natural that mobile advertising got its foothold in brand media, product discovery and inspiration.

But the next battleground for many mobile and social platforms will be harnessing the data that tells them what their audiences might be interested in and connecting that with the ability to buy right on the platform. Brands are able to make their posts shoppable across a variety of platforms, essentially bringing the point-of-sale right to the point-of-discovery. The path-to-purchase is no longer a path at all. It's a short moment.

And when the digital shelf extends to include these social platforms, merchandising will look more like search engine optimization as getting your digital content right not just for consumers but also the ranking algorithms will be crucial to winning the digital shelf. Is your organization ready to make that transition?

HEY YOU, BUY MORE LIPSTICK

We're in the midst of yet another technology transition to voice as a major input to our devices. As millions of consumers bring voice-based digital assistants into their homes, brands, retailers and platforms face new opportunities and challenges to connect with those consumers.

These devices make technology disappear. You simply talk to your device: there's no tapping, swiping or clicking. While some might say that spells the death of brand loyalty, these devices are a great way for brands to re-instill a connection with consumers. They reduce the friction in buying goods and empower consumers to more easily replenish the goods they already love. They can also tap a deeper knowledge of individual

consumer needs and purchase history. They're truly *personal* assistants, and increasingly, shoppers are utilizing their devices to shop. In fact, our research shows that more than one-third of Google Home owners have used their devices to buy a personal care item, followed closely by 29% of Amazon Echo owners.



HOW TO CAPITALIZE ON CONNECTED BEAUTY

As with social platforms, the rules for building brand loyalty in a voice-based world will be different. Without a shelf—digital, physical or otherwise—you won't be able to influence the purchase via packaging, brand name or many of the traditional tactics that merchants have used for centuries. But if you can find a way to leverage the data and technology on which these devices are built to make your products personally relevant for consumers, you'll have a greater chance to succeed in this future.

Building a connected beauty strategy is not the same as building a digital or even *omnichannel* strategy. It's about thinking about how you can leverage *all* of the platforms at your disposal for their maximum utility. How are you using technology to provide useful services to consumers—online and off? Are you making your products platform-worthy, enticing users to not only share your product but *love* your product?

WHAT'S NEXT FOR BEAUTY

Technology has never truly changed fundamental consumer needs. It may enable new behaviors, but the fundamentals of brand building have never really changed. Can you create a product that authentically fits a need that your consumers have and use the platforms at your disposal to achieve distribution at scale? The fact that consumers are more health and wellness focused, more diverse and more technologically empowered shouldn't fundamentally change your purpose as a brand, retailer or company. However, these shifts will require you to change how you reach—and ultimately prove your purpose to—those consumers.

To win in the future, brands will need to throw out their old playbooks. Consumers are as focused on the transparency of the company and their practices as they are on what goes into the products they make. The beauty brands—really *all* brands—that will be successful, will be authentic and true, flexible enough to be relevant to a wider array of consumers, and harness the digital tools and platforms to achieve this at scale.

SO, WHAT DO YOU STAND FOR?

ABOUT NIELSEN

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