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Potential Target Acquisition for L'Oréal: Is Elf Cosmetics Worth Pursuing?

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## ABSTRACT

The purpose of this paper is to evaluate, through key quantitative and qualitative methods, if the L'Oréal Group should acquire Elf Cosmetics. The project will offer a recommendation based on an analysis of values, culture match, product portfolio, and market positioning, as well as provide three different valuation methods and synergy valuation to understand if the investment is worth it. The paper intends to conclude with a recommendation on whether the acquisition should or should not be considered.

Keywords: valuation, DCF, cosmetics, synergy, acquisition, cosmetics.

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The cosmetic industry worldwide has seen solid and constant revenue growth for many years. The worldwide cosmetics industry revenue in 2015 was just under 80 billion dollars (Statista, 2021). This figure is expected to reach 100 billion US dollars in 2022 and 130 billion in 2026. The only significant drop in revenue in this industry was in 2020, due to the lockdowns and reduction in consumer spending habits caused by the COVID-19 pandemic.

The cosmetics industry is composed of different segments. Among those, there are haircare, makeup, skincare, body care, and fragrances. Skincare accounts for the largest portion of revenues currently, recording 137 billion US dollars in 2021 (Statista, 2021).

The leader of the cosmetics industry, the L'Oréal Group, is a conglomerate composed of more than 30 global brands including Lancôme, YSL Beauty, Giorgio Armani, La Roche-Posay, CeraVe, L'Oréal Paris, Kerastase, among others. In 2021, the Group recorded 36 billion euros in revenues (L'Oréal, 2022), followed by Unilever and Estee Lauder, with revenues of 24 billion and 16 billion US dollars respectively (Statista, 2021). Other relevant players in this industry include Procter & Gamble, Moët Hennessy Louis Vuitton, Shiseido Co, and Beiersdorf.

Sales in the beauty industry are mainly driven by keeping up with marketing trends and constant product innovation. A recent trend that has caught the eye of cosmetic conglomerates is advertising in the digital space, such as those of TikTok and Instagram. This trend accelerated during 2020 and has sustained its momentum so far. New cosmetic brands have thrived in this digital environment, mainly in the skincare segment, founded and backed by celebrities, such as Kylie Skin by Kylie Jenner, Rhode by Hailey Bieber, and SKKN by Kim Kardashian. These are just some examples that gather millions of followers on Instagram and rely on social media platforms to drive sales. To put that into numbers, in 2021, out of the 32.2 billion euros of L'Oréal's sales, 9.3 billion (28.9%) came from e-commerce, an increase of 25.7% from the previous year (L'Oréal Annual Report 2021).

This only shows that not only new players are betting on this space, but old and mature ones have made their moves as well. L'Oréal for example has announced many initiatives to expand its digital footprint. The most recent one was the partnership between L'Oréal, Meta, and the notorious university HEC Paris to launch a metaverse startup accelerator in Paris. According to L'Oréal's Chief Digital and Marketing Officer, the partnership "...brings a lot of young talents together. They're the future. Imagine the massive creative energy that it generates" and "The benefit for us is that we can use that creativity for our DMI [international marketing direction] and brands. So, of course, we will leverage that." (Vogue, 2022).

In summary, the L'Oréal Group is well positioned in the market and enjoys many competitive advantages such as access to vast marketing budgets, celebrity endorsements, and a global footprint when compared to its smaller competitors. Its sales grew 16.1% from 2020, its operating profit in 2021 was 6.16 billion euros and the company achieved an operating margin of 19.1%. At L'Oréal, sales are divided into business segments, with the highest portion coming from skincare and sun protection (40% of sales), followed by makeup (20.5%), haircare (15%), fragrances (10.9%), hair coloring (9.3%) and others (3.9%). In terms of geographical zones, Europe, North Asia, and North America account for the largest share of revenues, 87.3% combined. The Group structures itself into four main divisions: Consumer Products Division (CPD) - mass-market, low-price offerings; Professional Products Division (PPD) - mainly focused on haircare for saloons and hairdressers; Active Cosmetics Division (ACD) – which offers a range of skincare and sun care brands, from essential oils to high medical products; and finally Luxe Products Division (LPD) - offers high-end skincare, makeup, creams and fragrances with a higher price point.

L'Oréal has a unique business model of growing its size by acquiring smaller companies, incorporating them into their business, and making them bigger, more relevant players in the market. This paper will analyze some of its most recent acquisitions to better understand the motivation behind them and if there could be a precedent to use in looking at a new acquisition.

In 2021, L'Oréal signed an agreement to buy Youth to the People, a California-based vegan skincare brand that combines blends of superfood extract and science. According to L'Oréal's Luxe president Cyril Chapuy, Youth to the People's expertise based on healthy, vegan, and high-efficacy products will complement the Luxe department of L'Oréal. According to his statements, he is glad that his company's values of building a fairer world will be celebrated at L'Oréal. At the time of the acquisition, the company's founder and CEO, Joe Cloyes, talked about representing their community and making products that are good for the people and the planet.

Fast forward to 2022, L'Oréal agreed to purchase Skinbetter Science, a physician-dispensed American skincare brand backed by cutting-edge, dermatological science, combining patented efficacious ingredients with luxurious sensorial textures. After the deal was announced, Jonah Shacknai, founder and executive chairman stated that the firm looks forward to collaborating with such an innovative and socially responsible company as L'Oréal. He also stated that he believes there to be an alignment in terms of mission and values between the two companies.

The acquisitions of these two American brands highlight some important similarities. The first is that both firms are skincare-focused brands with quality-focused products and a sustainable strategy toward the planet. The second is that they are American-founded and focused brands. That provides a benchmark for analyzing future good candidates for an acquisition that match the corporate strategy of the Group.

The North American market, driven by the United States, is one of the most strategic markets for L'Oréal and it is where the company focuses many of its resources to drive growth.

Many of its international marketing teams such as those of CeraVe and Kiehl's are based in the US, even though the company's headquarters are in France. With that in mind, future acquisitions by the group should focus on local companies that have the potential to capture consumers in that market and increase market share in the region.

Taking that strategy into consideration, this paper is analyzing Elf Cosmetics, a multi-brand beauty company that offers cruelty-free cosmetics and skin-care products. To assess some similarities between the two firms, let us analyze factors such as history, size, revenues, product portfolio, and culture and values.

The company was founded in 2004 by father and son Alan and Joey Shama with a goal in mind - to disrupt the beauty industry by offering premium cosmetics on the internet with a starting price tag of \$1. In 2016, the company went public through the New York Stock Exchange (NYSE), raising \$141 million (Reuters). In 2020, the company expanded its portfolio of brands by adding to the current brand's elf makeup and elf Skin, W3ll People, a clean beauty pioneer, and Keys Soulcare – a lifestyle beauty brand in partnership with the singer Alicia Keys. (Refinitiv)

The company offers a wide range of makeup products, from lipsticks to eyeshadows, concealers, mascaras, lip glosses, and others. They also offer skincare products such as cleansers, moisturizers, serums, sunscreen, makeup remover, scented candles, face rollers, and others.

Elf cosmetics recorded 392 million US dollars in sales for the year ended March 2022, an increase of 23.2% from the previous year (Elf Annual report 2022). Among the company's top seller products are Brown Lift, Power Grip Primer, Poreless Primer, Hydrating Concealer, Glossy Lip, Lip Filler Liner, and others (Elf Cosmetics website).

For the year ended March 31, 2022, the number of full-time workers amounted to approximately 303 people. Over the five years from 2018 to 2022, the number of employees increased slightly but steadily: 224 in the United States, United Kingdom, and Canada, and 79 in

China (Statista & Annual Report 2022). Out of 303 full-time employees, 81% are women and 19% are men, 65% are Gen Z and Millennial, 57% are white, 18% are Asian, 13% are Hispanic, 6% are Black, and 6% are two or more races.

In terms of physical space, the story is a bit different. In 2018, Elf Cosmetics announced that it was closing its physical stores. In 2018, physical sales accounted for only 5% of total revenues. This marked a major turn point in the company strategy, which would now shift from physical + digital, to exclusively digital.

The company sells its products on elfcosmetics.com, and distribution is then taken by its retail customers after receiving the customer pay online. It distributes products both through national and international retailers (see below), as well as direct-to-consumers through its e-commerce channels. Elf sells its products in the US primarily in the mass, drug stores, food, and specialty retail channels. Its products are also sold across international markets, including the United Kingdom, Canada, Australia, and Germany, however, only 7.3% of its sales in 2022 came from foreign markets ([Refinitiv](#)).

The company's sales come mainly from three major retailers as customers, who accounted for 61% of revenues in 2022. They are Walmart (26%), Target (23%), Ulta Beauty (12%).

A crucial element of validating the recommendation of this paper is to examine if Elf Cosmetics and L'Oréal have an organizational culture match. However, it is not always easy to exactly define what corporate culture is. In an article to examine the success of mergers and acquisitions through a company culture approach, Schraeder and Self argue that many monetary gains anticipated from mergers and acquisitions don't usually occur because of incompatible values and culture. Between 55-70% of mergers and acquisitions fail to meet anticipated outcomes (Schraeder and Self).

This research will take some framework provided by Schraeder and Self. The authors divide organizational culture into two: subjective and objective. They argue that what determines subjective culture are shared values and beliefs among employees. Characteristics of objective culture, on the other hand, are more tangible such as office location and setting, rules and regulations, etc. To make this analysis more practical, this part of the research will look at (i) Shared Values and Beliefs and (ii) Company Narrative, Engagement, and Initiatives.

The history of L'Oréal starts in 1909 and has shaped its corporate culture since then. In 1909, a young chemist named Eugene Schueller "...with an entrepreneurial spirit, founded the company that was to become the L'Oréal Group." (L'Oréal). The history starts when the young chemist developed the first hair dyes seen on the market and sold them to local shops in Paris. This story only emphasizes research and innovation, which is at the core of the company's history. To become a leader in the beauty market, L'Oréal has been innovating from its first hair dye back in 1909, to some of the company's boldest ventures in beauty tech such as skin recognition and personalized lipstick maker devices.

In 2006, when Jean-Paul Agon became the CEO of the Group, the company embraced diversity and the universalization of beauty. The company's mission changed to "Beauty for All". This appears to mark a shift in the culture of the company which would shape the next decades of its history as well as brings these values to the cosmetics industry. Consequently, new acquisitions would not only have to transmit this message to their audience but also fill in current gaps in their current portfolio of international brands. The Group states on its website that it continued to make acquisitions to address the cosmetic needs of its customers and to promote initiatives that are socially, environmentally, and digitally responsible while caring for sustainable development for the world.

L'Oréal says there are six values at the heart of everything the company does. They are Passion, Innovation, Entrepreneurial Spirit, Open-mindedness, Quest for Excellence, and Responsibility. There is a seventh one that is widely spoken out in the company halls and meeting rooms: simplicity. Many employees focus on being effective while being simple and straight to the point, avoiding extra and unnecessary steps. One could argue that for a company of that size, having this value in mind is to the benefit of everyone.

In terms of engagement and projects, L'Oréal divides its commitments into three areas: For the People, for the Planet, and its Products. There are a vast number of issues the company is trying to tackle. In the Planet sphere, the Group has engaged in fighting climate change, water consumption, respecting biodiversity and preserving natural resources, respecting animal welfare, investing in nature, and many more. Many of these projects are gathered in a company-wide plan called L'Oréal for the Future - a bundle of targets to be met by 2030, respecting the so-called "Planet Boundaries". In the People sphere, the company has initiatives such as L'Oréal for Youth to boost the employability of young people and the Citizen program to encourage volunteering impact. In terms of products, the Group strives for the best possible quality with the least possible environmental footprint.

Some of these efforts have been recognized by the international press. In 2020, the company ranked 16th in the world by Forbes as Best Employer for Diversity and 6th in the US as Best Employer for Women in 2022. In an attempt to reinforce its commitment to diversity and inclusion, the company signed the Declaration of Inclusion for Refugees and Exiled People in 2022. The document intends to help refugees with employability, foster integration of those already employed, and develop a positive culture of interculturality. The Group is also engaged in other initiatives related to immigration, such as TENT Partnership for Refugees, which includes hiring, training, and mentoring of refugees, as well as PLACE – a European collective that aims to show

how migration is a source of innovation for society. These actions and narratives portray a picture of L'Oréal corporate culture - one that is engaged with society beyond its primary business model of selling customer care products.

Shifting the focus now to the target company, Elf's mission is defined as: "We build brands designed to disrupt industry norms, shape culture, and connect communities through positivity, inclusivity, and accessibility" (Elf Annual report 2022). Their company purpose is "We stand with every eye, lip, face, and paw". The company states that "...our products are clean, cruelty-free and offer unparalleled quality for the price." They believe in four values: Delight Our Consumers; Do The Right Thing; Work Together to Win; Execute With Speed and Quality.

In 2022, for the first time, the company released its "Impact Report", detailing its ESG initiatives for the year, as well as a detailed explanation of how each metric is being evaluated. As explained by the company, the Impact Report details how these initiatives are being carried out and the steps taken to make progress in each of them. Praised by the beauty industry, the report is said to focus on the consumer, rather than the investor, and represents a "shift in communications" (Cosmetic Business). In the same report, the company's CEO - Tarang Amin - states that "...We lead with empathy, intention, and an innate desire to empower others." The report is extensive, focusing on four main areas of positive impact: ESG Strategy, Encouraging Self Expression, Empowering Others, and Embodying Our Ethics.

Project Unicorn is one of the company's initiatives that stands out. According to Elf Cosmetics, the company launched it in 2019 to improve the packaging and display of its projects. The project is led by Elf Cosmetics' Chief Creative Officer Ashley Rosebrook, she states that "We named this initiative Project Unicorn because, like the mythical creature, no one thought it could be possible". One year after the project was launched, the company claims that "...it had eliminated an estimated 650,000 pounds of waste and earned three design patents for packaging innovation".

These efforts have been recognized and awarded. The company won many awards - including 4th Best Small and Medium Workplaces in Manufacturing and Production in 2021 (Forbes). It was the first beauty company to have a third-party manufacturing facility Fair Trade Certified™, Glossy 2020 Top 50 Changemakers in Beauty & Retail, among others.

Elf Cosmetics has not been involved in many scandals during its existence. However, in 2019, the company was sued in the US for importing counterfeit products from North Korea between 2012 and 2017. These products were produced in China and some of them contained materials imported from North Korea. The lawsuit argued that companies should have internal protocols and technology able to track the originality of all the materials used in production. Tarang Amin issued a statement recognizing that the irregularities were found during a self-conducted internal audit in 2017 – this attitude provided the company with some leniency despite the five years of violating North Korea sanctions (Vox).

So far it seems like the two firms share some common ground in terms of values and strategy. Both firms are vocal about sustainable topics and take action to achieve ESG goals. They both created programs such as L'Oréal for the Future and the Impact Report which reflect these values. In terms of product portfolio, however, Elf Cosmetics doesn't have much to add. The L'Oréal group already has many affordable makeup and skincare brands such as L'Oréal Paris, Maybelline New York, and CeraVe, which have a strong presence in the North American market and cater to the mass public by offering. The value added perceived in this deal could be the digital strength of Elf, which could drive e-commerce revenue for L'Oréal and expand the Group's footprint in the digital world.

## Valuation Findings

There are four main topics in this valuation part: Discounted Cash Flows valuation, Comparable valuation, Precedent Transactions valuation, and Synergy valuation.

The first one is the Discounted Cash Flows model. It has four main drivers: Revenue Growth, EBITDA Margin, Revenue normalized estimates for Capital Expenditures, Net Working Capital, Depreciation and Amortization, and Corporate Tax Rate.

To forecast revenue growth for the upcoming years, the model first takes into account the historical revenue growth rate for the company. From year ended 2016 until the year ended 2022, revenues grew by an average of 13% (appendix 1). This revenue can be broken down into US and International segments. From 2020 until 2022, the US segment had an average weight of 89% on total revenue, while the International segment had an average weight of 11%.

The model also looks at the United States Gross Domestic Product (GDP) growth as well as Cosmetic Industry CAGR for North America and Europe. US GDP registered an average growth of 1.9%. The estimated CAGR from 2022 until 2027 for the North American Cosmetics segment is 4.6% (Statista), while the European CAGR for the same period and the same segment is 5.4% (Statista). The model breaks down revenue estimates into these two geographies since it is where most of the revenues come from. Taking all that into account, the model assumes a higher-than-market average revenue growth for Elf and assumes that it will gain market share in the upcoming years, given its past performance and business growth momentum. The assumption going forward is revenue growth of 9.3% for the US segment until 2030. To reach that conclusion, the model takes the average between historical growth and CAGR for the region plus a premium due to the rapid growth of e-commerce in the US. For the European segment, the model takes the average between historical growth and CAGR for the region and estimates a growth of 9.2%. In this step,

there is a special assumption for the year 2019. Given that the company changed its reporting policy, switching from ending its fiscal year in December to March, the transition year of 2019 was excluded so that revenue is not distorted.

Historical data shows that Elf cosmetics has maintained an average EBITDA / revenues margin of 15%, from 2014 until 2022 (see appendix 2). The trend is stable; therefore, the model assumes an EBITDA margin of 15% moving forward. Capex also seems to be stable when looking at historical data, maintaining an average of 3% of revenues since 2014. During this time, 2015 was the year with the highest ratio of Capex spending when it reached 5% of revenues, and 2022 was the lowest, with 1% of revenues spent. It is interesting to note that in 2018, the company announced it would shut down its physical stores, however, this change does not seem to have an impact on CAPEX. The model assumes a stable ratio of Capex at 3% of revenues moving forward (appendix 3).

To forecast Net Working Capital, the model assumes that  $NWC = \text{current assets} - \text{current liabilities}$ . It also assumes that all current liabilities are operational, and all long-term liabilities are financial. The only expectations are the current portion of long-term debt and the current portion of finance lease obligations, which are excluded from the calculation. The model takes into account the historical ratio between the calculated Adjusted NWC as a percentage of revenues to forecast future NWC. This ratio is estimated to be 28% and is assumed throughout the following years (See appendix 4).

The model assumes a weighted average cost of capital (WACC) for Elf cosmetics of 11.1% (Appendix 5). Using the CAPM model, the cost of equity is estimated to be 12%. To get there, the model uses an equity beta of 1.56. The risk-free rate uses the 10-year Treasury bonds at valuation date (11.11.2022), which is 3.97% (Trading Economics). Market Risk Premium is assumed to be 5% and Debt / Value target to be 10%, which is the company's peers' average and also taking into

account recent increase in interest rates which can increase the value of the tax shield. Therefore, the model assumes that the company will increase its D/V ratio moving forward. The CAPM model is also used to estimate the cost of debt. The model assumes debt beta to be 0.05 given the credit rating A. By taking risk-free rate + debt beta x market risk premium, the model assumed the cost of debt to be 4.22%. The model looks at the historical D/V ratio for Elf cosmetics by taking total net debt and dividing it by enterprise value. The model takes adjusted closing prices at year-end and multiplies them by outstanding shares of that period to reach the equity value of past years. In the end, the assumption for the historical D/V ratio is 7.8%.

After taking all assumptions into account to forecast future performance, the model used the free cash flows (FCF) calculated from the forecast table (appendix 6) and discounts it at the post-tax WACC. Then, the discounted FCFs are added up. Next, the terminal value is calculated by taking the last estimated FCF at the year-end of 2030 and applying the perpetuity formula. For that formula, the model assumes a growth rate to be 1.7%, which is the average US GDP growth from the last 13 years. Adding up the sum of FCFs and the terminal value, the model reaches an Enterprise Value (EV). Next, Net Debt (total debt - cash) is subtracted from the EV to reach Equity Value. The final equity value is then divided by current outstanding shares of 52,244m, reaching a price target of \$10.64. (Appendix 7). The final share price implies a downside potential of 80% compared to the price share of the date of valuation, which was \$54.18.

The second valuation method used is the relative (or comps) method. The model uses three multiples: EV/EBITDA, EV/EBIT, and EV/Revenue. The model uses twelve peers. They were selected based on current competitors, industry segments, size, and services offered.

For the EV/EBITDA multiple valuations, the average multiple is 16.7x. By multiplying the target's EBITDA by that multiple, the model estimates EV. After that, the model subtracts net debt to reach equity value and then divides it by the shares outstanding. For this valuation method, the

share price estimate is \$17.24 (Appendix 8). Using the same group of peers and methodology and using EV/EBIT multiple of 30.2x, the model estimates a share price of \$16.35. Using the same group of peers and methodology, and using an EV/Revenue multiple of 3.8x, the model estimates a share price of \$27.72. (Appendix 8).

The third part is the Precedent Transactions method (Appendix 9). For this part, the model selected a dataset with twelve deals. They have been filtered to include target firms in the sectors of luxury beauty, personal products, cosmetics and perfumes, and luxury cosmetics. All deals were made within the last 5 years and only include transactions where the purchaser acquired 50% or more of the target firm. The same three multiples from the relative valuation were used. From this method, the lowest share price estimate was \$14.40 (from EV/EBIT multiple), and the highest was \$19.89 (from EV/Revenue multiple).

The fourth part includes a synergy valuation analysis to understand the possible gains or losses from this acquisition. The first step is to compute the value of the standalone firms (which results in different estimates from the DCF model given different methods used). The second step is to compute the value of the firms combined without synergy, simply by adding their values. The third step is to compute the value of the firms combined with synergy. And the final step is to compute the offer price, based on the level of synergy shared between the firms.

In step one, the model takes unlevered betas, pre-tax cost of debt, tax rate, debt to capital ratio, revenues, EBIT, pre-tax return on capital, reinvestment rate, and length of high growth period into account. (Appendix 10). With these inputs, the model then calculates the cost of capital (WACC) for the respective firms. After, it takes the EBIT from the last recorded year and calculates free cash flows for years 1-5 of our chosen period length. This estimate uses the tax rate, reinvestment rate, and expected growth rate. (Appendix 10). After having the FCFs for each firm over 5 years, the model discounts them by using the individual WACC. Then the model calculates

the terminal value using the perpetuity formula and reaches the value of the firm at  $t=0$  for each firm. In step 2, the model simply adds up the values found in step 1 = Value = (A) + (B).

In step 3, a similar approach is conducted. However, some assumptions are taken into account. First, combined levered beta by using the weighted value of each firm. Given the disproportionate value between the firms, Elf being much smaller, the beta ends up unchanged. The model also assumes that the tax rate and pre-tax cost of debt remain unchanged. Due to operational synergy, the model assumes some cost savings and revenue growth, adding \$ 109M to EBIT (Appendix 11 for breakdown). This increase in EBIT comes from three sources:

- Revenue Gains: the assumption here is that L'Oréal could gain additional revenue from access to Elf's online platforms and create bundle strategies by offering skincare routines combining multiple brands. Elf gains access to marketing expertise from L'Oréal and increases brand visibility following the deal announcement.
- Cost Savings: this section assumes that some costs could be eliminated. The costs were identified in the company's financial statements, and they include the rental of corporate headquarters, rental of corporate offices, and rental of the distribution center and manufacturing plant. These costs are detailed in the excel model, as well as in appendix 11.
- Restructuring Costs: this section assumes that some costs could be incurred to implement the changes after acquisition.

After calculating WACC for the combined firms, considering the assumptions detailed above, the model estimates the value of the firm (A + B). Finally, by subtracting step 2 from step 3, we can see the value of synergy created. In this model, the value of synergy is \$ 2.38 billion. To reach a final offer price, the model simulates values depending on the percentage of synergy

achieved. For example, if 50% of the synergy value is shared, the offer price, given current outstanding shares of 52 million, is \$29. (See appendix 12).

To conclude, the model assumes that synergies generated by this acquisition are mostly operational. In great part, they are due to economies of scale. Coming from the fact that the combined firms will be more cost-efficient and more profitable. It also assumes some higher growth synergy arising from the assumption of a stronger position in the target market,

Now that the paper has analyzed the target company culture and business strategy match as well as calculated price targets using different valuation techniques, it can perhaps offer an answer to the question: Is the acquisition of Elf Cosmetics worth pursuing?

From a valuation perspective, the models used in this study estimate a share price far below the current market price, which implies that L'Oréal would be paying a much higher price for a firm valued much lower. To illustrate, the highest price out of all methods used would be \$27.72, which is still much lower than the current share price. However, when looking at synergies generated, one could argue that if 100% of synergies were shared, the implied price per share would be around \$52. However, synergy seems far easier to achieve on paper than in reality. Synergy is extremely hard to evaluate and is often looked at with skepticism, given the track record of acquirers in delivering such synergies (Damodaran, 2005).

In conclusion, the study finds that the acquisition should not move forward given the high premium of the acquisition for the little benefit for the L'Oréal Group. In terms of product portfolio, Elf Cosmetics does not seem to add value or fill in any gaps in L'Oréal's current product portfolio. L'Oréal already possesses many brands which offer quality goods for a low price and cater to the mass public. Although the model implies synergies created by the deal, it is more likely that they will not be realized. Acquisition deals focused on small private firms are more likely to be successful than those focused on publicly traded companies (Damodaran, 2005). This is because

private firms operate under far tighter capital constraints than public firms and because the acquirer does not have to start with a market price, which already reflects synergy value and market premium in it (Damodaran, 2005). When looking at past acquisitions of the L'Oréal group, this is exactly what happens. The Group focuses on small private companies with growth and internationalization potential rather than publicly traded companies.

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### Appendix:

#### 1. Historical Revenue Growth

Historical Revenue Growth							
Year	Elf Total Hist Revenue	Growth	US Rev	Weight	Int. Rev.	Weight	US Inflation
2015	\$ 191,413						0.12%
2016	\$ 229,567	20%					1.26%
2017	\$ 269,888	18%					2.13%
2018	\$ 267,435	-1%					2.44%
2020	\$ 282,851	6%	\$ 255,284	90.3%	\$ 27,567	9.7%	1.81%
2021	\$ 318,110	12%	\$ 282,273	88.7%	\$ 35,837	11.3%	1.23%
2022	\$ 392,155	23%	\$ 347,484	88.6%	\$ 44,671	11.4%	4.70%
<b>Average</b>		<b>13%</b>		<b>89.2%</b>		<b>11%</b>	<b>2%</b>

#### 2. Historical EBITDA Margin

EBITDA Margin				
Year	EBITDA	ELF Rev	EBITDA Margin	
2014	\$ 15,059	\$ 144,944	10%	
2015	\$ 35,860	\$ 191,413	19%	
2016	\$ 36,231	\$ 229,567	16%	
2017	\$ 47,800	\$ 269,888	18%	
2018	\$ 44,023	\$ 267,435	16%	
2020	\$ 46,811	\$ 282,851	17%	
2021	\$ 37,220	\$ 318,110	12%	
2022	\$ 56,903	\$ 392,155	15%	
<b>average</b>			<b>15%</b>	

#### 3. CAPEX, Depreciation, and Amortization

CAPEX and Dep & Amortization					
Year	rev	CAPEX	%	Dep & Am	%
2014	\$ 144,944	\$ 1,616	1%	\$ 7,985	6%
2015	\$ 191,413	\$ 10,242	5%	\$ 10,289	5%
2016	\$ 229,567	\$ 9,139	4%	\$ 13,152	6%
2017	\$ 269,888	\$ 7,544	3%	\$ 14,521	5%
2018	\$ 267,435	\$ 8,872	3%	\$ 17,861	7%
2020	\$ 282,851	\$ 9,422	3%	\$ 22,843	8%
2021	\$ 318,110	\$ 6,474	2%	\$ 25,179	8%
2022	\$ 392,155	\$ 4,818	1%	\$ 27,083	7%
<b>3%</b>			<b>6%</b>		

## 4. Historical NWC

NWC										
Year	Rev	Current Ass	Current Lib	Current LT debt	Current Lease	Current Liab. exc. Financial	ADJ NWC	% of rev	Delta	
2014	\$ 144,944	\$ 63,439	\$ 35,553	\$ -	\$ -	\$ 35,553	\$ 27,886	19%		
2015	\$ 191,413	\$ 70,718	\$ 45,854	\$ -	\$ -	\$ 45,854	\$ 24,864	13%	\$ 46,469	
2016	\$ 229,567	\$ 124,904	\$ 80,270	\$ -	\$ -	\$ 80,270	\$ 44,634	19%	\$ 38,154	
2017	\$ 269,888	\$ 123,644	\$ 51,361	\$ -	\$ -	\$ 51,361	\$ 72,283	27%	\$ 40,321	
2018	\$ 267,435	\$ 141,743	\$ 43,015	\$ 9,075	\$ -	\$ 33,940	\$ 107,803	40%	\$ (2,453)	
2020	\$ 282,851	\$ 132,360	\$ 51,123	\$ 11,756	\$ 3,083	\$ 36,284	\$ 96,076	34%	\$ 15,416	
2021	\$ 318,110	\$ 170,144	\$ 73,331	\$ 15,469	\$ 4,292	\$ 53,570	\$ 116,574	37%	\$ 35,259	
2022	\$ 392,155	\$ 193,029	\$ 65,017	\$ 5,000	\$ 4,391	\$ 55,626	\$ 137,403	35%	\$ 74,045	
								<b>AVERAGE</b>	<b>28%</b>	

## 5. WACC Calculation

WACC	
D/V (historical)	7.8%
Beta_e (historical)	1.56
Beta_d	<b>0.05</b>
Beta_u	1.44

D/V target	10%
Beta_d	<b>0.05</b>
Beta_e	1.60

Risk-free rate	3.97%
MRP	5.00%
Tax Rate	21.27%
Cost of Debt	4.2%
Cost of Equity	12.0%

WACC (post-tax)	<b>11.1%</b>
Growth Rate	<b>1.7%</b>

Valuation Date 12/7/2022

## 6. FCF Forecast Table

(in million of USD)	Actual	Forecast ->							
	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30
<b>Total Revenue</b>	<b>392,155</b>	<b>428,633</b>	<b>468,505</b>	<b>512,086</b>	<b>559,720</b>	<b>611,786</b>	<b>668,695</b>	<b>730,897</b>	<b>798,886</b>
US Segment	347,484	379,845	415,219	453,888	496,158	542,364	592,874	648,088	708,443
Growth		9.3%	9.3%	9.3%	9.3%	9.3%	9.3%	9.3%	9.3%
International Segment	44,671	48,789	53,286	58,198	63,562	69,422	75,821	82,810	90,443
Growth		9.2%	9.2%	9.2%	9.2%	9.2%	9.2%	9.2%	9.2%
<b>EBITDA</b>	<b>56,903</b>	<b>65,280</b>	<b>71,353</b>	<b>77,990</b>	<b>85,245</b>	<b>93,174</b>	<b>101,841</b>	<b>111,315</b>	<b>121,669</b>
EBITDA Margin	15%	15%	15%	15%	15%	15%	15%	15%	15%
<b>Depreciation &amp; Amortization</b>	<b>27,083</b>	<b>27,631</b>	<b>30,201</b>	<b>33,010</b>	<b>36,081</b>	<b>39,437</b>	<b>43,106</b>	<b>47,115</b>	<b>51,498</b>
% of Revenue	7%	6%	6%	6%	6%	6%	6%	6%	6%
<b>EBIT</b>	<b>29,820</b>	<b>37,650</b>	<b>41,152</b>	<b>44,980</b>	<b>49,164</b>	<b>53,737</b>	<b>58,736</b>	<b>64,199</b>	<b>70,171</b>
Taxes	6,342	8,007	8,751	9,565	10,455	11,428	12,491	13,653	14,923
Tax rate	21%	21%	21%	21%	21%	21%	21%	21%	21%
<b>NOPLAT</b>	<b>23,478</b>	<b>29,643</b>	<b>32,400</b>	<b>35,414</b>	<b>38,709</b>	<b>42,309</b>	<b>46,245</b>	<b>50,547</b>	<b>55,249</b>
<b>CAPEX</b>	<b>4,818</b>	<b>12,406</b>	<b>13,560</b>	<b>14,821</b>	<b>16,200</b>	<b>17,707</b>	<b>19,354</b>	<b>21,154</b>	<b>23,122</b>
% of rev	1%	3%	3%	3%	3%	3%	3%	3%	3%
<b>NWC</b>	<b>137,403</b>	<b>120,240</b>	<b>131,424</b>	<b>143,650</b>	<b>157,012</b>	<b>171,617</b>	<b>187,581</b>	<b>205,030</b>	<b>224,102</b>
% of rev	35%	28%	28%	28%	28%	28%	28%	28%	28%
<b>Change in NWC</b>	<b>74,045</b>	<b>-17,163</b>	<b>11,185</b>	<b>12,225</b>	<b>13,362</b>	<b>14,605</b>	<b>15,964</b>	<b>17,449</b>	<b>19,072</b>
<b>Free Cash Flow</b>	<b>-28,302</b>	<b>62,031</b>	<b>37,857</b>	<b>41,378</b>	<b>45,227</b>	<b>49,434</b>	<b>54,033</b>	<b>59,059</b>	<b>64,553</b>

## 7. Valuation Results

<b>Sum (dFCF)</b>	\$	279,824
<b>Terminal Value</b>	\$	323,710
<b>EV</b>	\$	603,534
<b>Net Debt</b>	\$	47,727
<b>Equity Value</b>	\$	555,807
<b>Nr. Of Shares</b>		52,244
<b>Price Target</b>	\$	10.64

<b>Share Price at Date of Valuation</b>	\$	54.18
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**Downside potential** -80%

## 8. Comps Valuation

EV / EBITDA	
Peer	EV / EBITDA
LVMH Moet Hennessy Louis Vuitt	15.6
Procter & Gamble Co	18.6
L'Oreal SA	23.2
Unilever PLC	13.3
Estee Lauder Companies Inc	22.0
Ulta Beauty Inc	12.9
Beiersdorf AG	19.1
Kao Corp	12.7
Shiseido Co Ltd	24.4
Coty Inc	12.4
Olaplex Holdings Inc	9.0
Beauty Health Co	719.3
<i>(in millions of USD)</i>	Multiple
	<b>16.7</b>
ELF EBITDA FY22	\$ 56,903
ELF EV	\$ 948,246
ELF Net Debt	\$ 47,727
ELF Equity	\$ 900,519
ELF # Shares	52,244
<b>Price Target</b>	<b>\$ 17.24</b>

EV/EBIT	
Peer	EV/EBIT
LVMH Moet Hennessy Louis Vuitton SE	22.9
Procter & Gamble Co	20.5
L'Oreal SA	38.2
Unilever PLC	14.9
Estee Lauder Companies Inc	26.3
Ulta Beauty Inc	14.6
Beiersdorf AG	21.3
Kao Corp	18.4
Shiseido Co Ltd	62.7
Coty Inc	38.4
Olaplex Holdings Inc	54.6
Beauty Health Co	0.0
<i>(in millions of USD)</i>	Multiple
	<b>30.2</b>
ELF EBIT FY22	29,820
ELF EV	\$ 902,017
ELF Net Debt	47727
ELF Equity	\$ 854,290
ELF # Shares	52243.76
<b>Price Target</b>	<b>\$ 16.35</b>

EV / Revenue	
Peer	EV / Revenue
LVMH Moet Hennessy Louis Vuitt	5.4
Procter & Gamble Co	4.7
L'Oreal SA	5.6
Unilever PLC	2.7
Estee Lauder Companies Inc	5.1
Ulta Beauty Inc	2.4
Beiersdorf AG	3.1
Kao Corp	1.7
Shiseido Co Ltd	2.6
Coty Inc	2.1
Olaplex Holdings Inc	5.7
Beauty Health Co	4.7
<i>(in millions of USD)</i>	Multiple
	<b>3.8</b>
ELF Revenue FY22	\$ 392,155
ELF EV	\$ 1,495,744
ELF Net Debt	\$ 47,727
ELF Equity	\$ 1,448,017
ELF # Shares	52,244
<b>Price Target</b>	<b>\$ 27.72</b>

## 9. Precedent Transactions

EV / EBITDA	
Target	EV / EBITDA
Avon Products Inc	7.0
Coty Inc	12.3
Ci:z Holdings Co Ltd	0.0
Oriflame Holding AG	62.3
Apollo Healthcare Corp	5.3
Trilogy International Ltd	10.7
Natural Beauty Bio-Technology	8.4
KM Pharmaceutical Co Ltd	0.0
Korres Natural Products SA	19.7
Bonne Co Ltd	0.0
Euro Cosmetic SpA	0.0
Korres Natural Products SA	19.7
<i>(in millions of USD)</i>	Multiple
	<b>17.5</b>
ELF EBITDA FY22	\$ 56,903
ELF EV	\$ 994,707
ELF Net Debt	\$ 47,727
ELF Equity	\$ 946,980
ELF # Shares	52,244
<b>Price Target</b>	<b>\$ 18.13</b>

EV / EBIT	
Target	P/E
Avon Products Inc	8.8
Coty Inc	28.9
Ci:z Holdings Co Ltd	0.0
Oriflame Holding AC	78.7
Apollo Healthcare C	6.5
Trilogy International	11.1
Natural Beauty Bio-1	9.7
KM Pharmaceutical	0.0
Korres Natural Prod	0.0
Bonne Co Ltd	0.0
Euro Cosmetic SpA	0.0
Korres Natural Prod	0.0
<i>(in millions of USD)</i>	Multiple
	<b>26.8</b>
ELF EBIT FY22	29,820
ELF EV	\$ 799,947
ELF Net Debt	47727
ELF Equity	\$ 752,220
ELF # Shares	52243.76
<b>Price Target</b>	<b>\$ 14.40</b>

EV / Revenue	
Target	EV / Revenue
Avon Products Inc	0.7
Coty Inc	1.8
Ci:z Holdings Co Ltd	0.0
Oriflame Holding AC	9.5
Apollo Healthcare C	1.5
Trilogy International	2.1
Natural Beauty Bio-1	3.3
KM Pharmaceutical	0.0
Korres Natural Prod	1.7
Bonne Co Ltd	0.0
Euro Cosmetic SpA	0.0
Korres Natural Prod	1.7
<i>(in millions of USD)</i>	Multiple
	<b>2.8</b>
ELF Revenue FY22	\$ 392,155
ELF EV	\$ 1,086,760
ELF Net Debt	\$ 47,727
ELF Equity	\$ 1,039,033
ELF # Shares	52,244
<b>Price Target</b>	<b>\$ 19.89</b>

## 10.

	L'Oreal	ELF	Combined firm without synergies	Combined firm with synergies
Beta ( $\beta$ )	0.59	1.56	0.59	0.59
Pre-tax cost of debt (rd)	2%	3.9%	2.00%	2.00%
Tax rate (t)	25%	21%	24.77%	24.77%
Debt to capital ratio (D/D+E)	12%	13%	12%	12%
Revenues (in \$ m)	\$38,191	\$392	\$38,583	--
EBIT (in \$ m)	\$7,305	\$30	\$7,335	\$7,444
Pre-tax return on capital	23%	14%	23.30%	22.00%
Reinvestment rate (1-Payout Ratio)	8%	7%	7.61%	7.61%
Length of high-growth period	5	5	5	5

  

Calculation of stand-alone values:	L'Oreal	ELF	Combined firm without synergies	Combined firm with synergies
Cost of equity	6.91%	11.78%	6.92%	6.92%
After-tax cost of debt	1.50%	3.09%	1.51%	1.51%
Cost of capital (WACC)	6.26%	10.64%	6.27%	6.27%
After-tax return on capital	17.53%	11.06%	17.53%	16.55%
Reinvestment rate	7.61%	7.48%	7.61%	7.61%
Expected growth rate	1.33%	0.83%	1.33%	1.26%
Value of firm				
PV of FCFF in high growth period	\$ 22,065	\$ 83	\$ 22,152	\$ 22,434
PV of terminal value	\$ 181,678	\$ 213	\$ 181,872	\$ 183,976
Value of firm at t=0	\$ 203,743	\$ 296	\$ 204,024	\$ 206,410
	Step 1^		Step 2^	
			Step 3^	

## 11. Operational Synergies Breakdown

Gains assumptions:	In M \$	Why?	Reasoning / Assumptions
<b>Revenue gains</b>	39	<b>Sales growth in digital space</b>	Loreal could gain additional revenue from access to ELF's online platforms and create bundle strategies by offering skincare routines combining multiple brands. Elf gains from access to marketing expertise from loreal and increasing brand visibility following deal announcement.
<b>Cost savings (overhead)</b>	75	<b>Rental, Distribution, Manufacturing consolidation</b>	ELF Rental 2022: 4,68m (combine offices with loreal), ELF COGS: 140m (2022) = could realize savings from combining manufacturing plants in NJ, and use same distribution centers = currently split between ontario and ohio operated by third party = assumption = reduce ELF's costs by 50% = 70m
Cash management improvements	0	<b>None</b>	
Gains from divestitures	0	<b>None</b>	
<b>Restructuring costs (fixed)</b>	-5	<b>Moving costs</b>	Employee severance, loss on sale of impaired property, inventory disposal, other asset write-off costs. In 2021 ELF closed a manufacturing site and recorded restructuring costs of 2.6m.
<b>Total</b>	<b>109</b>		

## 12. Synergy achieved breakdown

	Percentage of synergy shared ( )	Dollar value of synergy shared	Value of target + Synergy	Offer price with 52m shares outstanding as of Oct. 2022
Minimum price (pay value of target only)	0%	\$ -	\$ 296	6
	10%	\$ 239	\$ 534	10
	20%	\$ 477	\$ 773	15
	30%	\$ 716	\$ 1,011	19
	40%	\$ 954	\$ 1,250	24
Range of offer prices	50%	\$ 1,193	\$ 1,489	29
	60%	\$ 1,431	\$ 1,727	33
	70%	\$ 1,670	\$ 1,966	38
	80%	\$ 1,908	\$ 2,204	42
	90%	\$ 2,147	\$ 2,443	47
Maximum price (pay all synergies to the target)	100%	\$ 2,386	\$ 2,681	52