MAY 2005 EDITION

Annual report

Cosmetics consumption in Italy in 2004

04

ABSTRACT

Unipro

Foreword

The Unipro Annual Report, edited by the Association's Corporate Culture and Study Centre, constitutes not only the traditional annual appointment with the previous year's statistics, but also the most important tool for understanding the dynamics that make this industry function, as well as for being ever alert to the phenomena and scenarios that distinguish it from other sectors of industry.
This is because the Italian cosmetics industry in general – and the market phenomena typical of it in particular – constitutes a significant anomalous economic model compared to other sectors of consumer goods, even though it, too, has inevitably been influenced by the country's negative economic climate in recent years: the Italian economy is still very much subject to increases in the prices of crude oil, which have unavoidable fallout effects on inflation and therefore on consumers' buying power.
At the beginning of 2004, the increase in the exchange rate of the Euro, which had a drastic effect on Italy's competitive edge, also exerted a significant influence on the country's cosmetics industry.
While succeeding in maintaining rates of development significantly higher than the domestic average for consumer products, the cosmetics market, which is worth more than 8,400 million Euros in Italy, once again ended the year on a note of deceleration in 2004, which was especially noticeable in the component that had stood out for its more pronounced dynamism in recent year: the mass market. Nevertheless, it is important to note that the overall growth rate is an average of several quite different trends, in terms both of channels of distribution and of product families, which is the mark of an overall scenario that features some very diversified possibilities for buying.
Once again this year, firms have encountered difficulties that they have had to tackle in the framework of a political and economic context that is far from stimulating. Despite this, and as a result of operations of concentration, merger and corporate reorganisation, undertaken in particular to overcome the chronic inadequacy of the country's medium-sized enterprises, Italy's cosmetics firms have succeeded in maintaining the competitive positions, especially on the international scale, that they had scaled in previous years. In point of fact, with an industrial turnover verging on 7,400 million Euros and a strong traditional vocation for research and product innovation, Italy's enterprises achieved a significant increase in exports, which were up by 8.8% in 2004, making a significant contribution to the increase in the industry's balance of trade, which ended the year with a surplus of 720 million Euros.
It is quite probably that the next few years will witness an important process of consolidation in the sector: it will be necessary to valorise those capacities that have enabled the industry to maintain its competitive edge this far. At the same time, corrections will have to be made to some points, such as the small dimensions and the still underdeveloped propensity to internationalisation that beset many of the industry's enterprises: the risk they run if they do not make these corrections is that of a merciless exclusion from the processes of development.
Unipro decided some time ago to support these processes, assisting the industry in its growth by flanking it with increasingly specific, qualified services, without neglecting the important function of institutional representation that is so central to the Association. This means that also in future, like today, we shall not restrict our activities to merely monitoring the industry, but shall do our best to foresee its evolution and requirements more precisely all the time, calling attention to risks and valorising its competitive capacities.

Alberto Donati
President Unipro

The cosmetics industry

In 2004, the turnovers achieved by Italy's cosmetics manufacturing concerns achieved a growth rate in value terms of 3.8%, reaching a total production worth 7,413.5 million Euros.

The main impetus for this result, which compares rather favourably to those achieved by other sectors of consumer products, came to a quite evident extent from the foreign component of the demand side. While the domestic market grew by an average of 2.2%, in fact, Italy's cosmetic product exports returned to their previous model of significantly growth, increasing by 8.8%, to a total value of just under 2,000 million Euros.

The marked tensions that reined in consumers' propensity to buy, influencing the increase in domestic demand in previous years, continued to maintain their hold also in 2004. That domestic demand actually retrenched if we look at the professional channels, whose turnovers dropped by 1.6%, while the traditional channels made a meaningful comeback with growth rates set at 2.5%.
The percentage shares of turnovers generated by channels of distribution in 2004 confirm the picture already established in previous years: nearly 35% was cornered by the mass market, whose sell-in value is now of the order of more than 2,580 million Euros.

COSMETICS INDUSTRY TURNOVER BY CHANNEL OF DISTRIBUTION

(Figures in millions of Euros)

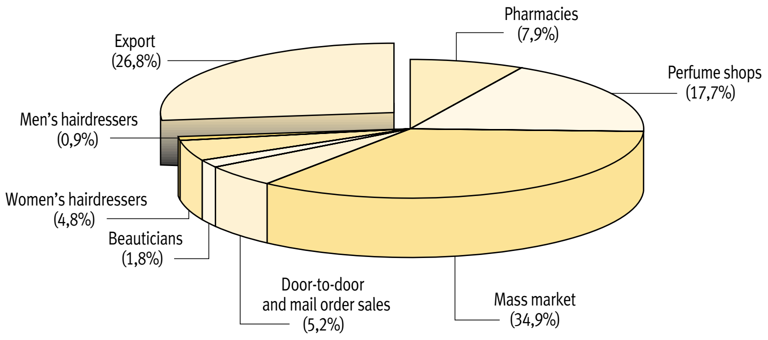
Distribution channels	2003		2004	
	% variation	values	% variation	values
Traditional channels:	**4.751,8**	**3,8%**	**4.871,6**	**2,5%**
– Pharmacy	541,3	4,6%	587,9	8,6%
– Perfume shop	1.282,1	0,6%	1.310,9	2,2%
– Mass Market*	2.559,1	5,6%	2.586,3	1,1%
– Door-to-door and mail order sales	369,3	2,3%	386,5	4,7%
Professional channels:	**567,8**	**-3,9%**	**558,5**	**-1,6%**
– Beauty salons	136,5	-14,9%	133,1	-2,5%
– Women's hairdressers	359,6	0,2%	355,2	-1,2%
– Men's hairdressers	71,7	-	70,2	-2,0%
Export	**1.822,4**	**-0,8%**	**1,983,4**	**8,8%**
Total turnover of cosmetic industry	**7.142,0**	**2,0%**	**7.413,5**	**3,8%**

(*) *Includes* **Herbalist** *shops with a turnover of 125.8 million Euros in 2003 and of 133.3 million Euros in 2004, for a relative increase of 6.0%.*

As was mentioned above, exports were the component of the demand side that exerted the greatest influence on the growth of industrial turnovers. Nevertheless, at 26.8%, the share of production that goes for export is actually still very low when compared to the shares found in other industries that produce consumer goods. This confirms the fact that there are still ample opportunities to develop this sector, as it still suffers today from its chronic small and medium dimensions and from general difficulties in tackling the processes of internationalisation.

Although the outlook for the domestic market leaves little space for optimism, the industrial indicators for the cosmetics sector suggest that the situation is potentially still under development: employment has maintained the same levels in the last few years, investments in expanding production capacity are gradually on the way up, while investments in research and development confirm that there is a will among Italian firms to hold onto the competitive positions that they have acquired.

PERCENTAGE SHARES OF TURNOVERS BY CHANNEL OF DISTRIBUTION IN 2004



Channels of distribution

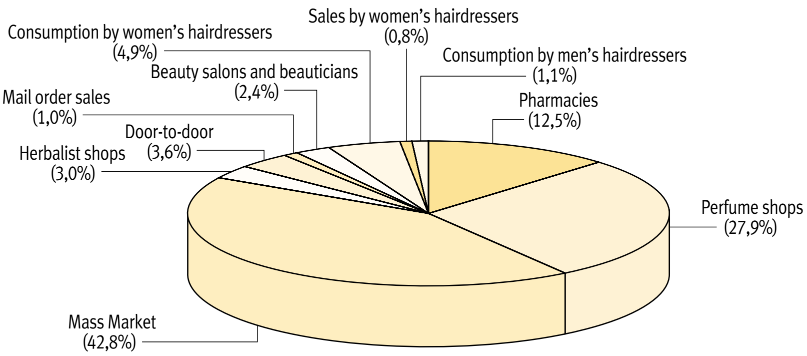
On the one hand, Italy's domestic consumption of cosmetics products, which grew by 2.2% in value terms in 2004, is influenced by the socio-economic tensions that discourage and slow down family spending, while on the other it is being impacted by significant changes in demand patterns.
This background explanation throws the necessary light on the interpretation of the trends in channels of distribution, which tend to lurch up and down like yo-yos from one year to the next, as they react also to increasingly specific and individualised buying orientations.
So, while the revival of sales through the perfume shop channel (up by 2.2% over the previous year) comes as a pleasantly positive surprise after several years on a downward path, this is counterbalanced by the significant slow-down in the rate of growth achieved by the mass market, down to only 0.7%, although on its own it still accounted for more than 42% of all cosmetics consumption in 2004.

TOTAL MARKET FOR COSMETICS PRODUCTS IN 2004

Consumption in millions of Euros – Prices to the public including VAT.

		% variation 04/03
Total sector	**8.461,6**	**2,2%**
Total retail channels	**7.297,4**	**2,5%**
Pharmacies	**1.058,2**	**8,6%**
Perfume shops	**2.359,7**	**2,2%**
Mass market	**3.626,2**	**0,7%**
Herbalist shops	**253,3**	**6,0%**
Door-to-door sales	**303,8**	**5,5%**
Mail order sales	**82,7**	**1,7%**
Sales to beauty salons and beauticians	**199,7**	**-2,5%**
Consumption by women's hairdressers	**415,4**	**-1,2%**
Sales by women's hairdressers	**71,3**	**-1,7%**
Sales by men's hairdressers	**91,3**	**-2,0%**

PERCENTAGE SHARES OF CONSUMPTION BY CHANNEL OF DISTRIBUTION IN 2004



The drop in the levels of consumption that move through the professional channels was a cause for concern, as the average decrease was 1.5%, with a negative peak of 2.5% in sales through beauty salons and beauticians.

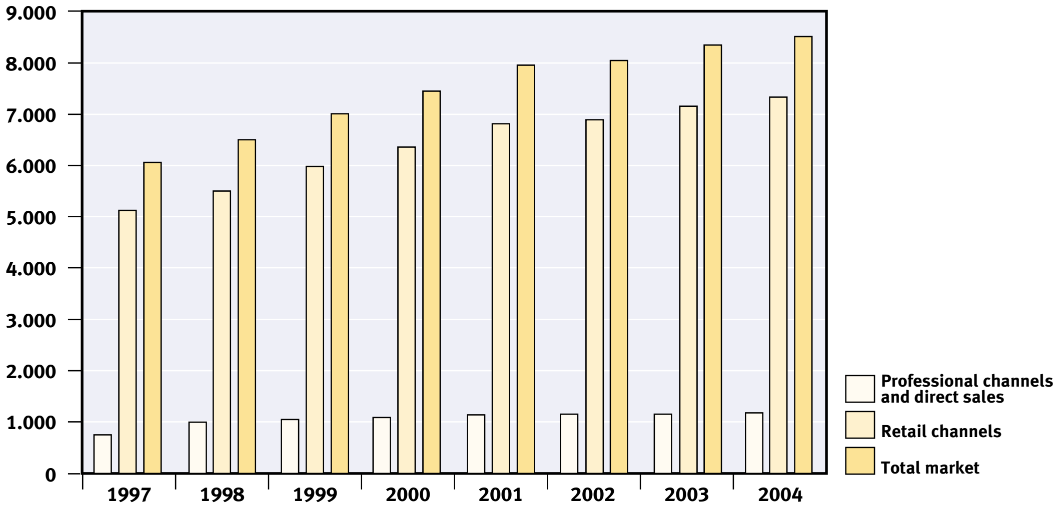
Meanwhile, the positive trend continued for sales in pharmacies, which surpassed the 1,000 million Euros threshold in 2004, achieving a growth rate of 8.6%.

TRENDS IN THE CHANNELS OF DISTRIBUTION FOR THE COSMETICS INDUSTRY

	Consumption	Quantities	Prices
Pharmacies	8,6%	5,5%	2,9%
Perfume shops	2,2%	-0,5%	2,8%
Mass market	1,1%	-0,9%	2,0%
TOTAL TRADITIONAL CHANNELS	**2,5%**	**0,1%**	**2,4%**
Door-to-door and mail order sales	4,7%	3,1%	1,5%
Sales to Beauty Salons and Beauticians	-2,5%	-3,9%	1,5%
Consumption through women's hairdressers	-1,2%	-4,1%	3,0%
Consumption through men's hairdressers	-2,0%	-4,9%	3,0%
GENERAL TOTAL	**2,2%**	**-0,2%**	**2,4%**

EVOLUTION OF COSMETICS CONSUMPTION PERIOD 1997 – 2004

Real values, prices to the public, including VAT



In the area of prices, the year is confirmed to have brought an increase of more than two percentage points in the price-lists practised in traditional channels, while pricing trends developed differently in the professional channels, where the increases amounted to 1.5% in sales to beauty salons and beauticians and to 3% in hairdressing salons.
A look at past trends confirms that the growth maintained by the various channels of sale was practically constant.
It is only when the data are evaluated in terms of constant values that the gradual deceleration of rates of development since 2001 becomes evident. As always, though, there is a distinction to be drawn between the cosmetic products sector and the other sectors of consumer goods, in which demand has been contracting significantly for the last five years.
One last comment on the 2004 scenario calls attention to the comparison with other European countries: with a growth of 6.3%, Spain is developing at a faster rate than Italy, as is the United Kingdom (+5.3%), while France (0.0%) is showing signs of a clear slow-down and the German market is actually shrinking (-1.7%).

THE PHARMACY

Once again in 2004, sales through the channel of the pharmacy marked up development trends that were more vigorous than the average of all the other channels: with a value of sales now approaching 500 million Euros, consumption through this channel was actually up by 8.6%. Also in terms of quantities turned over, la pharmacy channel's development trend was well above average, at +5.5% compared to the mean of all the traditional channels, which hovered around zero.
Now accounting for 12.5% of the entire market for cosmetics products, the pharmacy channel constitutes clear confirmation of the alterations taking place in consumers' buying preferences, alterations that have been developing as an evident characteristic of the cosmetics market since the end of the nineties.
The combined effect of the service offered by pharmacists and their staff, the expanded range of products on sale and specific marketing policies has not only enabled the pharmacy to hold its own in the market during a period when the economic climate is negative, it has also put it in a position to make significant inroads into the other traditional channels, such as the perfume shop and the mass market.

THE PERFUME SHOP

After several years of significant contraction, 2004 witnessed a tangible revival of 2.2% in the perfume shop channel, which reached a value of sales in excess of 2,350 million Euros, second only in volume terms to the mass market channel and accounting for 27.9% of the entire Italian market. This growth certainly derived from a substantial increase in prices, which were up by 2.8%, as the quantity statistics show that volumes were once again down by 0.5%.
In consideration of the fact that alcohol-based perfume products constitute the most important category of sales through the perfume shop channel and that this category put up a practically constant performance in 2004, it is fair to deduce that the channel is evolving towards offering an increasingly diversified range of product categories. This thesis is backed up by the growth encountered among products for facial make-up, which were up by 5.1%, and for men's products, which soared upwards by nearly twelve percentage points.

The channel has certainly not yet completed the process of pulling out of the profound structural modification that has affected it in the last five years; nevertheless, the signs highlighted here indicate that there is now a chance for the new characteristics of the selective channel to be successful, as a result of the strategies of service valorisation, product specialisation and qualification of range now being adopted in this channel and setting it apart from the others. This being said, however, in the short term it will be important to continue monitoring the reactions of consumers who are increasingly demanding, concrete and alert to the specific characteristics of each range.

THE MASS MARKET

With a volume of sales exceeding 3,600 million Euros, accounting for 42.8% of the entire Italian market, the mass market channel ended the year with a sluggish growth rate of only 0.7%, a deceleration in its development that constitutes a cause for concern after years of growth above the market average. As yet, it is too early to tell whether this deceleration in the rate of growth constitutes a reverse of the trend enjoyed in recent years or whether the recuperation of market shares by other channels, such as the pharmacy and the perfume shop, is the results of the introduction of new products and of the application of pricing policies that go beyond the mass market channel as such.
In 2004, the most conspicuous sales were achieved by the category of products for haircare and the scalp, although they only increased by 1.1%, with a value of just over 925 million Euros. In terms of rate of growth, the most positive performance was achieved by facial make-up products, up by 9%, and by facial care products, up by 5.7%. On the other side of the equation, the reduction in sales of body hygiene products, down by 2.2%, and of alcohol-based perfume products, down by 4.7%, is a cause for concern.
These figures are indicative of an evolution that is also conditioning this channel, traditionally more dynamic in reacting to alterations in consumers' buying habits: only the future will tell whether the phenomenon constitutes a structural change or, as seems to be the case, no more than a chapter dictated by the economic climate.

THE DIRECT SALES CHANNELS

The value of door-to-door and mail order sales exceeded 385 million Euros in 2004, achieving an average increase of 4.7% over the previous year that was also matched by a significant increases in quantities, which the very modest mean price increase of 1.5% enabled to grow by 3.1% in the same period.
Also for this form of distribution, it is too early as yet to understand whether there is a structural modification afoot or whether the phenomenon can be considered to be no more than an episode. Among other reasons, this is also because direct sales have traditionally been less widespread in Italy than in the other countries of Europe.
Very much the same type of reasoning should be applied to sales via the Internet, which have been achieving consistently positive performances in the last few years, despite being notoriously difficult to measure. Now that the initial congenital diffidence towards an innovative method of sale has been largely overcome, it looks as though new areas of consumers and new marketing strategies are combining to attribute a previously unexpected rôle to e-commerce in Italy, much as has also been happening in other countries with a similar degree of technological and industrial evolution. Ad hoc studies and surveys indicate that the phenomenon has achieved growth rates of more than 20%, but with volumes that are not yet significant enough to be monitored with any degree of accuracy.

THE BEAUTY SALON

The most drastic reduction in sales of cosmetic products in 2004, a decrease of 2.5% to a total volume of approximately 200 million Euros, took place in the beauty salons and beauticians channel. Despite this fact, the phenomenon does not appear to be any cause for concern, as the channel's rapid transformation seems to have changed the range of products being bought in by the channel itself. When analysing these figures, it should always be remembered that understanding and classifying sales through beauty salons and wellness centres is difficult, because they are so often associated with other sales channels.

It is also worth noting that sales through beauty salons also fell significantly in quantity terms in the course of 2004: they were down by 3.9%, despite a modest increase in prices of no more than 1.5%.

THE HERBALIST SHOP

For some time now, the herbalist shop channel has earned the right to be treated with equal dignity from a statistical standpoint, in view of the significant growth and market volume it has achieved in recent years. In 2004, that market volume was worth more than 253 million Euros, up six percentage points over the previous year.

Although this is a channel that only accounts for about 3% of Italy's domestic cosmetics consumption, the herbalist shop partners with the pharmacy – albeit with different buying choices – to constitute the phenomenon that has left its mark on the Italian cosmetics market in the last ten years more than any other.

There is no doubt that this channel succeeds in catering better than any other for new buying choices and new perceived needs on the part of those consumers who associate a further enhancement of the concept of wellness with that of the natural product.

When making structural evaluations, it should also be remembered that the last few years have witnessed this channel experiencing the most dynamic evolution in terms of the rate at which new points of sale are opened.

THE HAIRDRESSING SALON

For the first time after years of substantially holding their own, sales of the products marketed through professional salons have fallen tangibly to a total value of approximately 590 million Euros: down by 1.5% in terms of value and 4.5% in terms of quantity, despite the year's highest mean increase in prices, which were up by 3%.

The major cause for concern is not so much the decrease in value as customer's probable defection to other points of sale.

Consumers' attitudes to the professional services offered by this channel are confirmed by the data relative to the product categories: in addition to the traditional area of dyes, increases were also recorded by products with a high degree of innovative content, such as masks and after-shampoo balsams and creams.

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