

PERSPECTIVES

Insights on Healthy Living & Aging

Science of Skincare:

DDF: Upgrade from Promises to Results



Interview with Rich Gersten and Joe Hawley

Since the 1500s, people have looked for the prever-



bal "fountain of youth." Today, consumers are not traveling the high seas but rather searching the spas, specialty retailers and internet for that product that

will reduce the appearance and consequences of aging. With the aging of the baby boomer and society's emphasis on personal care and maintaining a youthful appearance, it should be no surprise that the cosmeceutical industry has grown more than 20 percent per year since 2000. According to the consumer research firm, Packaged Facts, consumers spent approximately \$7 billion on skin care cosmeceuticals in 2005.

For North Castle Partners, a leading private equity firm focused on consumer businesses that benefit from Healthy Living and Aging trends, investing in the cosmeceutical industry was obvious but finding the right company became the adventure. In 2004, after approximately a three year relationship with the founders, North Castle invested in HDS Cosmetics Lab, Inc. and its Doctor's Dermatologic Formula ("DDF") brand.

Rich Gersten, North Castle Managing Director and developer of North Castle's Aesthetics and Personal Care vertical, in partnership with Joe Hawley, the CEO of HDS, are leading the company into a planned phase of high growth. Joe brings more than 25 years of senior manage-

ment experience and extensive knowledge of global brand marketing, sales and supply chain operations from his prior experience at leading global beauty and fashion accessories firms, most recently Avon Products, Inc.

We recently spoke to Rich and Joe about the cosmeceutical market and DDF's growth plan.

What are cosmeceuticals?

Joe: Cosmeceuticals broadly describe products that claim therapeutic benefits through ingredients that affect the structure or the function of the skin. The term, cosmeceuticals, was derived after numerous products emerged on the market that combined common cosmetic preparations and nutraceuticals. These products deliver a hybrid of cosmetic and pharmaceutical benefits and are considered more efficacious than non-cosmeceutical products.

How did North Castle come to invest in DDF and the cosmeceutical market?

Rich: As a focused fund, one of the things we pride ourselves on is finding high growth niche segments within larger industries. Back in 2001, North Castle identified skin care and cosmeceuticals as an interesting growth area. We met with the CEO and founder of the business and established a dialogue with them at a time that they were looking to raise capital. We declined the opportunity to invest in 2001 because the company was too small and our investment would have been a minority position. We stayed in touch with the founders over a 2½-year period and established a relationship with them that ulti-

mately resulted in North Castle investing in DDF in 2004.

Although DDF was still a small company for us, from our knowledge of the cosmetic and cosmeceutical market, we understood that this is a niche category, and that DDF as a \$15 million brand was fairly sizable. We believed then and today that we could build this business and have a successful sale to a large strategic acquirer.

Tell us about DDF's product portfolio.

Joe: DDF was the first and is the only skin care brand to group products in one simple protocol: Cleanse, Protect, and Treat. DDF takes into account the health of the skin by focusing on six specific skin care concerns. The first two concerns relate to anti-aging: a preventative regime geared to the younger customer that does not have serious environmental damage, and a restorative solution to help minimize severe damage that has already been done. Acne is the third concern. The fourth is Sensitive or Allergic. The fifth is Hyperpigmentation. And the last one is Body and Sun. Within each skin care concern, DDF has a comprehensive selection of products that offer solutions for current and future skin care. Our market research indicates that through these six skin care concerns, DDF addresses approximately 95% of the consumers' skin care needs.

How did DDF begin?

Rich: Dr. Howard Sobel, a renowned Park Avenue, New York City, dermatologist,

"Upgrade from Promises to Results" is a trademark of HDS Cosmetics.

founded the brand in 1991 to better serve his patient's needs. He began packaging product for his patients when they traveled and providing specific products to his patients' friends and family members that did not live locally. In 1993, Elaine Linker, a nutritionist, and Dr. Sobel's sister, joined DDF to organize the business and enhance the product line.

What distinguishes DDF from other doctor brands?

Joe: DDF is recognized as the first prestige skin care company to listen to consumers and address skin care by consumer concerns utilizing our Cleanse, Protect and Treat protocol. Unlike other doctor brands that were created by one dermatologist in isolation, DDF was developed by a team of experts including, a dermatologist, nutritionist, and team of biochemists

who integrated cellular and nutritional science. But the best way to illustrate what distinguishes DDF from other doctor brands comes from our consumers.

We recently engaged a market research firm to better understand how the consumer views DDF. We consistently heard two related themes: one spoke to the products' efficacy, and the other to the breadth of the product line that enables DDF to satisfy current and future skin care needs.

What was North Castle's original vision for DDF?

Rich: Our vision was to continue to grow the brand through its existing retail customer base and to build up the professional channel. DDF was fully penetrated within Sephora, the premier specialty retailer of beauty products. Sephora has been opening 25 to 30 stores a year, representing tremendous growth for DDF. The company had also begun to penetrate some of the department store accounts, such as Bloomingdale's and

Nordstrom. So there was significant growth from the retail channel just by continuing to penetrate and grow with our existing customer base. It wasn't a requirement for us to procure new customers in a meaningful way in retail.

North Castle saw a great opportunity to capitalize on the company's heritage of the efficacy of its products in the professional channel. We had a vision to build our professional channel sales force to exploit the opportunity in the spa channel in particular. We also recognized the need to professionalize the business. Based on our



DDF organizes skin care by consumer concerns utilizing their Cleanse, Protect, and Treat protocol.

experience, we often buy companies from entrepreneurs who are exceptional at taking a business from Point A to Point B, but hit that proverbial wall and need help taking it to the next level, which often requires investment in infrastructure, systems and most importantly people. The transformation of an organization requires making the right hires and putting the right people in place.

Tell us about the DDF team.

Rich: With the hiring of a new CEO, CFO, VP of Marketing, and VP of Operations, just to name a few, DDF has an outstanding team of dedicated professionals to further grow this business.

Joe: The background of the team is quite impressive. First, Vivienne Bosch, our VP of Marketing, previously hailed from Revlon, Clinique and Clarins (retail and spa). She has significant new product development experience as well an understanding of the spa business. Additionally, Jeff Padnis, our

CFO, began his career at Ernst & Young and then as the CFO of Grand Expeditions, a former North Castle portfolio company. He knows the world of finance as well as understands what it's like to run a smaller entrepreneurial company. Next there is Fred Forman who joined DDF after 15 years of experience with Johnson & Johnson, a world class pharmaceutical company. Fred also headed up the global supply chain at Avon. Last but not least, Karen Costa, a Ph.D., heads up our new product development and our whole R&D effort. Her background was at Avon and Playtex.

Finally, I would be remiss not to mention the strength and importance of our founders. I am privileged to have a very good relationship with Dr. Sobel. We get together regularly, and he works in sync with our new product

development team, talking about what goes on in his medical practice as a world class dermatologist. Additionally, I'm fortunate to have Elaine Linker who works with us on both new product development and training. She was the brand originator and creator, and talks about DDF with the passion and conviction that nobody else in the world can. Elaine is also part of my advisory team.

What else has North Castle done to add value to DDF?

Rich: As a focused fund, we're in dialogue with a lot of the large cosmetic companies and potential buyers of a business like DDF. One of our learnings from our discussions was that there were too many SKUs and the original product line was too broad. So we embarked on a program with management and North Castle resources to aggressively focus the line and take out underperforming SKUs. We also needed to improve the cost structure of the business.

The most important step was to take a business that was manufactured primarily in-house and fully outsource it. This is consistent with the model that we have been very successful with at Avalon as an example. By moving to an outsourced model, DDF became a virtual sales and marketing organization which was critical for the successful execution of our operating plan.

What does your consumer want?

Joe: Today's consumers want a simple, results driven regimen that fits into their lifestyle and makes them feel good about themselves. They want to see results when they look in the mirror and feel as though they have made an intelligent choice in their product selection.

Where can you buy DDF?

Rich: Our largest channel is retail, including Sephora, Nordstrom, Beauty First and Pure Beauty. DDF also has a significant presence in the professional channel, primarily spas. For example, Agna Spa at Delano, Canyon Ranch and Georgette Klinger.

Joe: We also have a growing international business, through dermatologists' offices, spas, hospitals, pharmacies and department stores.

Do you see DDF moving into the mass market?

Rich: Not today. DDF is a prestige brand. Perhaps in the future there could be off-shoots or segments of the line that could be introduced under a different brand, but the DDF line is a prestige brand that starts with the halo effect of spas and doctors' offices and migrates down to specialty retail like Sephora and Nordstrom.

What is the biggest skin care concern today?

Joe: Anti-aging products are most prevalent in the cosmeceutical market and not just in the restorative arena. It is the fastest growing segment. We are even seeing younger consumers using our preventive anti-aging products to try to prevent signs of the aging process or at least slow it down. The high growth is also driven by the aging boomers.

What are some other high growth areas?

Joe: Sun care. People used to think about sunscreen only when they went to the beach. However, the reality is that consumers need to apply SPF protection every day. There is a clear connection between sun protection and anti-aging. It's almost one and the same, and people who use sun protection are automatically using an anti-aging product by use of the proper SPF on a daily basis.

What about new product launches?

Joe: Our new product development team has analyzed our product portfolio based in part on the findings of our market research, and have identified very clear and specific new product development opportunities for the next three-years. We expect to launch six new products next year. Our new product launches will each have a 180-day advance campaign and specific public relations efforts in place. There will be new product testers and in-store sampling. We are going to market each new product by individual door, by each spa and each retailer very carefully and very deliberately. We are very excited about the opportunities our new products represent.

How important is PR to a company like DDF?

Joe: Public relations is extremely important. This is a word of mouth referral based business. Many consumers' point of entry into this market is a magazine article that highlights one of our products. Continuing to get those favorable press mentions in magazines is critically important to our long term success.

What are some of DDF's values?

Joe: DDF's core value is to honor the consumer, which means listening to her needs and exceeding her expectations every day by delivering fast-acting results which corrects existing damage and prevents future skin care concerns. Other DDF values include our commitment to consumer education and to research and development. We are focused on working harder to offer the most technologically

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cosmeceutical facts

- ▶ Packaged Facts predicts cosmeceutical sales for skin care, makeup, and hair care products could exceed \$17 billion by 2010.
- ▶ In 2002 and 2003, skin care sales in department stores increased 4 and 6 percent respectively, while sales of cosmeceuticals and clinical brands increased 62 and 77 percent for the same periods.
- ▶ 11.9 million cosmetic procedures were performed in the U.S. in 2005, and the average procedure cost \$5,000. Women accounted for more than 91% of patients.
- ▶ More than 156,000 cosmetic and toiletry products were launched in 2005.
- ▶ Consumers spent nearly \$94 million on firming/anti-cellulite body care in 2005, up from just \$30 million in 2000.
- ▶ Botox® is the number-one cosmetic procedure in the United States, with 3.8 million treatments in 2005, an increase of approximately one million treatments over the prior year.

advanced formulas integrating dermatological, nutritional, and biodynamic ingredients.

DDF is part of North Castle's aesthetics and personal care vertical. What other investments does North Castle have in this vertical and what are the advantages of partnering with a private equity firm with industry expertise?

Rich: Within the aesthetics and personal care vertical, North Castle has three portfolio companies. In addition to DDF, there is Avalon Natural Products, which is a leading natural and organic personal care company, and Red Door Spas, which is a combination of the Red Door and the Mario Tricoci branded spas, and is a leader in the highly fragmented day spa and salon industry.

North Castle focuses on this vertical because of its high growth characteristics. We have developed a significant amount of knowledge and a vast network in this vertical, which allows us to be smarter value-added investors. We are able to more efficiently assess and evaluate opportunities. We know the questions to ask and the issues that the entrepreneurs are facing. We're credible buyers and knowledgeable partners because we know the business and have seen the same challenges and opportunities in other companies.

Are there any synergies between the companies?

Rich: Yes, our companies have experienced benefits in operations, procurement and new product development. We recently had our three personal care companies meet to discuss vendors and purchasing costs. By working together, the companies created some negotiating leverage across the portfolio, which yielded

“As an entrepreneur/CEO, to have a partnership with North Castle is a unique advantage.”

new relationships and cost savings. Another area is distribution. For example, Red Door as a retailer of beauty products, could certainly be a good retail customer for a company like DDF.

When you joined DDF, was North Castle's focus important to you?

Joe: Yes. Quite frankly it's a privilege to be running a company, standalone, but at the same time have a partner that is knowledgeable about the industry, reading the periodicals, has the connections, and is ready, willing, and able to be involved. Honestly, as an

entrepreneur, you're out there alone. To have a partnership with North Castle is a unique advantage, because you have access to a lot of horsepower, intellectual capital, and industry experience. It's a great position to be in.

How about the NCP advisors?

Joe: Absolutely. The advisors are hands-on and true members of the team. I met with Dr. Pam Peeke last month with my marketing and sales team. She shared her industry perspective and insights into the science and the marketplace. She also opened up her Rolodex and said, "How can I help you?" She then agreed to introduce DDF to the owners of the top 50 or 100 spas in the country. To have access to advisors who have this breadth of knowledge about your industry and the resources and network to help you succeed is a significant competitive advantage for me as a CEO/entrepreneur.

How do you think about exit?

Rich: We have received a lot of inbound inquiries from large consumer packaged goods companies and cosmetic businesses. We have an ongoing dialogue with several of them. It is very interesting, given the size of this brand, how DDF is on the radar screen for the largest cosmetic companies. Our goal here is to build a "professional" business to \$30 or \$40 million in sales and have it be able to plug right into one of these buyer's business units and be its entry point into clinically-based cosmeceutical skin care.



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North Castle targets high-growth, middle market companies in the Aesthetics & Personal Care, Consumer Health, Fitness & Recreation, Home & Leisure and Nutrition industries. North Castle is a hands-on, value-added investor. We utilize our cumulative knowledge and network, which results from our industry focus, to partner with management and entrepreneurs to create world-class companies.

Perspectives is published by North Castle Partners, a leading private equity firm focused exclusively on investments in consumer-driven product and service businesses that benefit from "Healthy Living and Aging" trends.

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