



**VALUATION
REPORT**

January 25, 2016

BeautyKind LLC

(OTC QX: BTYK)

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MANAGEMENT

John Hilburn Davis IV, Founder & CEO

SECTOR: Consumer Staples
SUB INDUSTRY: Personal Care
SHARES OFFERED: 1,200,000

PROJECTED IPO PRICE RANGE: \$6.00-\$6.25
PROJECTED IPO DATE: Week of 1/25/2016
UNDERWRITERS: W.R. Hambrecht + Co., LLC

INVESTMENT CASE

- ❖ We believe BeautyKind represents a unique approach within the price-fixed, high-margined beauty products retailing industry. By tying “cause” to an inherently individual purchase, BeautyKind may be able to encourage higher levels of customer spending. The beauty industry is characterized by replenishment spending, contributing to recurring revenue streams from individual customers. Given the growing popularity of cause-tied commerce, as well as network effects among target Millennial (and older) female customers, BeautyKind seems well-positioned to acquire and retain customers and grow revenue and profits much more rapidly than the beauty products industry overall.

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OVERVIEW & ORIGIN

BeautyKind is a primarily internet-based retailer that ties sales of beauty products with a “cause,” or giving back. BeautyKind customers designate their preferred charities, and a given percentage (typically 5%) of their purchase price is then donated back to the charity by BeautyKind.

The BeautyKind concept was launched in October 2013. Management worked with Scott Bedbury, a veteran of key campaigns by Nike (“Just Do It”) and Starbucks, to develop the concept. The go-to-market model resulted from extensive research, workshops and prospective customer input.

In its pre-launch research, management learned that cause alone does not drive site traffic and that cause was most effective when tied to perceived benefits to the consumer. Customers want to give back while simultaneously getting something for themselves.

BeautyKind founder Hil Davis also applied lessons learned in developing the J. Hilburn company, which brings a direct-sales approach to customized high-quality menswear. J. Hilburn associates, overwhelmingly female, proved to be viral in their online and offline sharing, which helped build the brand outside conventional advertising channels. Similarly, the core BeautyKind customer helps build the brand by sharing enthusiasm toward the company’s products and its links to national and local causes.

Regular customers have a “scorecard” where they can track their contributions to favored charities. When charity contributions reach a certain level, customers gain points which can be used for additional purchases on the site, given back to their cause as a donation, or as cash back on a BeautyKind branded debit card. Users also gain points for purchases made by referred customers in the users’ network.

The company’s tag line of “Beauty for the Greater Good” captures the interplay between giving back and benefiting the community, while simultaneously executing on a resilient retailing model. Cause-linked retailers, including Tom’s in the footwear space and Warby Parker in eyeglasses, are growing much faster than traditional rivals, proving that cause is a powerful retail-sales driver.

Millennials are cause-driven and attracted to companies that enable the customer to participate in their targeted charities. The company also attracts women beyond the millennial generation, a group that may be less technologically savvy but is typically better financially positioned to support causes. The site is designed to be intuitive and user friendly for all customers.

MARKET OPPORTUNITY

BeautyKind is exposed to a massive opportunity within a market that has changed little in the past half-century. The global beauty products business generates approximately \$265 billion in annual revenue, much of that coming from sales at discount stores and drug stores. BeautyKind is focused on the Prestige beauty space, in which products are sold through dedicated beauty retailers and department stores. In the United States, Prestige Beauty is a \$14.5 billion annual revenue market, with department stores commanding a slightly bigger share than the two major dedicated beauty retailers.

eCommerce penetration of global beauty products is just 6% of global sales. Given that eCommerce represents about 13% of all consumer product sales, eCommerce is underrepresented in overall Beauty product sales. As well, eCommerce offers an higher-than-average opportunity in Prestige Beauty, given the relative scarcity of Prestige Beauty brick & mortar outlets in exurban and rural areas.

Marketing of Prestige Beauty in traditional retail venues often employs an antiquated model, characterized by absence of customer personalization; limited rewards programs tied to unpopular products; a dearth of cause-linked purchase opportunities; and retailer disincentives to grow online sales. BeautyKind believes it is positioned to disrupt this model via its cause-linked process, best-in-class rewards program and ability to personalize each user's beauty experience.

COMPETITIVE ADVANTAGE

The cause-based personal products industry is an attractive end-market for several key reasons. Perhaps most important, "beauty" is an ideal match with and perfect complement to "cause."

- **Cause breaks down inhibitions on beauty spending.** Beauty product consumers, who are overwhelmingly female, typically direct most household spending, such as for food and clothing, to family members. These users may regard money spent on personal beauty as an extravagance at best and selfish at worst. By tying beauty purchases to cause, beauty product consumers feel free to spend a little more on themselves, knowing that they are simultaneously benefiting others with each purchase.
- **Ability to migrate mix toward higher-end and more personal products.** BeautyKind has initially been stronger in color products (nail polish, lipsticks, etc.) because these are less specific to a personal facial type than skin products such as mascara or blush. As the customer base grows more familiar with the product lines, skin products and color products are expected to come into better balance.
- **Beauty replenishment cycle works well in online world.** Customers deplete a range of products and order again. The online format simplifies the replenishment process, because the site, unlike stores, never "runs out" of product; and stored data makes reordering easy. Cause and network effects contribute to replenishment.
- **Stable pricing for prestige beauty products.** At the insistence of the beauty companies, prestige beauty products are sold at manufacturers' suggested retail price. That levels the playing field and prevents small vendors such as BeautyKind from being undercut by competitors. BeautyKind does not have to compete with fiercely discounted product from Amazon and instead has price protection around a good margin.
- **Ability to personalize cause and link to major charities.** While gaining access to the product categories, site visitors are encouraged to indicate preferred causes and charities. As site traffic and cause contributions grow, BeautyKind is developing increasingly important relationships with major charities such as the American Heart Association, the American Cancer Society and the Juvenile Diabetes Research Foundation. Over time, BeautyKind and its customers should be positioned to participate in and lead local initiatives in the cause and charity space.
- **Network effects enrich rewards.** Customers of BeautyKind are incentivized to enlist new customers on the "give-get" model that has proved so successful for companies such as Uber. As referred customers make purchases and generate charity contributions, a portion of each referred-customer charity contribution is accredited to the contribution "scorecard" of the referring party. Referrals accelerate charity contributions on referring customers' scorecards, in turn accelerating points accumulated for purchases by the referring customer. Once sufficient points are accumulated, customers can unlock cash rewards via purchases.
- **Superior rewards program.** BeautyKind believes its rewards program is superior to rewards programs at the company's dedicated competitors, which it views as frequently limited to discounted purchases of lower-tier, discontinued or unpopular products. The rewards program drives long-term value, while cause drives customer acquisition.

GROWTH STRATEGY

- **Cultivate Millennials' strong affinity with cause.** Drawing on multiple studies, BeautyKind believes that Millennials (born between early 1980s through early 2000s) are more inclined to trust companies that are associated with charitable giving. Further, Millennials are more likely to patronize and buy products from companies associated with giving back.
- **Develop personalized "beauty counters" for each individual shopper.** BeautyKind will develop a personalized homepage for established customers. The customer's preferences and replenishment purchases will drive content on the personal beauty counter, including like products and promotions on frequently replenished items. Additionally, BeautyKind envisions linking each customer's preferred causes to their personal beauty counter. The site's "skin" for the individual user might include colors and banners associated with a supported charity.
- **Develop and deploy cause ambassadors.** An important element of the growth strategy is a strengthening the company's (and its customers') ties with causes, representing both national charities and local causes. At the local level, BeautyKind develops and deploys "cause ambassadors" who are typically well tied-in to their communities and already active in local causes and events. The company is deploying brand ambassadors in Charlotte, Austin, Atlanta and other target cities. The company is integrating its cause ambassadors program into its gift-card strategy. As of late 2015, BeautyKind had over 330 Cause Ambassadors, and over 60 College Ambassadors, with a goal of adding 10 more new ambassadors each week.
- **Increase brand awareness via cable advertising.** While local cause ambassadors represent BeautyKind's "ground" strategy, its "air" campaign is based around targeted national cable TV placement. Return on investment from national cable TV is higher than ROI from online advertising, according to the company's research. BeautyKind is developing its cable TV advertising campaign both independently and with leading national charities such as the American Heart Association. Based on projected national cable TV spending of \$50,000 weekly, BeautyKind believes it can reach 8-12 million viewers weekly while achieving a 2%-4% conversion rate.
- **Develop pop-up stores and other physical formats.** Supplementing its primarily online presence, BeautyKind is developing various physical formats designed to build brand awareness and drive traffic to the website. The company has achieved early success in its store-within-store concept at the Bloomingdale's outlet on 72nd Street in Manhattan, and could develop similar concepts in other outlet venues. Management also intends to prominently place seasonal pop-up stores within U.S. cities with moderately upscale tourist traffic, ranging from Las Vegas to Los Angeles to Dallas and other sites. Additionally, the company is working on college pop-up sites. These physical outposts are targeted for late 2016 or in 2017 on a preliminary basis.
- **Increase attach rate among first-time site browsers.** First-time visitors to the BeautyKind site have typically proceeded only after furnishing an email or Facebook address and selecting preferred causes and charities. Management regarded this step as necessary to build a core customer group and apply advanced data analytics. With this core group now assembled, BeautyKind is enabling instant site access and guest shopping in a user-friendly manner.
- **Improve retention and drive replenishment growth.** Currently, the customer mix is skewed toward new or first-time customers. Customer retention and replenishment trends are encouraging, however. The customer repeat rate is already above 20%. Gift cards currently comprise half of revenue. Management is modeling that as site traffic increases and re-orders continue, gift cards will diminish as a revenue source, falling to as little as 7% of total revenue by calendar 2017.

- **Develop private-label brands.** While BeautyKind currently operates as a retailer of existing brands, the company believes there is an opportunity to develop private label products. Private label has succeeded at rival brick & mortar firms including Sephora and Ulta Beauty. To assess interest in this business, private-label products will initially be sent as samples to regular purchasers within specific product categories, based on analysis of customer data. Should these initial efforts build customer demand for private-label products, the company intends to develop the category further.
- **Generate participation by top-tier vendors.** As the BeautyKind model matures and gains customers and market share, we expect all major industry participants to be represented on the company's site and in other venues, including pop-up stores and store-in-store concepts. As the company increasingly adds leading brands to its product line-up, we believe BeautyKind will have significant first-mover advantage in the Beauty-plus-Cause space.

CHALLENGES

- **Enroll top prestige beauty vendors.** BeautyKind is a retailer of many well-known beauty brands, but it has not yet signed on several major companies. These include category leaders such as Estee Lauder and L'Oréal. BeautyKind has met with these companies and other leading category players including Lancôme, Clinique, and Kiehl's, and discussions are ongoing. Major players in the beauty and personal care space may hold off on doing business with BeautyKind until the company demonstrates "staying power" by continuing to operate and grow for a year or more. The big brands know the beauty industry is saturated, and they are highly attuned to market-share shifts. Should BeautyKind demonstrate that it is able to take share from traditional retail venues, the large companies are expected to make their products available to BeautyKind and to support its marketing efforts.
- **Lessen hurdles for first-time visitors.** First-time visitors to the BeautyKind site provide an email or Facebook address in order to gain access. By contrast, customers at brick & mortar rivals are exposed to product immediately upon entering the store and without surrendering any personal data. Now that it has built an initial base of customers, revisions to the BeautyKind graphic user interface are being researched and planned. BeautyKind intends to make its site friendlier to the casual visitor, while continuing to feature cause as a key element of the transaction and encourage information sharing by new and existing customers.
- **Level playing field with Incumbent players.** Established rivals such as Ulta Beauty and Sephora have built brand awareness. The dedicated providers use their stores to offer wide product availability, promote private-label products, and potentially to act as fulfillment centers for online sales. BeautyKind's cause-based giving represents a cost not faced by dedicated beauty retailers. At the same time, costs associated with cause and with reward programs are much lower than the spending required to build and maintain physical store infrastructure. BeautyKind is deploying a limited number of physical concepts, including pop-up and store-in-store, in a small set of highly visited cities. BeautyKind does not intend to develop a national brick & mortar retail model. Savings from eschewing a full brick & mortar model will be dedicated to technology development -- including site personalization, improving links with national and local causes, and gift card and reward programs. BeautyKind estimates that these costs will be well below costs encountered by brick & mortar retailers.

OPERATING MODEL

BeautyKind came out of beta and became a fully operational site in March of 2015. Given the site's newness, annual comparisons against prior periods are meaningless.

As of autumn 2015, BeautyKind was generating approximately \$300,000 per month in gross merchandise volume (GMV).

Management originally targeted \$3 million in GMV for the January 2016 fiscal year, predicated on aggressive gift-card promotions. Beginning in fiscal 3Q16, management sought to gauge underlying demand by "turning off" its gift-card strategy. Accordingly, management estimates that FY16 GMV reached approximately \$1 million. The company turned the gift-card strategy back on in January 2016, which has had a significant positive impact on GMV.

BeautyKind believes it can generate fiscal 2017 (calendar 2016) revenue in the \$10-\$15 million range. Attainment of that revenue goal is dependent on building brand awareness based on national cable TV presence. Other growth drivers include accelerating customer acquisition & retention, increasing individual customer spending, and benefitting from viral network effects around cause. Specifically, the company is targeting \$11.1 million in GMV for FY17.

Contribution margin for BeautyKind is targeted at 30%-35%. That is based on targeted ranges including 40% cost of goods; 5% for cause; 4%-5% for rewards; 3% in credit-card transaction fees; and fulfillment costs of 12%-15% of revenue.

BeautyKind believes that if revenue growth develops as modeled, the company should achieve operating profitability as of fiscal 1Q17 (quarter ending April 2016). Management is targeting an initial operating margin in the 3% range at that time, with potential for additional margin expansion as revenues grow more rapidly than costs.

BeautyKind has raised approximately \$10.25 million in several funding rounds, including a \$4 million "friends and family" round and a second \$4 million round. As of mid-2015, BeautyKind had cash on hand of \$4.2 million. The annual cash burn is expected to be about \$4 million for calendar 2016.

MANAGEMENT

BeautyKind, incorporated in Texas and based in Culver City, CA, was founded by CEO Hil Davis, an experienced entrepreneur and former financial analyst who has developed several concepts within retail.

John Hilburn Davis IV is co-founder, Chief Executive Officer, and Chairman of the Board of BeautyKind. Prior to co-founding BeautyKind in 2013, "Hil" Davis founded J. Hilburn in 2008 and served as its CEO until leaving to establish BeautyKind. J. Hilburn, a custom clothing company utilizing a direct sales model, generated \$55 million in 2014 revenue and was included in Inc. Magazine's Inc. 500 Fastest Growing Companies in 2012 and in 2013. J. Hilburn was also named by Forbes as one of America's Most Promising Companies and was recognized by Esquire for best dress shirt. Prior to founding J. Hilburn, Mr. Davis worked in financial services, including serving as an equity research analyst covering consumer/luxury brands. He also headed the IR department at Brinker International, operator of the Chili's restaurant brand. Mr. Davis is a graduate of Rhodes College.

Other executive officers at BeautyKind include Gina Kohler (General Manager Beauty) and Michael Hawley (General Merchandise Manager).

RISKS

BeautyKind faces numerous risks, beginning with its status as a start-up in an established retail niche. The company could face intensified competition from promotional activity at dedicated competitors; could see its cause-linked strategy copied or amplified by rivals; or could be hurt by shifts in consumption patterns within the beauty products industry.

The company may lose access to top brands sold on the site and/or fail to successfully negotiate rights to retail major national brands not now offered; may fail to develop relationships with leading national charities and causes; and may fail to develop presence within local cause communities via its cause ambassadors.

BeautyKind is at risk of being superseded by more innovative go-to-market strategies and/or technologies; may fail to generate revenue growth sufficient to justify company development spending; and may not generate sufficient return or customer interest from planned national cable TV advertising and other promotional activities.

Additionally, BeautyKind may fail to develop new customers and/or retain existing customers; may fail to safeguard customers' data or suffer other security breaches; has a history of operating losses; and may fail to generate profits in future. BeautyKind stores limited amounts of data such as email addresses and does not store credit-card processing information

The company is at risk from shifts in consumer spending patterns, priorities and preferences; is subject to potential downturns in the consumer economy that might diminish discretionary spending; and may lose business related to product safety recalls.

Finally, the company has historically been dependent on funding from outside investors and could be at risk if that funding were to decrease or become unavailable.

CURRENT (PRE-IPO) OWNERSHIP

All ownership stakes in BeautyKind were established in friends and family funding rounds; there are no venture capitalists invested. Based on issued shares at year-end 2015 and prior to the Reg A+ filing, Hil Davis and related trusts owned 37.04%; other employees collectively owned 2.89%; a stock-option program held a 15.0% stake; and a debt holder had a 5.0% stake. Remaining ownership is split among friends and family investors.

REGULATION A+

The SEC has adopted final rules to facilitate smaller companies' access to capital. Regulation A had been the existing exemption from SEC registration for small companies seeking to go public. In March 2015, the SEC updated and expanded Regulation A with establishment of the Regulation A+ guidelines. The Reg A+ guidelines became effective on 6/19/15.

The new guidelines create two tiers of securities offerings. Tier 1 consists of public offerings up to \$20 million within a 12-month period, with not more than \$6 million in offers by selling shareholders affiliated with the issuer. Tier II consists of public offerings up to \$50 million within a 12-month period, with not more than \$15 million in offers by selling shareholders affiliated with the issuer. For both tiers, Regulation A+ securities purchased by non-affiliates are free-trading (no lock-up period) from the initiation of trading.

For Tier II offerings, the new rules preempt Blue Sky laws at the individual state level. These companies can take advantage of a coordinated review program developed by NASAA, which should help reduce cost and facilitate faster time to market.

Both tiers are subject to basic requirements, including issuer eligibility and disclosure. Tier II companies have a more rigorous set of requirements, including an obligation to file audited financial statements in the offering document. Tier II companies are responsible for filing audited annual financial statements, but are not subject to the quarterly filings required for larger companies. Tier II Reg A+ companies must file an annual report on Form 1-K; a semi-annual report on Form 1-SA; and current reports (event-driven) on Form 1-U.

REGULATION A+ IPO OF BEAUTYKIND

BeautyKind intends to file under Regulation A+ as a Tier II company. BeautyKind intends to issue between 800,000 and 1.6 million shares at a proposed IPO price per share in the \$6.00-\$6.25 range. The company expects to generate proceeds of approximately \$5 million to \$10 million. Proceeds will be used to fund a national cable TV advertising campaign, for technology development, and for general corporate purposes.

Following IPO, there are expected to be approximately 6.5 million to 7.3 million shares outstanding

VALUATION

Using the mid-point of \$6.13 in the proposed IPO per-share price and based on 6.9 million shares outstanding, BeautyKind will have an implied market capitalization in the \$42.3 million range. Given expectations for fiscal 2017 (calendar 2016) revenue at a \$12.5 million midpoint range, BeautyKind would be valued at inception at 3.4-times forward sales. While that is a high P/S range for a retailer, the multiple is well below 4- to 6-times P/S multiples accorded retailers with growth rates similar to BeautyKind's projected 30%-plus rate. BeautyKind is growing many times faster than the overall retail industry or the beauty retail niche, thus justifying this P/S premium. (Jim Kelleher, CFA)

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