Investment

> "As an investor Harbert took the time and effort to listen and consider as the Aesop working culture was introduced.
> As a result what had steered our brands success was never comprised and the resulting expansion then occurred."
> Suzanne Santos, Country Manager Australia/NZ, Aesop

"As the CEO of a private business you can be very isolated—there are only so many things you can talk to direct reports about. The private equity team provided me with a great sounding board for ideas and problems." Michael O'Keefe, CEO. Aesop.

An unusual skin-care company required a private-equity partner that could respect and understand its philosophy as well as drive it to new international heights.

Aesop is a cosmetics company with a difference. In a sector renowned for huge advertising budgets and a billboard approach to brands, Aesop stands out for its understated, diligent and aesthetic approach to its products and customers. Its stores are famous for their pared-back presentation, which is somewhat akin to an old-fashioned pharmacy.

That distinct and somewhat contrarian approach is what attracted Harbert Management Corporation when Aesop was looking for investment.

"One of the things that was fascinating about the business was that it had a unique point of difference," says Jeremy Steele, senior managing director at Harbert. "It was a very understated player. Most cosmetics companies are in your face when it comes to advertising but Aesop had taken the view that it was not going to go down that path, it would respect that its customers could make their own choices without needing celebrity endorsement."

After going to one of the Aesop stores, Jeremy noted that "when you see the way they sell, then you understand how it operates—there is no judgement about the customer and their beauty regime, and these are not things that are easy to replicate."

But it wasn't just the in-store service or the philosophy that convinced Harbert to take a 40 per cent stake for $5 million in 2009. It could also see from the cold, hard figures that this would be a good investment.

"We could see clearly that it was well run and the local operation was profitable," Jeremy said. However, Aesop's international presence needed backing. "It had a nascent international operation that had much potential but had yet to really find that potential." What was holding it back was capital—but what it got from taking on private equity as a partner was so much more.

Aesop CEO Michael O'Keefe had joined the company in 2003 from a corporate finance background. His skills complemented that of founder Dennis Paphitis, who is the creative force behind the brand. However, while Michael had driven its commercial success, by 2008 he could see the pressure its expansion plans were putting on resources and cash flow.

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The company had been exporting from day one of its operations, with Dennis researching the stores and jurisdictions that would be open to the product.

The push into overseas markets had been successful for the company, but now it needed more capital if it was to really penetrate into the US and Asian markets. At this point, Aesop had a healthy presence in Australia as well as a handful of stores around the world in locations such as France, Taiwan and the UK.

"We knew that local banks would only take us so far and there was only a certain degree of leverage that we were comfortable with," says Michael to illustrate why private equity was its main option.

However, for a company with the particular sensibilities of Aesop, private equity—with its reputation for being fixated on numbers—might not have seemed an obvious choice and the Aesop team were alive to this. Suzanne says the company was looking for something quite specific: "The private equity firm would need to understand that we are very unusual. It needed to be someone who was highly educated and imaginative in themselves in what was possible and someone who could recognise the potential not just in a piece of paper, crudely, but also at the philosophical level of what we do—that comes at a cost in terms of staffing and in terms of how we operate."

Jeremy and his team at Harbert fulfilled these requirements and also brought much more to the table. Corporate governance was almost immediately rejuvenated, as monthly board meetings were held for the first time. "We had spoken about having an advisory board and proper board meetings but we kept putting it off," Michael says. "Now there was a new shareholder agreement and that brought more discipline."

Jeremy's team also led a bank re-financing program to get additional capital for an expansion and a management incentive structure was put in place so Aesop could attract the kind of global talent it needed.

Up to this point, the company had sold products overseas without necessarily asking itself which markets would make the most sense for clear and defined reasons. Jeremy joined the new board and helped management drive strategy and planning.

Michael recalls that while most of the company's growth was coming from Asia, it didn't yet have stores on the ground. Instead it had distribution agreements in Japan, Malaysia, the USA and the EU where Aesop products were sold in counters at major stores—but this had drawbacks.

"What we found was that as a brand the integration across the whole business was really important to us and with distributors managing the relationship with the customer it wasn't working for us," he says.

This led to a decision by the board to move away from those distribution arrangements and expand with company-owned stores into Europe, Hong Kong, Japan and into the US for the first time. The success of this can be seen by the fact that now more than 50 per cent of Aesop's revenue comes from overseas.

However to achieve this, the supply chain had to be renewed. Aesop manufactures locally and now it had to make sure it could get the product not only to Melbourne but also to Manhattan.

The decision was made to outsource its warehousing needs and it also brought on two external manufacturers. The management team then built logistics capability in the countries where it was now operating. Michael said it was "a really important part of building the back-end platform to support our growth domestically and around the world." The ability to push more strongly into new markets came about partly because of the confidence that Harbert showed in the organisation. "It had invested in the business because it believed in us," says Michael. "Harbert was positive and confident about us investing in new territories."

Jeremy also helped on a practical level by interviewing new additions to the management team. Because Harbert in Australia is part of a larger global manager—Harbert Management Corporation—when Aesop was expanding into the US, it was given access to office space at a reduced rent for the first two years.

Jeremy agrees that what made a massive difference was the encouragement the management team received around making decisions. "The business was very hesitant to look at the US and Japan," he recalls. "I was insistent that these things needed to be tried." In a strange way, the business suffered from having been consistently successful. "Every piece of expansion they had done had been successful, so I said, 'You are not trying hard enough because if a store wasn't profitable then at least you would know what works and what doesn't.' "

Fortunately, none of the new areas Jeremy pushed them into were unprofitable. That explains why three years after he invested he was able to sell out to Natura Cosmetics for 5.5 times the money originally invested. According to reports, Natura paid $68 million for Harbert's stake, along with half of Paphitis' holding, giving the Brazilian player a 65 per cent stake.

However despite the very successful commercial result, what stays with Michael is the sense of partnership with Harbert. "As the CEO of a private business you can be very isolated—there are only so many things you can talk to direct reports about," he reveals. "Jeremy provided me with a great sounding board for ideas and problems."