

INDUSTRY OVERVIEW

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OVERVIEW OF CHINA’S COSMETICS INDUSTRY

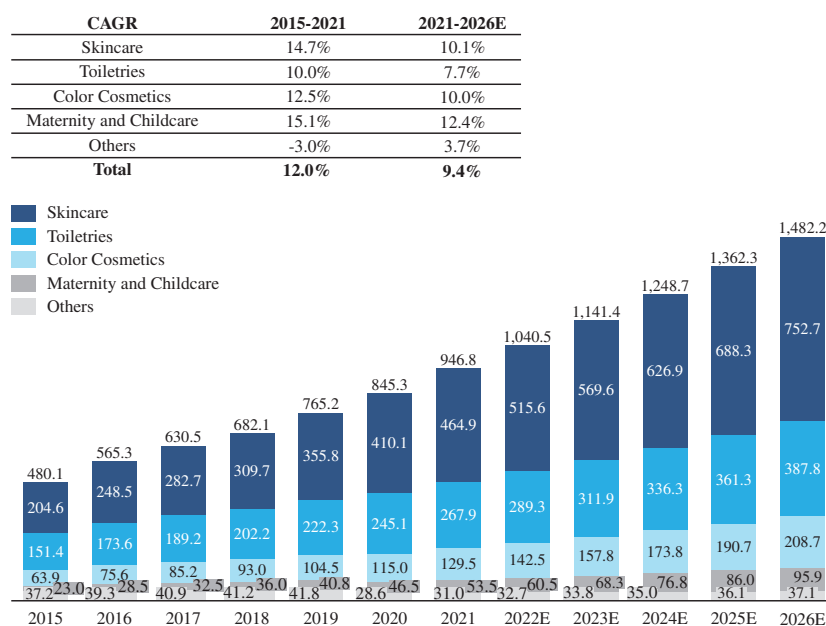
Overview

China has the second largest cosmetics market in the world. According to the Frost & Sullivan Report, the cosmetics market in China showed rapid growth from 2015 to 2021 due to its economic development as well as the increase of consumption expenditure of individuals in China. The market size of the cosmetics market in China, in terms of retail sales, grew from RMB480.1 billion in 2015 to RMB946.8 billion in 2021, representing a CAGR of 12.0%, while, during the same period, the market size of the global cosmetics market grew at a CAGR of 2.2%. China has the fastest growing cosmetics industry among all major economies¹ in the world. According to Frost & Sullivan Report, the market size of cosmetics market in China is expected to reach RMB1,482.2 billion in terms of retail sales in 2026, growing at a CAGR of 9.4% from 2021.

According to the Frost & Sullivan Report, cosmetics products can be divided into five categories: skincare, toiletries, color cosmetics, maternity and childcare and others. The following chart sets forth the breakdown of the market size of the cosmetics industry in China by retail sales broken down into product category.

Market Size of Cosmetic Industry in China by Retail Sales, Breakdown by Product Categories

Billion RMB, 2015-2026E



Source: Frost & Sullivan Report

According to the Frost & Sullivan Report, operating multiple brands is a common feature shared by reputable international cosmetics groups based on the observation of their development histories. By adopting a multi-brand strategy, cosmetics companies can more effectively broaden the boundaries of their business and capture opportunities arising from

¹ Major economies refer to countries with more than USD2.0 trillion of nominal GDP in 2021.

INDUSTRY OVERVIEW

categories beyond their existing product portfolios. A multi-brand strategy also enables cosmetics companies to develop in a balanced and dynamic approach, with resilience through a downturn. In 2021, all of the top ten cosmetic companies measured by retail sales were multi-brand companies. The current cosmetics market in China is also characterized by a trend in adopting a multi-brand strategy by launching and operating new brands by cosmetic companies to gain a larger market share. It has been an increasingly popular awareness that different consumer needs should be addressed by different product categories, which drives the development of product categories focusing on specific concerns of consumers. In addition, Chinese consumers are paying more attention to ingredients and technologies used in cosmetic products. In recent years, the concept of clean beauty has gradually spread from the European and American markets to China. The growing importance of environmental protection and sustainability among domestic consumers, coupled with the significant increase in consumers’ awareness of cosmetic safety after the COVID-19, have all contributed to the rise of clean beauty in China. In accordance with the product safety regulations with respect to cosmetics and cosmetics industry standards, it is a common practice for cosmetics companies to perform animal testings during the product development stage, especially for products targeting sensitive skin, baby skins or eye skin, to prevent the side effects of the ingredients used in their products, such as irritation and allergy.

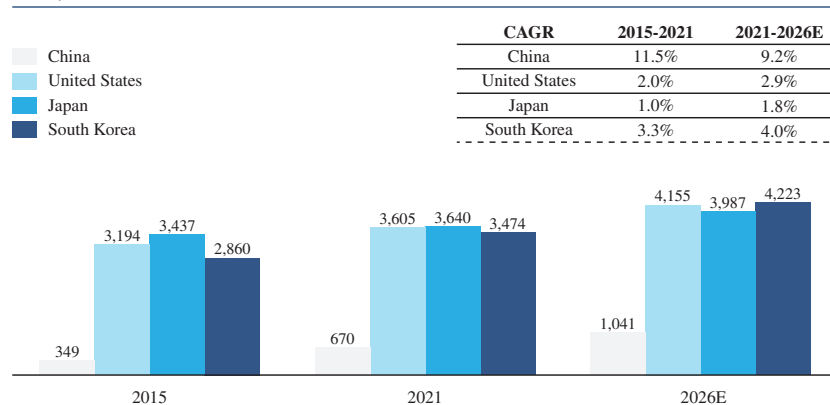
Potential for Growth in per Capita Spending on Cosmetics Products in China

Driven by the steady growth of China’s economy, the improvement in living standards of Chinese people and their changing spending habits, according to the Frost & Sullivan Report, the average per capita expenditure on cosmetics products in China reached RMB670 in 2021, representing a CAGR of 11.5% from 2015 to 2021, and is expected to further reach RMB1,041 in 2026, representing a CAGR of 9.2%.

Despite the significant growth in the past few years, China’s cosmetics market remains relatively under-developed when compared to developed countries; according to the Frost & Sullivan Report, the per capita expenditure on cosmetics in the United States, Japan and South Korea is RMB3,605, RMB3,640 and RMB3,474 in 2021, respectively. The per capita expenditure on cosmetics in China is lower than in such developed countries, indicating a potential for faster growth than those economies. The following chart sets forth per capita expenditure on cosmetics of selected countries.

Per Capita Expenditure on Cosmetics of Selected Countries

RMB, 2015-2026E



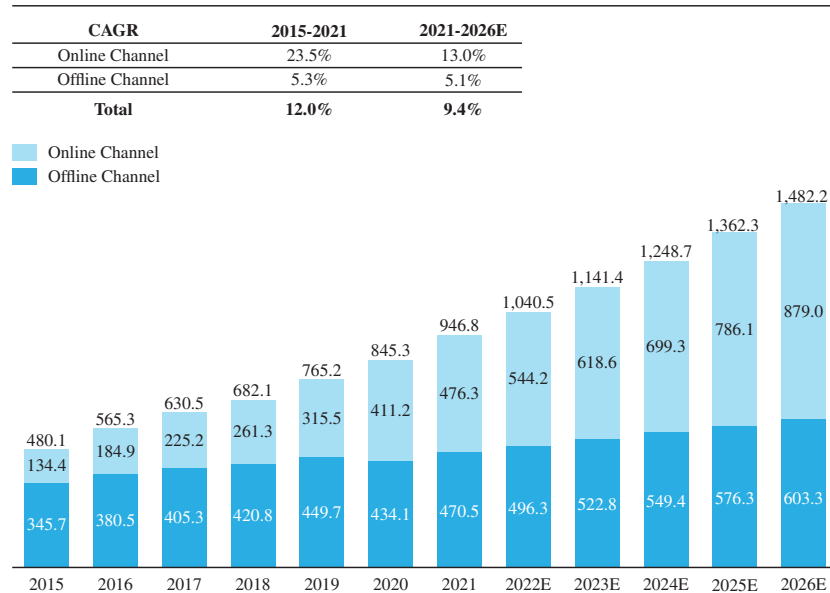
Source: World Bank, Frost & Sullivan

INDUSTRY OVERVIEW

Growth of Online and Offline Markets

Benefitting from the development of e-commerce platforms in China, the retail sales of cosmetics products through online channels have grown at fast pace in China, with a CAGR of 23.5% from 2015 to 2021 based on data from the Frost & Sullivan Report. In 2021, the total retail sales value of cosmetics products generated from online channels in China reached RMB476.3 billion, surpassing the offline channel, according to the Frost & Sullivan Report. Offline channel sales in China maintained solid growth despite an uncertain economic environment during the COVID-19 period, and are expected to reach RMB603.3 billion in 2026. The following chart provides a breakdown of market size of China’s cosmetics industry by sales channel from 2015 to 2026:

Market Size of Cosmetic Industry in China by Retail Sales, Breakdown by Sales Channels
Billion RMB, 2015-2026E



OVERVIEW OF CHINA’S SKINCARE INDUSTRY

Skincare products refer to products which improve skin integrity, provide relief from skin conditions and address specific skin concerns such as acne, dark spots, hyperpigmentation, fine lines and inflammation. Skincare is the largest segment, with a market share of 49.1% in terms of retail sales in 2021, of the overall cosmetics market.

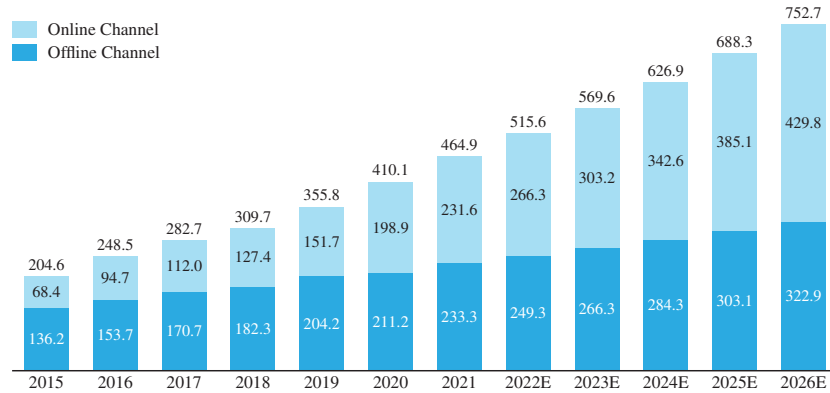
According to the Frost & Sullivan Report, the market size of the skincare market grew from RMB204.6 billion in 2015 to RMB464.9 billion in 2021, representing a CAGR of 14.7%. This growth is expected to continue at a CAGR of 10.1% from 2021 to 2026, and the market size will reach RMB752.7 billion by 2026. The development of the skincare market in China is primarily driven by the following: (i) given that the long-term skincare concept has been widely accepted by consumers, they tend to use skincare products to resolve their skin issues; (ii) there is a trend that consumers start to use skincare products at a younger age; (iii) emerging e-commerce platforms, such as social media channels and live streaming e-commerce, facilitate consumers’ online purchases and improve their shopping experience, especially for Generation Z and Millennials, who are the major consumption forces for cosmetic products; and (iv) With the high operating costs of e-commerce and the waning of the online traffic dividend, the value of offline channels in terms of user experience and brand building has been emphasized again, and the expansion of offline sales channels and multi-dimensional reach to consumers will become a breakthrough for skincare brands to achieve long-term development and drive the offline channel, especially the cosmetics store channel, to burst out with new growth vitality. The following chart sets forth market size of the skincare industry in China by retail sales, broken down into sales channel.

INDUSTRY OVERVIEW

Market Size of Skincare Industry in China by Retail Sales, breakdown by Sales Channels

Billion RMB, 2015-2026E

CAGR	2015-2021	2021-2026E
Online Channel	22.5%	13.2%
Offline Channel	9.4%	6.7%
Total	14.7%	10.1%



Source: Frost & Sullivan Report

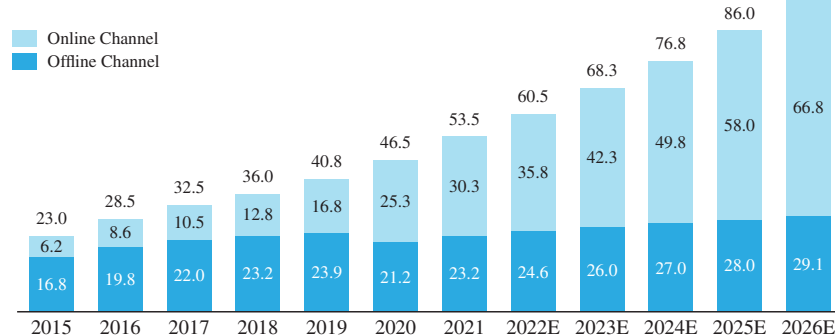
OVERVIEW OF CHINA’S MATERNITY AND CHILDCARE INDUSTRY

Maternity and childcare products are defined as those products which provide skin and personal care specifically for pregnant women, new mothers and children (under 12 years old). With the improvement of the standard of living in China, the development of the maternity and childcare market is driven by the heightened demand for high-quality and safe products for pregnant females and children. Moreover, social media platforms increase consumers’ interests in maternity and childcare products through enabling them to obtain the experience shared by other consumers as well as the endorsements by KOLs. The increasingly prominent e-commerce environment also offers pregnant females and new mothers a more convenient channel to purchase relevant products. According to the Frost & Sullivan Report, growing at a CAGR of 15.1%, the size of this market reached RMB53.5 billion in 2021. The growth of this product category remains the highest among others from 2021 to 2026, and the size of this market is expected to reach RMB95.9 billion in 2026, growing at a CAGR of 12.4% from 2021. Such rapid growth has been primarily driven by the growing willingness of the large number of consumers in China for maternity and childcare products. The market size of online channels increased at a CAGR of 30.1% from 2015 to 2021 and is expected to further increase at a CAGR of 17.1% from 2021 to 2026, being the major driver for the development of the maternity and childcare market in China. The following chart sets forth market size of the maternity and childcare industry in China by retail sales, broken down into sales channel.

Market Size of Maternity and Childcare Industry in China by Retail Sales, breakdown by Sales Channels

Billion RMB, 2015-2026E

CAGR	2015-2021	2021-2026E
Online Channel	30.1%	17.1%
Offline Channel	5.5%	4.7%
Total	15.1%	12.4%



Source: Frost & Sullivan Report

INDUSTRY OVERVIEW

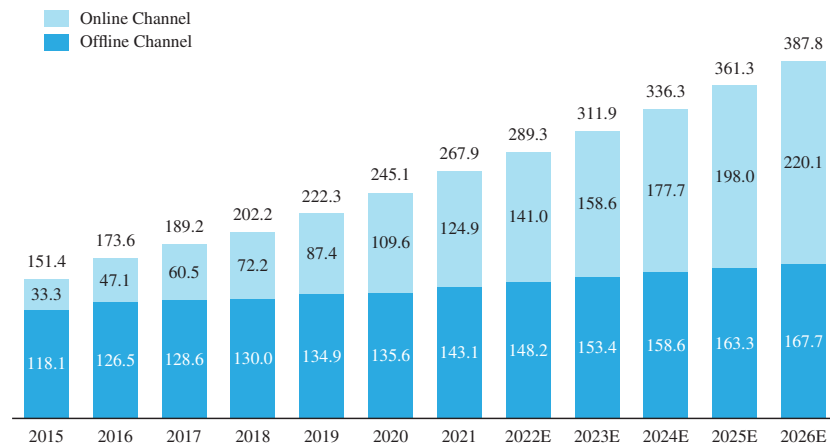
OVERVIEW OF CHINA’S TOILETRIES INDUSTRY

Toiletries products refer to products which clean and groom the skin, body, hair and mouth. Toiletries products can be mainly divided into bath and shower, hair care and oral care products. It is the second largest segment of the cosmetics industry. The growth of the toiletries market in China is primarily driven by the consumption habits of consumers underscored by consumer demands for functional products in different market segments, such as hair-loss prevention and scalp care. According to the Frost & Sullivan Report, the market size of this segment will reach RMB387.8 billion by 2026, representing a CAGR of 7.7% from 2021 to 2026. The following chart sets forth the market size of the toiletries segment in China by retail sales, broken down into sales channel.

Market Size of Toiletries Industry in China by Retail Sales, breakdown by Sales Channels

Billion RMB, 2015-2026E

CAGR	2015-2021	2021-2026E
Online Channel	24.6%	12.0%
Offline Channel	3.3%	3.2%
Total	10.0%	7.7%



Source: Frost & Sullivan Report

OVERVIEW OF CHINA’S MARKET FOR DOMESTIC BRANDED COSMETICS PRODUCTS

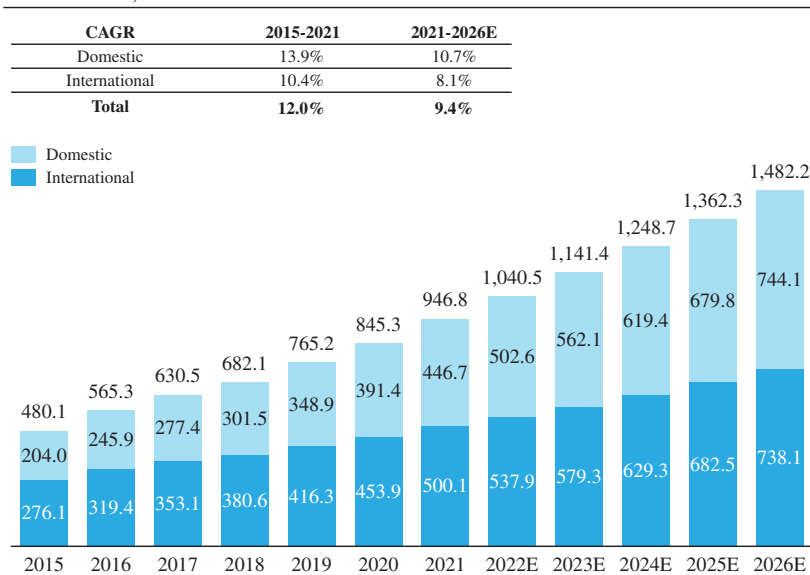
According to the Frost & Sullivan Report, Chinese domestic cosmetics brands refer to cosmetics brands owned by companies whose headquarters are located in China; foreign cosmetics brands refer to cosmetics brands owned by companies whose headquarters are located in overseas countries. Chinese domestic cosmetics brands have experienced fast development in recent years, primarily due to: (i) domestic companies’ deeper insight into the demands of Chinese consumers and the changing market conditions of China market, which enable them to adapt to the popular marketing strategies on social media platforms and continuing offer of suitable products to Chinese consumers, (ii) the increasing in R&D investment of Chinese domestic cosmetics companies, (iii) the increasing spending power of younger consumer groups, such as the Millennials and Generation Z, who are more receptive to Chinese domestic cosmetics brands and products that involve traditional Chinese elements and culture, and (iv) adoption of various favorable governmental policies in the past decade to encourage the development of Chinese domestic cosmetics industry in China. They are also beginning to adopt more creative sales strategies and more favorable product designs to satisfy consumer needs.

According to the Frost & Sullivan Report, retail sales of the Chinese domestic cosmetics market in China reached RMB446.7 billion in 2021, growing at a CAGR of 13.9% from 2015 to 2021. The market size of the Chinese domestic cosmetics market in China is expected to reach RMB744.1 billion in 2026, with a CAGR of 10.7% from 2021 to 2026, higher than the

INDUSTRY OVERVIEW

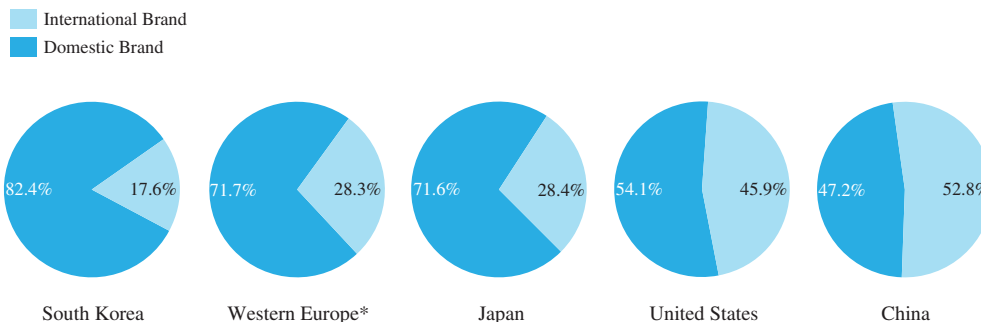
growth of foreign brands during the same period at a CAGR of 8.1%. Compared with the proportion of domestic brands in developed countries, with the increase in R&D investment of domestic brands and China’s per capita GDP, there is huge room for growth of the domestic cosmetics market in China, and the replacement of international brands by domestic brands will become an inevitable trend. The National Medical Products Administration issued the “Cosmetics Efficacy Claim Evaluation Specification” 《化妝品功效宣稱評價規範》 in April 2021, and the “State Administration of Market Regulation issued the “Supervision and Administration of Production and Operation of Cosmetics” 《化妝品生產經營監督管理辦法》 in August of the same year, both of which will come into effect in 2022. The standardized operation of the industry will accelerate the liquidation of unqualified small and medium-sized enterprises and result in consolidation of the industry. With the increase in consumer acceptance and brand power leverage of Chinese domestic cosmetics brands, product prices will also increase. This means that Chinese domestic cosmetics brands will occupy a larger share of the high-end market. The following charts sets forth the market size of the cosmetics industry in China in terms of retail sales, broken down into Chinese domestic brand and foreign brand as well as the proportion of Chinese domestic and international brand in the cosmetics industry in selected countries and areas, in terms of retail sales.

Market Size of Cosmetic Industry in China by Retail Sales, Breakdown by Domestic and International Brands
Billion RMB, 2015-2026E



Source: Frost & Sullivan

Proportion of Domestic and International Brands in Cosmetic Industry in Selected Countries/Area, in terms of Retail Sales
%, 2021



* Western Europe: include Andorra, Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Gibraltar, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, Malta, Monaco, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom.

Source: Frost & Sullivan

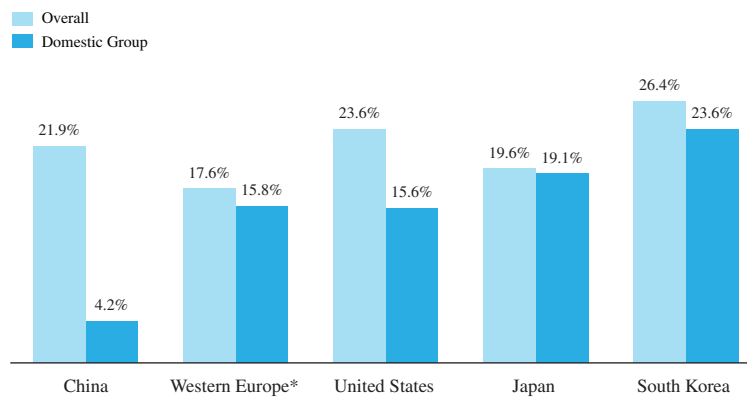
INDUSTRY OVERVIEW

COMPETITIVE LANDSCAPE

According to the Frost & Sullivan Report, the cosmetics market in China is fragmented, with the top five players occupied a market share of 21.9% in terms of retail sales, with all of them being international cosmetics groups. We ranked fourth in the Chinese domestic cosmetics market in China with retail sales of RMB7,556 million in 2021 and with a market share of 1.7% in the domestic cosmetics market. With more mature R&D capabilities and supply chains, advanced production facilities and extensive distribution channels, leading cosmetics companies are expected to further expand their market shares resulting in an increase in market concentration in the future. In addition, Chinese domestic cosmetics brands are expected to capture an increasing market share in China’s cosmetics market. The chart below sets forth the details of market share of the top five domestic and international groups in selected countries and area in terms of retail sales.

Top 5 Market Share of Domestic and International Groups in Cosmetic Industry in Selected Countries/Area, in terms of Retail Sales

%, 2021



* Western Europe: includes Andorra, Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Gibraltar, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, Malta, Monaco, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom.

Source: Frost & Sullivan

INDUSTRY OVERVIEW

Benefiting from in-depth understanding of local markets, effective marketing strategies, enhanced R&D capabilities, popularity among young consumer groups and favorable governmental policies, Chinese domestic cosmetics brands are expected to catch up with international brands in the future in terms market share in the Chinese market. However, the brand awareness of international groups is relatively high, mainly because of the different marketing strategies of international and domestic cosmetic groups. International groups focus on brand communication and implant brand concepts into consumers’ minds, while some of the domestic new celebrity brands rely on explosive products to open the market, and the cultivation of consumers’ brand awareness needs to be strengthened. The chart below sets forth the details of retail sales value of the top fifteen players on the Chinese cosmetics market and the top five players on the Chinese domestic cosmetics market in 2021.

Ranking of Cosmetic Group in China, by Retail Sales (2021)

Ranking	Group Name	Retail Sales (2021)	RMB Million	Market Share*
1	Company J		72,894	7.7%
2	Company K		55,745	5.9%
3	Company L		36,109	3.8%
4	Company M	23,060		2.4%
5	Company N	19,934		2.1%
6	Company O	13,088		1.4%
7	Company P	12,549		1.3%
8	Company Q	10,970		1.2%
9	Company R	9,547		1.0%
10	Company B	8,929		0.9%
11	Company A	8,379		0.9%
12	Company S	8,124		0.9%
13	Company C	7,633		0.8%
14	Our Group	7,556		0.8%
15	Company D	7,424		0.8%

Note: The market size of cosmetic industry by retail sales in 2021 was RMB946.8 billion.

Source: Frost & Sullivan

Ranking of Domestic Cosmetic Group in China, by Retail Sales Generated from Cosmetics Products (2021)

Ranking	Group Name	Retail Sales (2021)	RMB Million	Market Share*
1	Company B		8,929	2.0%
2	Company A		8,379	1.9%
3	Company C		7,633	1.7%
4	Our Group		7,556	1.7%
5	Company D		7,424	1.6%

Note: The market size of domestic cosmetic group by retail sales in 2021 was RMB446.7 Billion.

Company A: A cosmetic group registered in 1995 and listed on Shanghai Stock Exchange in 2001, the revenue was RMB7.6 billion in 2021. Engaged in R&D, production and sales of skincare, household cleaning, and maternity and childcare products, focusing on offline channels such as department stores, supermarkets and cosmetics franchise stores.

Company B: A cosmetic group registered in 2006 and listed on Shanghai Stock Exchange in 2017, the revenue was RMB4.6 billion in 2021. Engaged in the R&D, production and sales of efficacy skincare products and color cosmetics, mainly focusing on online sales channels.

Company C: A cosmetic group registered in 2015 and listed on New York Stock Exchange in 2020, the net revenue was RMB5.8 billion in 2021. Mainly engaged in the R&D, production and sales of color cosmetics and skincare products, mainly focusing on online sales channels.

Company D: A cosmetic group registered in 2004, with nearly 8,000 direct employees. Engaged in R&D, production, and sales of color cosmetics, personal care products and functional foods, with a relatively even distribution of sales between online and offline sales channels.

Non-public information about industry peers is primarily based on Frost & Sullivan’s primary research, including interviews with employees of these industry peers. These identities are not disclosed to fulfill confidentiality obligations without the consent of employees of these industry peers.

Source: Frost & Sullivan

INDUSTRY OVERVIEW

In terms of sub-segments in the cosmetics industry, according to the Frost & Sullivan Report, in 2021, we ranked third in the Chinese domestic branded skincare product market with a retail sales of RMB6,447 million, first in the Chinese domestic branded facial mask product market with a retail sales of RMB1,842 million and first in the Chinese domestic branded maternity and childcare product market with a retail sales of RMB1,789 million. Leveraging their advantages in product mix, R&D capabilities, supply chain management and marketing strategies, leading Chinese domestic cosmetics companies will increase their market shares in the future. The charts below set forth the details of market shares and retail sales value of the top five players in the domestic skincare product market, domestic facial mask product market and maternity and childcare product market in China.

Ranking of Domestic Skincare Product Group in China, by Retail Sales (2021)

Ranking	Group Name	Retail Sales (2021)	RMB Million	Market Share
1	Company B		7,688	1.7%
2	Company D		6,533	1.4%
3	Our Group		6,447	1.4%
4	Company F		5,848	1.3%
5	Company E		5,737	1.2%

Note: Skincare products include facial skincare, body care and hand care products for adult, pregnant women, newborn mothers and children (under 12 years old).

Company E: A cosmetic group registered in 2000 and owns 8 cosmetic brands. Focusing on skincare products with natural and safe ingredients, mainly focusing on offline sales channels.

Company F: A cosmetic group registered in 2012 and listed on Shenzhen Stock Exchange in 2018, the revenue was RMB5.0 billion in 2021. Engaged in R&D, production and sales of facial masks, toner, lotion, cream, color cosmetics, personal care and cleaning products, mainly focusing on online channels, such as e-commerce and self-operated platforms.

Source: Frost & Sullivan

Ranking of Domestic Facial Mask Product Group in China, by Retail Sales (2021)

Ranking	Group Name	Retail Sales (2021)	RMB Million	Market Share
1	Our Group		1,842	3.2%
2	Company B		1,786	3.1%
3	Company F		1,784	3.1%
4	Company A		1,683	2.9%
5	Company T		1,210	2.1%

Note: Facial mask products include facial mask products for adult, pregnant women, newborn mothers and children (under 12 years old).

Company T: A cosmetic group registered in 2017, the revenue was RMB1.6 billion in 2020. Engaged in the R&D, production and sales of medical device dressing products and functional skin care products, mainly focusing on offline sales channels.

Source: Frost & Sullivan

INDUSTRY OVERVIEW

Ranking of Domestic Maternity and Childcare Product Group in China, by Retail Sales (2021)

Ranking	Group Name	Retail Sales (2021)	RMB Million	Market Share
1	Our Group	1,789	1,789	3.3%
2	Company G	1,354	1,354	2.5%
3	Company A	1,033	1,033	1.9%
4	Company H	865	865	1.6%
5	Company I	705	705	1.3%

Note:

Company G: A personal care group registered in 2005, with over 5,000 employees. Mainly engaged in the R&D, production and sales of childcare, household hygiene and adult care products, mainly focusing on online sales channels.

Company H: A cosmetic group registered in 2000 with 3 major brands, 12 series and more than 200 products. Mainly engaged in the R&D and sales of skincare products, haircare products, childcare products and color cosmetics, mainly focusing on offline sales channels.

Company I: A cosmetic group registered in 2005, of which core brand has over 2,000 sales outlets in China. Mainly engaged in the R&D, production and sales of childcare products and lip care products, with a relatively even distribution of sales between online and offline sales channels.

Source: Frost & Sullivan Report

MARKET DRIVERS

Growing Willingness and Capabilities to Consume. Compared with developed countries such as the United States, Japan, and South Korea, the level of per capita spending on cosmetics products is still relatively low. According to the Frost & Sullivan Report, there is a strong positive correlation between per capita disposable income and per capita expenditure on cosmetics products. With the steady growth of China’s economy and the improvement in the living standards of Chinese people, per capita cosmetics expenditure in China will continue its growth in the future.

Expanding Functional Product Categories. Along with the development of the cosmetics market, there emerges more segments in the cosmetics industry focusing on different functions corresponding to the evolving needs of consumers, which encourage cosmetics companies to launch new products and further enrich their product offerings. Products focusing on specific functions including anti-aging function, sensitive skin repairing, whitening, oil and acne control, anti-wrinkle and replenishing can provide more choices for Chinese consumers, who thereby increase their purchasing frequencies.

Expanding Consumer Base. The emergence of emerging media platforms, such as Xiaohongshu, Weibo and Douyin, and innovative marketing methods, such as live-streaming platforms, have improved the shopping experience of internet users and fostered their interests in cosmetics products. Diversified online shopping channels and marketing activities are more adaptable to the spending habits of younger consumer groups, such as Generation Z and Millennials, which are becoming the main force of consumption for cosmetics products.

Mature Supply Chain. China has formed a comprehensive supply chain for the cosmetics industry in China. A mature supply chain would enable both Chinese domestic cosmetics companies and foreign cosmetics companies to launch and produce products more effectively and efficiently in response to the changing markets.

Favorable Policies. Favorable policies have been issued by local and central governments in China to encourage the development of the cosmetics industry. For instance, the “14th Five-Year Plan” clearly pointed out that it is necessary to incubate premium Chinese domestic cosmetics brands and products. In addition, the “Shanghai Cosmetics Industry High-Quality Development Action Plan (2021-2023) 《上海市化妆品产业高质量发展行动计划(2021-2023年)》” proposed that by 2023, Shanghai’s cosmetics market will strive to reach

INDUSTRY OVERVIEW

RMB300 billion and establish 10 leading companies with revenue exceeding RMB5 billion and with three to five leading international brands. The “Several Opinions on Promoting the Development of Shanghai’s Beauty and Health Industry” proposed that by 2025, Shanghai’s beauty and health industry should form a RMB100 billion industrial capacity and cultivate 10 key industry enterprises with annual sales of more than RMB10 billion. In addition, Zhejiang, Guangdong and other local governments continue to introduce favorable policies for the cosmetics industry, such as the “Implementation Plan for the High-Quality Development of the Cosmetics Industry in Zhejiang Province (2020-2025) 《浙江省化妝品產業高質量發展實施方案》(2020-2025年)” and the “Implementation Plan for Promoting the High-Quality Development of the Cosmetics Industry in Guangdong Province 《廣東省推動化妝品產業高質量發展實施方案》”, respectively.

INDUSTRY TRENDS

Popularity of Multi-brand Operational Model. Based on the observation of the development of international cosmetics groups, a multi-brand strategy has been proven to be a necessary path for cosmetics companies to become world-class cosmetics companies. Moreover, with different brands covering different cosmetics market segments, cosmetics groups can offer a broad product offering to consumers to address their specific demands. The multi-brand operational model also gives cosmetics companies the flexibility in formulating different sales and marketing strategies for different groups of customers. The multi-brand and multi-category operational model is strategically necessary to alleviate the risks derived from business concentration and market volatility faced by a single-brand cosmetics company.

Rise of Chinese Domestic Cosmetics Brands. Although international brands still dominate the cosmetics market, the market size of Chinese domestic brands is expected to grow at a higher CAGR than international brands from 2021 to 2026. With the increasing R&D investment from domestic cosmetics enterprises, it could be expected that they could soon compete with international brands in the cosmetics market. By business expansion and M&A in overseas markets, domestic groups are in the process of expanding their business to markets overseas. In addition, with the upgrading of the consumption structure and the deepening of urbanization in the Chinese market, consumers will have increased purchasing power for high-end cosmetics products. Based on the advantages of strong supply chain systems, R&D capabilities and brand power, leading domestic cosmetics brand groups are expected to capture more market shares in the high-end market.

Increasing R&D Investment. Nowadays Chinese consumer preferences are becoming increasingly focused on products with better and distinctive functionality and quality, as demonstrated by the rapid increase in demand for anti-aging products and sensitive skincare products, as well as the emphasis on clean beauty products. Therefore, leading domestic players in the industry are now devoting more resources into the R&D process to address the issue.

DTC Model. With increasing diversity in consumer demands, the traditional distribution model has a natural disadvantage in capturing consumer demands and responding to the market due to lack of information flow. In the meantime, some top cosmetics companies have started to establish a direct sales model to directly develop the relationship between brands and consumers. How to organically combine the omni-channel model of online sales and offline experience will be one of the most important development issues to be addressed in the future. The development of offline channels has become particularly important in recent years. The balanced development of omni-channels will provide more touchpoints for consumers, benefiting the long-term development of cosmetics companies.

Digital Transformation. With the vigorous development of the internet, China has fostered the most tech-savvy consumer group seeking an advanced digital experience. Given this background, many industries, including cosmetics, are facing the challenge to conduct digital transformation to meet the increasing demand for digital experience from Chinese consumers. Digital transformation aims to transform the entire supply chain of the industry, from upstream product production, midstream brand building to downstream sales. The specific implementation measures include, but are not limited to, flexible procurement, precision production, digital operation, personalized promotion, etc., to achieve the two core purposes of cost reduction and efficiency improvement within the enterprise and improvement in consumer experience.

INDUSTRY OVERVIEW

Rise of Maternity and Childcare. According to the Frost & Sullivan Report, it is expected that the market size of China’s maternity and childcare industry will exceed RMB60.5 billion in 2022. New retail models will become a major development trend in the maternity and childcare industry, which is believed to be expanding from products to services, from mass to high-end and be more subdivided and diversified. Products with professional and additive-free formulas and featured functions have started to gain recognition in the market.

ENTRY BARRIERS

Branding Barrier. As living standards improve and consumption philosophies and patterns evolve, brand recognition and loyalty have become important factors in consumption decision-making in the cosmetics industry. Brand awareness is a comprehensive illustration of product design, product quality, brand culture, manufacturing skills, management and service, marketing network and public recognition that requires large amounts of investment of capital, resources and time. The renowned enterprises at present have built their branding barrier and market recognition via years of operation in the industry, and new entrants would experience difficulties in achieving such brand recognition in a short period of time.

R&D Barrier. One challenge faced by the cosmetics industry is to develop new products that fulfill market demands in response to evolving industry trends. R&D of cosmetics products involves life science, chemistry, dermatology, botanical science, etc. Cross-section application and research would require a complete R&D process ranging from foundational R&D to engineering application which could fulfill the requirements of coordination and system completeness. As a result, existing companies who have more R&D experience, more funds, talents, and resources could obtain more R&D results and achieve commercialization of newly developed technology, thereby posing a technological barrier to new entrants in the industry.

Regulation Barrier. Multiple departments and agencies in China have the authority to regulate and manage the import of ingredients and products, and the manufacturing process of the products. Multiple laws, regulations, administrative guiding opinions have been issued to set up a high standard for cosmetics products and in turn raised the entry barrier for the industry. For instance, the Regulation on the Supervision and Administration of Cosmetics issued by the State Council of China came into effect in January 2021. Multiple regulations and administrative measures followed simultaneously to specify the details in the tightened regulation environment, such as Measures for the Supervision and Administration of Production and Distribution of Cosmetics issued by State Administration for Market Regulation that came into effect in 2022, Technical Guidelines of Cosmetic Safety Evaluation (2021) issued by the National Medical Products Administration that came into effect on May 1, 2021, and Measures for Cosmetics Registration that came into effect in May 2021. These regulations have made the regulation environment tighter than before, posing an entry barrier of regulation for new entrants. The National Medical Products Administration released the “Cosmetics Classification Rules and Classification Catalogue” 《化妝品分類規則和分類目錄》 in April 2021, pointing out that products for pregnant and lactating women are new efficacy products and need to be registered and regulated as special cosmetics, cosmetics for pregnant and lactating women. In addition, a series of registration and filing regulations such as the “Measures for the Administration of Cosmetic Registration and Filing” 《化妝品註冊備案管理辦法》 and “Regulations for the Administration of Cosmetic Registration and Filing Information” 《化妝品註冊備案資料管理規定》 clearly stipulate that new product registration and filing should be submitted with the product formula or overall ingredients. Cosmetics companies will be faced with the risk of formula leakage for OEM/ODM factories. The new policies make having independent R&D capabilities one of the barriers to entry for cosmetic companies.

Supply Chain Barrier. Nowadays, the success of developing a product requires cooperation and coordination of multiple subjects and geographical areas, and the success of a product requires cooperation and coordination of multiple functions, including R&D, ingredient procurement, distribution network, etc., all of which pose a challenge to the construction of a global supply chain. And the alternative to building a global supply chain, the ODM model, would raise the issue of intellectual property. The cost of establishing a global supply chain poses a barrier to those who have not entered the industry.

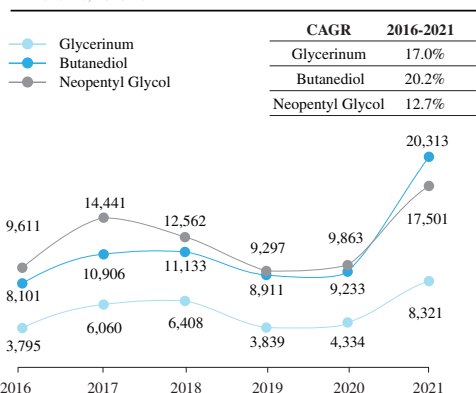
INDUSTRY OVERVIEW

Channel Barrier. Cosmetics products are highly reliant on sales channels as the products would directly face end consumers. Channel maturity and stability are of vital importance to cosmetics enterprises. Mature brands, accumulated operational experience, a well-established management team, and heavy capital investment is crucial for building a nationwide marketing network covering department stores, supermarkets, drug stores, e-commerce platforms, etc. It would be a serious challenge for new entrants to catch up.

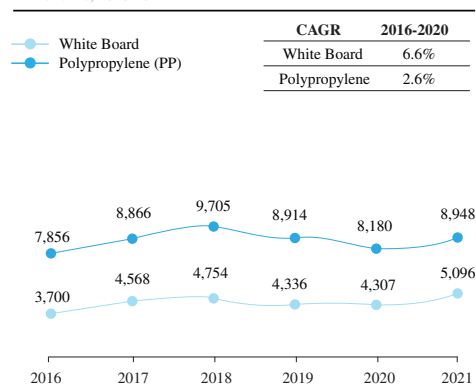
PRICE TRENDS OF RAW MATERIALS

The cost of raw materials represents a major cost item for a typical cosmetics company in China. The raw materials used in cosmetics product production primarily consist of packaging materials and ingredients. In particular, the cost of packaging materials accounts for a large proportion of the cost of raw materials for a company that operates in China’s cosmetics industry. The ingredients for skincare products mainly include moisturizers, grease and active ingredients. The packaging materials include glass bottles, plastic, paper boxes, etc. According to the Frost & Sullivan Report, the cost of packaging materials kept steady in past five years. The following charts set forth the key packaging materials and ingredients prices.

Key Raw Material Price
RMB/Tonne, 2016-2021



Key Package Raw Material Price
RMB/Tonne, 2016-2021



Source: Frost & Sullivan Report

According to the Frost & Sullivan Report, from 2016 to 2021, the price per tonne of glycerinum increased from RMB3,795 to RMB8,321, with a CAGR of 17.0%. In 2021, the price per tonne of butanediol and neopentyl glycol reached RMB20,313 and RMB17,501, with a CAGR of 20.2% and 12.7%, respectively, from 2016 to 2021. Since 2016, the Chinese government has implemented a series of policies to enhance environmental protection by shutting down certain outdated production facilities in the chemical industry, which led to production suspension and supply shortage of raw materials, resulting in increased prices for glycerinum, butanediol and neopentyl glycol. Since late 2018, the operation of manufacturers of these raw materials has begun to recover after several years of structural adjustment in the chemical industry, driving down the price of raw materials. In 2021, the combination of factors such as the continuation of monetary easing policies in major global economies, supply and logistics disruptions due to overseas epidemic prevention and control, and domestic curbs on the production of highly polluting and energy-intensive industries, indirectly pushed up the prices of butanediol, glycerinum and other important basic chemicals.

IMPACT OF THE OUTBREAK ON COSMETICS INDUSTRY IN MAINLAND CHINA

The COVID-19 pandemic, which regionally broke out in China in the first and second quarters of 2022, its strict lockdown measures led to the temporary closure of a large number of manufacturing facilities, offline stores, and corporate offices in some severely affected areas, which had a certain impact on the overall economic and social activities in China and to some extent reduced consumers’ willingness of discretionary consumption. Meanwhile, since the lockdown caused by this round of epidemic is limited to certain areas, and most economic and social activities are still operating normally, consumer demands for cosmetics continues to exist. As China’s ability to prevent and control COVID-19 is fully enhanced, the Chinese government’s handling of small domestic outbreaks is becoming more and more mature, and the buffer period of prevention and control is gradually shortening, the cosmetics

INDUSTRY OVERVIEW

industry is expected to be less affected by the COVID-19 and the consumer environment is expected to become increasingly stable. Taking into account the impact of COVID-19, the market size of the cosmetics industry in China is RMB946.8 billion in 2021, growing at a CAGR of 12.0% from 2015 to 2021 and is expected to grow at a CAGR of 9.4% from 2021 to 2026. The market size of domestic cosmetics industry in China is RMB446.7 billion in 2021, growing at a CAGR of 13.9% from 2015 to 2021 and is expected to grow at a CAGR of 10.7% from 2021 to 2026.

SOURCE OF INFORMATION

In connection with the [REDACTED], we engaged Frost & Sullivan, an independent market research consultant, to conduct an analysis of, and to prepare a report about, the global cosmetics industry and China’s cosmetics industry. Frost & Sullivan is an independent global consulting firm, which was founded in 1961 in New York. It offers industry research and market strategies, and provides growth consulting and corporate training. In connection with the market research services provided, we have paid a fee of RMB1,070,000 to Frost & Sullivan, which we believe to be consistent with market rates.

In compiling and preparing the Frost & Sullivan Report, Frost & Sullivan adopted the following assumptions: (i) the global social, economic and political environment is likely to remain stable in the five years from 2022 to 2026 (the “Forecast Year”), (ii) purchasing power is expected to continue to rise rapidly in emerging regions and to grow steadily in developed regions, (iii) the impact of the COVID-19 is phased and temporary, against the backdrop of accelerated vaccination, China’s epidemic control shows an overall positive trend and the Chinese economy shows long-term positive fundamentals, and (iv) related industry drivers such as increasing health and hygiene awareness, growing purchasing power and other key drivers are likely to drive the household care industry in the Forecast Year.

Except as otherwise noted, all the data and forecasts contained in this section are derived from the Frost & Sullivan Report. Frost & Sullivan has prepared the Frost & Sullivan Report based on detailed primary research which involved discussing the status of the cosmetics industry with certain leading industry participants and secondary research which involved reviewing company reports, independent research reports and data based on its own research database. Our Directors confirm that, after taking reasonable care, there has been no material adverse change in the overall market information since the date of the Frost & Sullivan Report that would materially qualify, contradict or have an impact on such information.