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*Nana Smith picks out her favorite nail polish colors at the Ulta on State Street.  
Katie Sciortino/MEDILL*

### **Ulta salon gives a beauty market makeover**

by KATIE SCIORTINO  
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Powder, polish, brushes and bronzer, lipstick and liner have long been tools of the trade for the business of beautiful. Ulta Salon, Cosmetics & Fragrances Inc. is attempting to give the industry a makeover.

Billing itself as a "one-stop shop" for women's beauty needs, the Bolingbrook, Ill.-based retailer is mixing up the conventional method for distributing cosmetics and salon products.

Traditionally, beauty products were sold through distinct channels: prestige brands such as Estee Lauder and La Prairie at department stores, mass brands such as Revlon and CoverGirl at drugstores and hair care products such as Aveda at specialty salons.

But Ulta recognized that women buy across categories. The stores carries more than 21,000 beauty products in 500-plus brands, including an Ulta private-label line.

The company also operates in-store salons that offer haircuts and color as well as other beauty services and skin treatments.

Ulta's large selection and big range of prices is a huge draw for self-proclaimed nail polish fiend, Kori Johnson, 21. Johnson said she can find the OPI polishes she loves for a better price at Ulta and can get her Urban Decay makeup at the same time.

"It's very well priced," said Johnson. "It has certain things that other stores don't have."

But Ulta is facing fierce competition and frugal consumers who have cut back on discretionary purchases.

"This category is highly competitive," said Tiffany Co, a director at Fitch Ratings, an international debt-rating agency. "Not only do you have your stand-alone stores, but you also have your department stores who carry cosmetics."

Aside from the department stores such as Macy's Inc. and Nordstrom Inc. that carry many of the same prestige brands as Ulta, drugstores and superstores carry similar mass beauty brands as well.

Also posing a threat are J.C. Penney Co.'s cosmetic counters and Sephora, a mall-based beauty chain that offers a mix of brands just like Ulta does. Sephora is a cosmetic and salon company owned by French luxury retailer Louis Vuitton Moët Hennessy.

In addition to the more than 250 stand-alone stores in the U.S., Sephora has set up shop inside more than 200 J.C. Penney department stores.

Despite the competition, Ulta thinks its strategy has staying power.

In 1999 Lyn Kirby entered the scene as CEO, bringing her experience as former president of Circle of Beauty, a subsidiary of Sears, and former vice president of Avon Products Inc.

Kirby primed and polished Ulta's business strategy and made way for additional retail spaces large enough to accommodate her new plans.

Between 2003 and 2007 Ulta nearly doubled its retail store count from 126 to 249. In that same time period, sales more than doubled to \$912.1 million from \$423.9 million.

The company also launched a campaign to remodel existing stores in order to accommodate new prestige brands and to enhance the look and layout for a better customer experience.

Within its stores, Ulta sets aside 200-sq. ft. spaces for various niche brands to showcase their products and "stamp their equity," said Kirby.

Ed Schack, 27-year industry veteran and CEO of distributor EES Cosmetic Solutions, said a positive thing about Ulta is the avenue it provides customers to see the latest products and ingredients.

On Oct. 25, 2007, Ulta became a public company with a successful stock offering. Its stock debuted a \$32 a share, giving it a market cap of around \$ 1.7 billion. Its current market cap is \$2.01 billion.

The following October, Ulta opened the doors on its "urban prototype," an 18,000 sq. ft. space on State Street in downtown Chicago.

But as customers were climbing the stairs at Ulta's first multi-level store, the company's stock price was dipping. The economy was already in decline and even though Ulta's sales weren't hurt much, investors bailed.

The stock bottomed out at \$4.40 on March 2, 2009, compared with \$13.48 almost a year before. Today, Ulta's stock has rebounded to an even higher price than the initial public offering, closing around \$34 Monday.

When it comes to tough economic times though, the beauty category is generally more resilient than other areas of retail, experts say.

Cosmetics distributor Schack said he believes the industry is almost recession-proof, adding, "A woman may not have \$100 or \$200 to go out and buy a new dress, but she does have a few dollars to change her makeup up a little bit and give herself a new look."

In fact, Ulta has managed to maintain solid top-line growth.

"We accepted the reality that customers wallets were going to be tighter," said CEO Kirby in a 2009 annual report video. "We set out to zig while everyone was zagging. We absolutely wanted to go after top line growth at a point in time when many other retailers pulled back."

After leading Ulta through the recession, in April Kirby announced she would be retiring after her 10-year tenure at the top.

Kirby officially handed over the reins in May to Chuck Rubin, former president of the North American retail division of Office Depot Inc.

Rubin assumed leadership of a financially sound company, yet he still has his work cut out for him in securing Ulta's position in the highly competitive retail sector.

Some experts agree that Ulta's decision to stay out of the malls has been key to its success and Rubin has no plans to change that. Ulta is continuing with its stand-alone store expansion. By the end of 2010, Ulta plans to have opened 46 new stores, bringing the retailer's store count to nearly 400.

As recently as 2008, the company said it believes it can grow its store base to more than 1,000 stores in the U.S.

"What I like about Ulta is that they didn't chase the mall-based retail stores," said Brit Beemer, chairman and founder of America's Research Group. "They've done a nice job with their store location."

Beemer added that only 31 percent of early holiday shoppers walked into a mall Black Friday, as the day after Thanksgiving is known, and the last weekend of November, compared with 55 percent 10 years ago.

The key will be whether or not Ulta finds the right locations said James Schragar, clinical professor of entrepreneurship and strategic movement at the University of Chicago Booth School of Business.

"Retail chains have a cycle they go through," said Schragar. "As long as Ulta has 600 more great sites, then they can have a nice long run."

Yet Schragar said Ulta's diverse brand strategy is extremely rare because a retailer's image is typically based on the price level at which it sells. Generally, it is difficult to have inexpensive and expensive products in the same place, Schragar said.

For example, Sephora carries many of the same prestige brands that Ulta offers – Benefit Cosmetics, Bare Escentuals, Stila and Smashbox - but doesn't offer CoverGirl or Revlon, drugstore brands.

Because Ulta carries a wide variety of lower-priced products as well, drugstores such as Walgreen Co. and CVS Caremark Corp., as well as superstore giants Wal-Mart Stores Inc. and Target Corp., also present competition.

Little by little Ulta is moving toward prestige brands and continues to add more to its shelves. In the second quarter, Ulta rolled out skincare lines such as Philosophy, Tart and Bliss as well as fragrances such as Big Pony from Ralph Lauren, DKNY Pure, and Peace, Love, Juicy Couture.

In the end, price points will not be as important as service, said Walter Loeb of Loeb Associates Inc., a Manhattan retail consulting firm.

Loeb thinks Ulta has a strong product presentation but will have to set itself apart by being friendlier and by working harder. "It's through their service and their attitude and their special offerings that they will get the recognition," Loeb said.

Being customer-focused is a large part of Ulta's strategy. Rather than trying to increase the average ticket price during tough economic times, Ulta focused on the quality and quantity of its shoppers.

The store launched a loyalty program, which offers exclusive deals for repeat customers. Lenda Reyes, 28, said the point-reward program is a big incentive to shop at the store.

"I always walk into the store without stuff to buy but always walk out with something," said Reyes.

Other customers appear to be doing the same. Ulta's profit in the first nine months of 2010 increased to \$40.9 million, compared with \$19.1 million in fiscal 2009.

In the same period, sales rose 18.7 percent to \$981.2 million from \$826.4 million in 2009. Comparable-store sales rose 11.3 percent, compared with a decrease of 0.8 percent last year.

Ulta's current price-to-earnings ratio is an expensive 38.35, which compares to 21.53 for the S&P 500. That doesn't stop William Blair & Co. analyst Mark Miller from touting the stock.

Miller characterized Ulta as "a great retail success story." Recognizing the company's aggressive growth, he rated the company to "outperform" the overall market.

Analysts surveyed by Bloomberg are predicting Ulta will earn \$1.04 per diluted share in 2011 compared with projected 2010 earnings of 62 cents per share.

"As we look to our fourth quarter, we are very pleased with our positioning," said CEO Rubin. "Our holiday strategy includes exciting merchandising and marketing programs that highlight our strong category and brand offering while providing both the newness and value our customers are looking for."



Katie Sciortino/MEDILL

The chart shows key prices in Ulta's stock history since the company went public until the present and is featured on a photo of Benefit Cosmetics, a brand Ulta carries in its stores.

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