

Foreword

As in previous years, we are glad to present Unipro's Annual Report, edited by our Corporate Culture and Study Centre. The Report will be distributed at the General Assembly and as usual, but this year in particular, it will serve as a key document of reference, providing an accurate picture of the industry today and the way it is changing.

In order to gain a better insight into the evolution of the industry, Unipro's Corporate Culture and Study Centre has long been promoting research studies and surveys, which have contributed to improving methods for data collection and analysis, while at the same time regularly providing production and consumption values. This has allowed a better understating of the numerous factors affecting the economic evolution of the Italian cosmetics industry, which must be seen in the wider context of the domestic and world economies, in particular in terms of the flexibility of demand.

In 2005 Italy's cosmetics industry reported a slight increase in production, which reached almost Euro 7,9 million. This was largely driven by exports, which rose by over 6 percentage points to Euro 2,1 million. Figures for the domestic market, however, showed a slowdown for the second consecutive year, with 2005 closing at just over Euro 8,6 million.

As often stressed in the past, compared to other industries, the Italian cosmetics industry stands out as an exception: for over five years now, although less so in recent years, there has been a downward trend in Italy's domestic demand for cosmetics, while consumption in other sectors, such as clothing and shoes, continues to show an upward trend.

As a whole, Italy still appears to have a dynamic domestic demand, characterised by changing and diverse consumer purchasing choices, slowed only by the country's negative economic performance. In general, after the weakening of the United States dollar against the Euro and the heavy repercussions of the oil crisis, especially on the prices of raw materials, the industry is also faced with increased competition from international markets.

Macro and micro-economic scenarios are changing rapidly: global competition has disrupted traditional borders to include new countries, new producers and new markets, which had been unknown to each other until recently.

The Association has set itself precise objectives in order to adapt to these changes. Since I took on the presidency one year ago I have shared with the Association's General Assembly several goals related to our service and communication role, and I have proposed a series of initiatives to promote Italy's cosmetics industry and to foster its consolidation, both at an institutional and commercial level.

Clearly, while we welcome the good results, we should not neglect some features of Italy's domestic entrepreneurial fabric, which may become problematic in the future: I am referring, for example, to the small to medium size of over 80% of our members and to insufficient investment in research and in globalisation processes, despite the international success of Italian innovative and high-quality products and services.

For all these reasons, Unipro will continue to support the growth of the new beauty and well-being industry by offering services and by promoting a corporate culture and winning entrepreneurial values.

Fabio Franchina
President of Unipro

The cosmetics industry

In 2005, Italian cosmetics producers reported a 1,6% increase in revenues at current values, posting a value of production of Euro 7.890,1 million.

As in the past few financial years, the foreign component of demand influenced results that, in light of a comparison with other consumable goods sectors, were still quite good. In the face of a largely stagnant domestic market, exports of Italian cosmetics products have continued by and large along their growth trajectory: +6,1% with a value of just under Euro 2.130 million.

At the same time, as in previous financial years, pressure exerted on the propensity to purchase influenced the stagnancy of domestic demand, extending its effects into 2005. The figure is negative especially when considering the professional channels, which see a 1,1% contraction in revenues against a fairly weak recovery in the traditional channels, which have grown by 0,2%.

The analysis of the percentage breakdown in revenues per distribution channel in 2005 confirms the weight of the most recent financial years: nearly 34% is held by large-scale retail which is valued, in terms of sell-in, at more than Euro 2.670 million.

COSMETICS INDUSTRY TURNOVER BY CHANNEL OF DISTRIBUTION (**)

(Figures in millions of Euros)

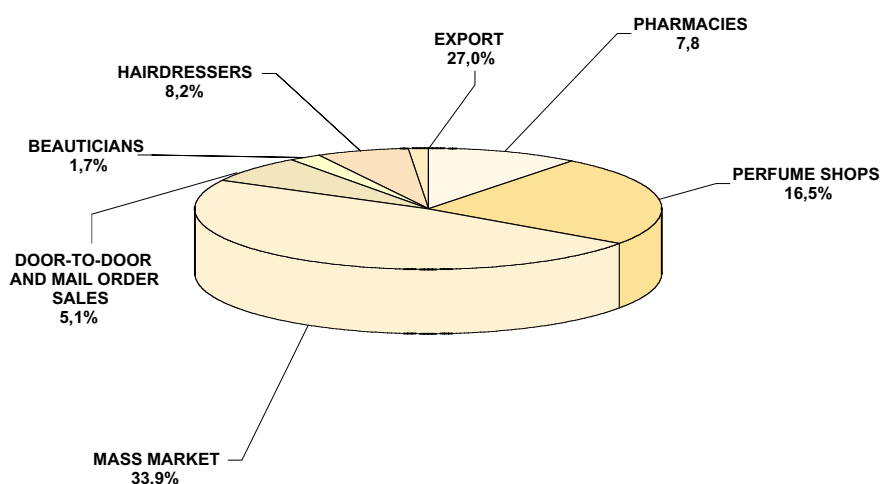
Distribution channels	2004		2005	
	% variation	values	% variation	values
Traditional channels:	4.979,0	4,8%	4.987,0	0,2%
– Pharmacy	587,9	8,6%	615,1	4,6%
– Perfume shop	1.329,1	3,7%	1.300,7	-2,1%
– Mass Market *	2.675,5	4,5%	2.671,7	-0,1%
– Door-to-door and mail order sales	386,5	4,7%	399,5	3,4%
Professional channels:	784,7	-1,3%	776,2	-1,1%
– Beauty salons	133,1	-2,5%	131,8	-1,0%
– Hairdressers	651,6	-1,4%	644,4	-1,1%
Export	2.003,8	1,0%	2.126,9	6,1%
Total turnover of cosmetic industry	7.767,5	3,3%	7.890,1	1,6%

(*) Includes Herbalist shops with a turnover of 133,3 million Euros in 2004 and of 138,6 million Euros in 2005, for a relative increase of 4,0%.

As mentioned, exports are the only component of demand that has influenced the growth of industrial revenues. The proportion of export to production, equal to 27%, is still very low when compared to the proportions that characterize other industrial consumable goods sectors. As mentioned on several occasions, there are significant areas of potential development for a sector that cannot shake its predominantly small-business dimension and generalized difficulty in facing internationalization processes.

In the short term, prospects on the domestic market show little room for optimistic evaluations; still, industrial indicators of the cosmetics sector report a potentially dynamic situation. Employment has remained at steady levels for several years; investments that expand production capacity are growing; and investments in research and development are also rising, as confirmation of the competitive positions acquired by Italian companies.

COSMETICS INDUSTRY TURNOVER BY CHANNEL OF DISTRIBUTION IN 2005 (**)



(**) Periodic checks on the survey bases have shown that the professional hairstylists channel has been undersized: as of this year, revenues and market values were reviewed and rose respectively to Euro 644,4 million and Euro 714 million.

With reference to market values, only aggregate data is reported for 2005 since checks were made on the destination of some production components for outlet channels. Price, quantity and volume trends are unchanged.

Several components, such as face cream and shaving products used in barber shops, will be monitored and removed from consumable products for professional hairstylists. In addition, it will be necessary to identify the values of sales outside the channel.

Channels of distribution

The value of domestic consumption of cosmetics products, which reported growth of 0,2% in 2005, was influenced by a decreased propensity to spend in Italian households, penalized by an unfavourable economic trend and consequent reductions in spending, and at the same time, is affected by changing needs.

This is the only explanation for the roller coaster performance of each year, influenced by increasingly specific and individualized buying habits.

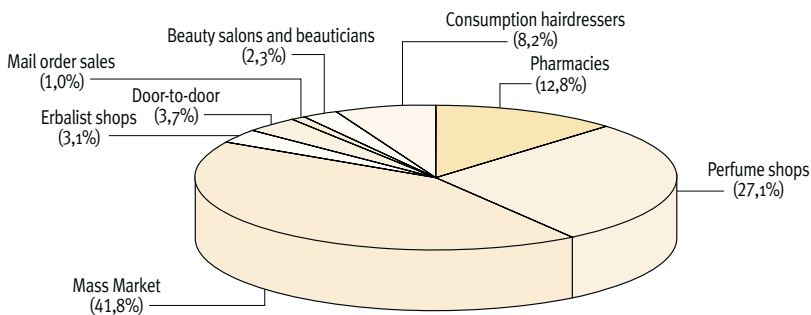
While it is not surprising to see a contraction in perfumery sales, which was 2,1% after several years on the upswing, the slowdown in mass-market consumption of -0,4% is rather troubling, despite the fact that on its own, mass-market accounts for 42% of the cosmetic consumption in 2005.

TOTAL MARKET FOR COSMETICS PRODUCTS IN 2005 (**)

Consumption in millions of Euros – Prices to the public including VAT.

		Variation % 05/04
Total sector	8.633,5	0,0%
Pharmacies	1.107,2	4,6%
Perfume shops	2.341,2	-2,1%
Mass market	3.610,5	-0,4%
Herbalist shops	263,4	4,0%
Door-to-door sales	316,0	4,0%
Mail order sales	83,5	1,0%
Sales to beauty salons and beauticians	197,7	-1,0%
Sales hairdressers	714,0	-1,1%

PERCENTAGE SHARES OF CONSUMPTION BY CHANNEL OF DISTRIBUTION IN 2005



Reporting a considerable downward trend was consumption in the professional channels (**), which decreased by 1,1% on average.

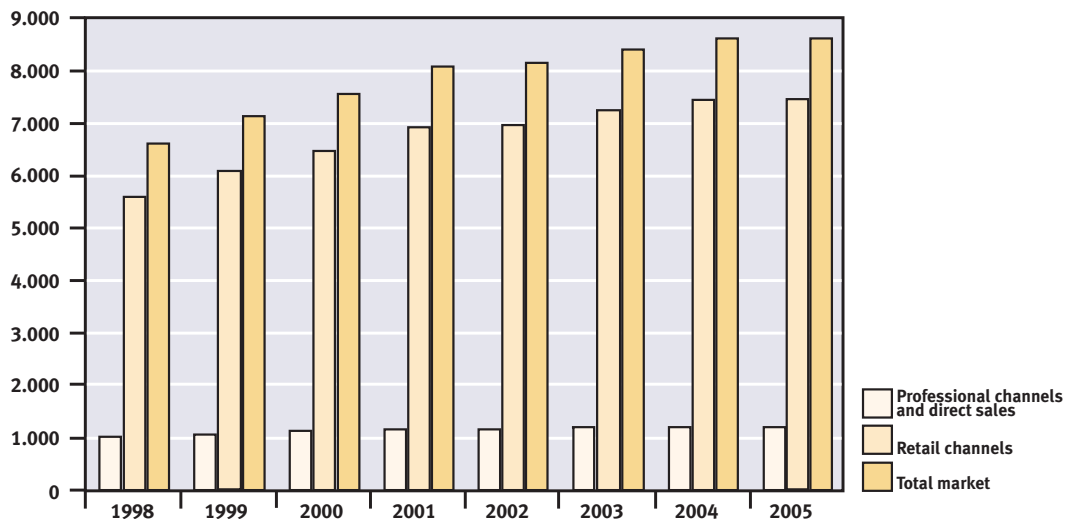
Figures confirmed the positive dynamic of sales in chemist's shops, which exceeded Euro 1.100 million with a rate of growth of 4,6%.

TRENDS IN THE CHANNELS OF DISTRIBUTION FOR THE COSMETICS INDUSTRY

CHANNELS OF DISTRIBUTION	PERCENTAGE VARIATION		
	Consumption	Quantities	Prices
Pharmacies	4,6%	3,1%	1,5%
Perfume shops	-2,1%	-5,0%	3,0%
Mass market	-0,1%	-0,1%	0,0%
TOTAL TRADITIONAL CHANNELS	-0,1%	-1,3%	1,2%
Door-to-door and mail order sales	3,4%	2,9%	0,5%
Sales to Beauty Salons and Beauticians	-1,0%	-1,5%	0,5%
Consumption through women's hairdressers	-0,8%	-3,2%	2,5%
Consumption through men's hairdressers	-2,0%	-4,4%	2,5%
GENERAL TOTAL	0,0%	-1,2%	1,2%

EVOLUTION OF COSMETICS CONSUMPTION PERIOD 1998 - 2005

Real values, prices to the public, including VAT



As regards prices, 2005 figures confirmed the increase of more than one percent in the list prices for the traditional channels; less uniform were the dynamics on professional channel prices, with increases of 0,5% in sales to beauty centres and beauticians and 2,5% increases in hair salons.

An analysis of the historic trends reports a slow but consistent growth in the various sales channels. If we look only at constant figures, we see a slowdown in the rates of development as of 2001. As always, however, the cosmetics products sector reported much more positive market dynamics than other consumable goods sectors which have posted significant decreases in demand in recent years.

Completing the reference scenario for 2005, we refer to the comparison with other European countries: the industry in Spain and England reported much more sustained growth than Italy, at 4,8% and 1,1% respectively, while it posted a clear sign of contraction in France (-1,2%); slow recovery is being demonstrated by the German market (+0,2%), after a few years of constant losses.

THE PHARMACY

Sales in the pharmacy reported growth rates in 2005 that were better than the average growth in all the other channels: with sales valued at more than Euro 610 million, consumption in the channel grew by 4.6%. Taking into consideration only volumes, the pharmacy also reported a broader development trend, up 3,1% against the average of traditional channels, which was preceded by a negative sign (down 1,3%).

The performance of cosmetics consumption in the the pharmacy channel, which covers 12,8% of the total market, represents a confirmation of the changes in the purchase options of consumers that have characterized the cosmetics market since the end of the 1990s.

Aspects such as the expansion of the sales mix, specific marketing policies, the perceived quality of the individual products, and the service offered to retailers made it possible to stem losses in a negative economic period and successfully won over significant shares against the other traditional channels, such as perfumers and the mass market.

THE PERFUME SHOP

On the wake of several years marked by considerable slowdown, the perfume shop channel posted a more significant contraction, -2,1%, with a sales value that exceeded Euro 1.300 million, second by volume only to the mass-market channel and accounting for 16,5% of total revenues in Italy. The decrease was certainly balanced between a sustained increase in prices, 3,0%, and by an even larger contraction in volumes, -5,0%.

Since the most important item of perfumery sales is represented by alcohol-based perfume products, which on its own posted a decrease of 3,1% in 2005, there would seem to be an evolution underway in the channel toward increasingly diversified products in the product offer. Sales of make-up kits increased by 16,9% and sales of men's cosmetics products reported a more than 5 percent increase.

The channel has not yet emerged from the deep structural modification that has influenced it in recent years and which will certainly not evolve in a reversible manner; the signals appearing seem to indicate a possible affirmation of the new characteristics of the selective channel for which, compared to other channels, is launching strategies to enhance the value of the service, attain product specialization and improve the quality of the product offer. It is important to evaluate and study how the reactions of a clientele that is increasingly demanding, knowledgeable and attentive to specifications, will evolve in the short term.

THE MASS MARKET

Despite a sell-out value of more than Euro 3.800 million, 53% of the total retail market, large-scale retail posted a worrisome sign of inversion in 2005, 0,1% down, after years of growth above market averages. It is important to distinguish whether the rates of growth represents an inversion in the trend with respect to the recent past or if the recovery of shares by other channels, such as pharmacy and perfume shop, has resulted from introduction of new products and implementation of list price policies to the detriment of the large scale retail.

In 2005, the product that accounted for the lion's share of sales was for hair and scalp products, which decreased by 1,7% with a value of just over Euro 900 million. In terms of rates of development, the most positive signs came from facial cosmetics products, up 2,4%, and from alcohol-based perfumes, up 3,8%. Although the volumes were negligible, there was also strong growth in skin cleansing products, which rose 5,2% with respect to 2004. More worrying were the decreases in sales of body care products, which fell 1,3%, and lip care products, down 1,8%.

It would seem that these are inevitable signs of the evolution that is influencing what is traditionally the most dynamic channel compared to the changes in consumer purchasing: time will tell if this trend represents a structural change or, as it seems, is only a brief economic episode.

THE DIRECT SALES CHANNELS

Data on door-to-door sales and mail order sales by value are near to Euro 400 million, with average year-on-year growth of 3,4%. This corresponds to significant growth in volumes, +2,9%, influenced by still limited price increases (+0,5%).

Although direct sales have historically been lower percentage wise in Italy than in other European countries, it is important to understand whether we are faced with a structural modification or if this trend can still be considered episodic.

A similar line of reasoning can be made for Internet sales which, despite being difficult to measure, have shown consistent signals in recent years, especially with reference to alternative products, destined to a consumer niche that could potentially increase over time. After overcoming the congenital scepticism toward this innovative sales method, it seems that new groups of consumers and new marketing strategies have rewarded electronic commerce with an unexpected role in Italy, as in other similarly technologically and industrially evolved nations. Recent ad hoc studies and research indicate that Internet sales grew by more than 20% in 2005 even though the volumes are not significant enough to be able to monitor the phenomenon with precision.

THE BEAUTY SALON

Revenues of cosmetics sold at the beauty salon reported an additional loss of 1% in 2005, with volumes close to Euro 131 million. While the trend is worrying because of its repetition in recent years, expectations for the future would appear less negative; the sudden transformation of the channel seems to have modified the mix of purchases by channel. Furthermore, it is important to remember the difficulty in understanding and classifying sales in wellness centres, which are very often associated with other sales channels.

In addition, note that in 2005, sales in beauty centres displayed a reduction in quantities, down 1,5%, against a marginal increase in prices, no higher than 0,5%.

THE HERBALIST SHOPS

The trend of cosmetics sold in herbalist shops has finally acquired the importance worthy of it, including in statistical terms, given the constant rise in recent years and the attainment of a market volume that amounted to more than Euro 260 million in 2005, with an annual growth rate of 4 percent.

Despite the fact that the channel accounts for about 3% of the domestic cosmetics consumption, sales in herbalist shops - together with sales in pharmacy - with different purchase options, represent the trend that more than any other have characterized the Italian cosmetics market in the past ten years.

Herbalist shops represent the channel that, more than any other, can cater to new purchase options and new needs by consumers who associate the natural product with an additional positive evolution in the concept of wellness.

A concept that is expanded to very modern sales methods; the proof is that the most dynamic changes in terms of new retail sales points have taken place in this channel.

THE HAIRDRESSING SALON (**)

After years of stability, for the first time, the products sold in professional hair salons are showing a significant reduction, with a market value close to Euro 715 million, representing a contraction 1,1% by value and 4% by volume, despite a high average price increase of 2,5%.

Professionals in this sector seem to be less worried about the reduction in values than they are about the growing trend of defection of several sales outlets, which represent a natural flywheel for this sector; the sector uses its reputation for quality as its primary sales tool.

The attitude related to the professional services offered by the channel is confirmed in the data related to the product categories that, in addition to traditional hair colourants, reports increases in highly innovative products such as masks, conditioners and after-shampoo treatments.