

THE DAY SPA MARKET

According to a North American Study by Pricewaterhouse Coopers, the "spa industry" in 2001 generated revenues of \$10.7 billion, up from \$5 billion in 1999, an increase of 129%. That high growth came despite economic uncertainty -- or perhaps because of it. The popularity of spas comes in large part because of the stress of modern living, and the desire of the aging population to stay as young looking and acting as possible.

The size of the spa industry at nearly \$12 billion (current estimate) dwarfs the \$3 billion for the U.S. ski industry, and \$7.5 billion in annual movie box office receipts.

The spa industry is made up of four segments: destination spas, resort spas, hotel spas, and day spas. Day spas is the largest segment, and the fastest growing. The Pricewaterhouse study counted almost 10,000 spas in the U.S. and 1,300 in Canada. About 75% of them, or 7500, are day spas.

Forbes estimates that Day Spas are among the most profitable of all businesses, with a 17% profit margin.

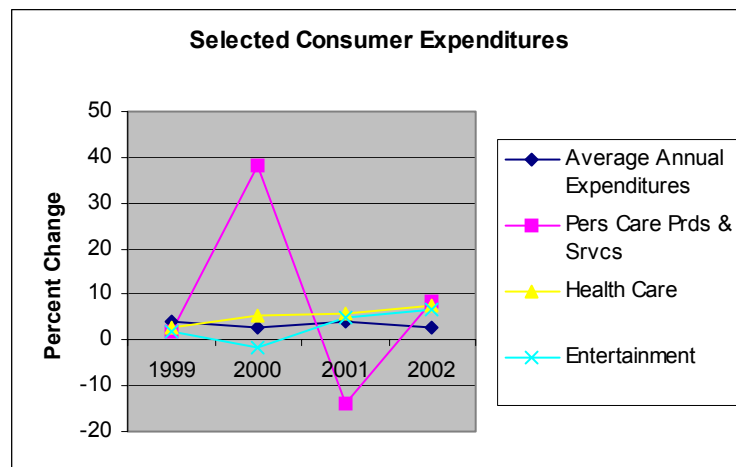
Despite the enormous total revenue and profitability, day spas are mostly independently owned and operated. There are no national day spa operations and few franchises. In 2001 a company called Stonewater was formed to acquire day spas throughout the U.S. with the goal of establishing a national operation. So far, Stonewater has acquired spas in some 15 states, including three spas in California. The Stonewater acquisitions have maintained their individual identity, although Stonewater is beginning to standardize some treatments.

One of the most successful spa operations is the high-profile Bliss Spa in NYC. It has two locations in NYC and one in London. It opened in 1996 with a single spa, a signature product called "Bliss Lemon Rub", and a theme that "beauty is fun". It began a whimsical catalog and web-site program in 1999 with an expanded product line, opened a second spa, and began selling through chains such as Sephora. Revenue grew dramatically to \$25 million in two years. In 2001 Louis Vuitton Moet Hennessy bought a 70% interest in Bliss Spa for \$30 million.

Individual day spas generate revenue from less than \$250,000 annually to a top of about \$10 million, with most generating from \$500,000 to \$1.5 million.

Since the Pricewaterhouse Coopers study, despite the economic downturn, consumer expenditures for personal care have led all other categories, with the exception of 2001 (Figure 1), and are once again growing at the high rate of the late 1990s.

Figure 1



Source: U.S. Census Bureau

The U.S. Census Bureau figures show that the total number of day spas in the U.S. decreased in number from 1999 to 2001, but the number of spas with more than 20 employees increased. The number of spa employees also increased, and so did payroll -- by 22%. Although this trend can be seen in all major U.S. Cities, it was particularly noticeable in Northern California.

Although some small day spas closed in the 2000-2001 period, the failure rate of day spas was half that of all retail and service businesses, and larger spas continued to grow and prosper.

PRODUCT SALES

Both Pricewaterhouse and Forbes report that about half of the \$12 billion in spa revenue comes from product sales. But in addition to the revenue generated within the spa through product sales, many spas also participate in the overall cosmetic market, selling their branded products through distribution outside of the spa.

Top end spas, such as the Bliss Spa in New York City, and the Adam Broderick Spa in Ridgefield, Connecticut, sell their own private label products both in their spas and through their catalogs and web sites.

Skin care products generated revenues of \$10 billion in 2000, with products such as cleansers, moisturizers, soaps, hand and body lotions, bath additives, sun blocks, and lip balms. Mass market retailers account for 60% of sales of skin care and cosmetic products. Specialty retailers, including spas, account for 40%. Sales through the specialty retailers are growing at a CAGR of 18%, versus 6% for mass marketers according to a survey by Kline & Company.

A Unilever study in 1997 focused on the psychographics of the demand for cosmetics and spa treatments. Unilever found three "Life Focus" groupings: the Social Group, the youngest of the three, the Family/Career Group, and the Empty nest group. Each of the three groups has different demands. The youngest is made up of free spirits, who are adventurous and Narcissistic. The Family/Career group are more risk-averse, but are also stressed and, for some, career focused. The Empty Nesters are dichotomous, with some striving to stay young and others experimenting with new ideas. Bliss successfully appealed to all three groups, with 22-year olds and 55-year olds finding products and services that appealed to them.

For many in those three psychographic groups cosmetics and spa treatments are not a luxury, but a necessity. While a day at the spa evokes thoughts of reducing tensions, clearing the mind, and uplifting the mood, many Americans cannot take the time out of their day to visit a spa. Instead, they bring home products that can turn their bathrooms into a spa once a week.

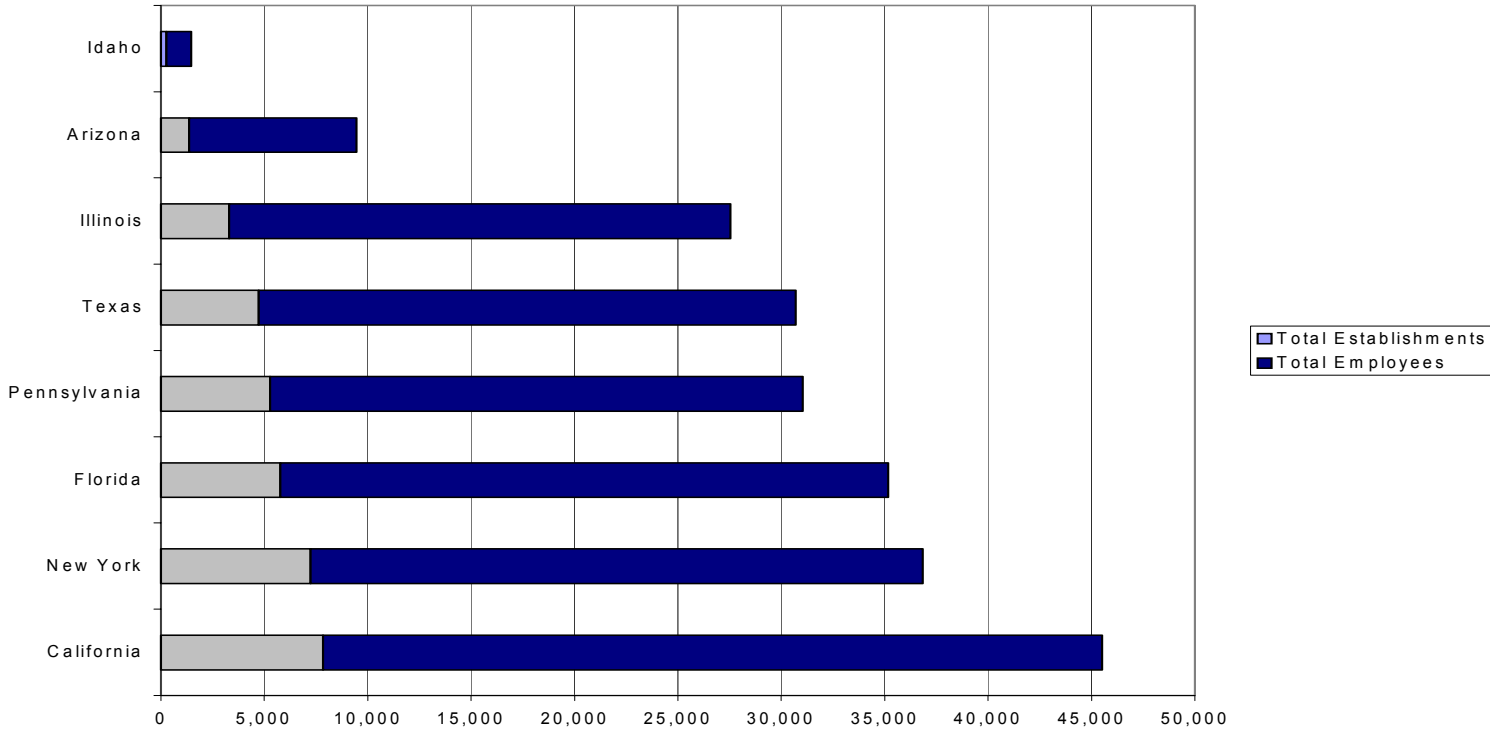
SPA LOCATIONS

The most attractive location for day spas is in Northern California, because of the outstanding demographics of that region. In all of the U.S., Northern California, and particularly, the San Francisco Bay area, has the most fertile environment to start and nourish spas.

California leads the nation in the number of establishments and number of employees engaged in the beauty businesses -- beauty shops, manicure shops, hair salons, and spas. Figure 1, on the next page, compares establishments and employees in the six leading states, and, for comparison, Idaho and Arizona.

Figure 1

ESTABLISHMENTS AND EMPLOYEES IN BEAUTY BUSINESSES



Source: County Business Patterns

Another measure of potential demand for day spas is the average annual household expenditure for personal care products and services. The West, which includes seven western States, leads the South by nearly 20%, and the Northeast by 10%, says the Bureau of Labor Statistics.

Still another measure of attractiveness for a spa location is the increase in the wealth of the citizens. If income is growing fast, consumers are more likely to spend than if income is increasing slowly, or not at all. Table 3 on the next page shows the change in personal income from 1999 to 2000 in 9 states with the greatest increase.

Table 3

**Percent Change in Personal Income -- 1999-2000
In Constant 1996 Dollars**

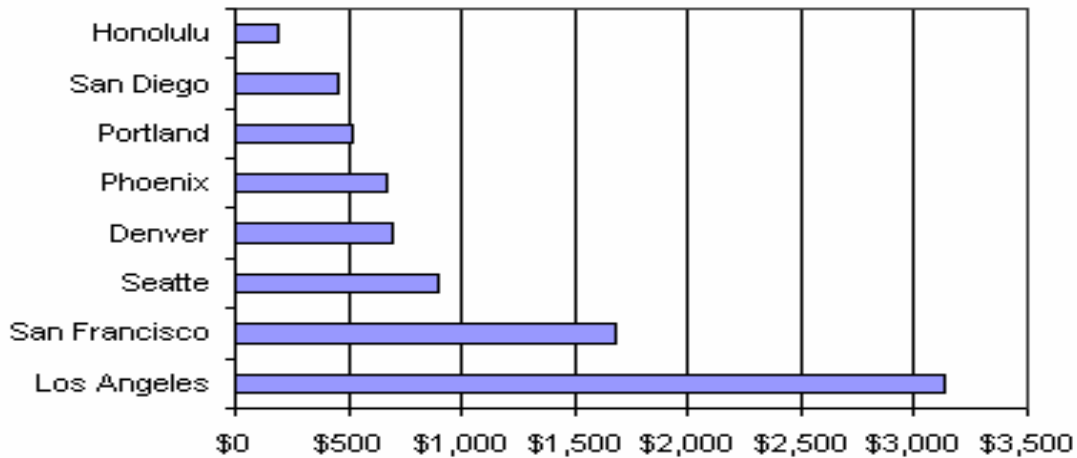
Colorado	8.2
California	7.9
Massachusetts	7.4
Idaho	6.7
Arizona	6.5
Oregon	6.0
Florida	4.6
Washington	3.8
Hawaii	2.3

Source: U.S. B.L.S.

Figure 2 shows the total household expenditures for personal care products among major cities in the West.

Figure 2

**TOTAL HOUSEHOLD EXPENDITURES FOR PERSONAL CARE PRODUCTS
AND SERVICES -- 2000**



Los Angeles leads by a lot, with San Francisco next. Looking just at this figure, the Southland looks like it might be the best location. But before we jump to that conclusion, let's look at some other indicators.

Table 4 looks at seven different measures of financial well-being in eight counties in California. Los Angeles is at the bottom of the pile in median income, along with San Diego. Los Angeles is three times the size in total personal income, with \$281.8 billion in 2000, and Los Angeles is king in Total Retail Sales, with just under 70 billion. There is a lot of money in LA, but it is harder to get..

Table 4

CANDIDATE COUNTIES FOR BLACK SEA SPAS
Income and Retail Sales Characteristics

	Median Income (Rank)	Median Household Income	Total Personal Income (\$Billions)	Per Capita Money Income	Persons Below Poverty	Total Retail Sales (\$Millions)	Retail Sales Per Capita
Contra Costa	1	63,675	\$39.2	\$30,615	7.6%	7,377	8,201
Marin	2	71,306	\$15.0	\$44,962	6.6%	2,775	11,836
San Mateo	3	70,819	\$41.5	\$36,045	5.8%	7,335	10,544
Santa Clara	4	74,335	\$92.9	\$32,795	7.5%	16,673	10,282
Alameda	8	55,946	\$56.0	\$26,680	11.0%	12,404	9,040
San Francisco	15	55,221	\$42.9	\$34,556	11.3%	6,795	9,170
San Diego	24	47,067	\$91.9	\$22,926	12.4%	22,215	8,161
Los Angeles	25	42,189	\$281.8	\$20,683	17.9%	69,534	7,619

Source: County Business Patterns; QuickFacts; 1997/2000

The four counties on top of Table 4 are in Northern California. Contra Costa leads in Median Income rank, but trails the other four in household income. Marin looks good in median household income, which means that half of the population made more than that in 2000, and half less.

But Marin's total personal income is less than half of Contra Costa and San Mateo, and total retail sales is a paltry \$2.8 billion, compared to \$16.7 billion for Santa Clara.

Table 4 says that the three most attractive counties for a day spa are Contra Costa, San Mateo, and Santa Clara. However, the sheer size of Los Angeles County tends to skew its median levels downward.

THE DAY SPA BUSINESS

The typical day spa offers a selection of treatments, ranging from manicures to deep tissue massage.

- **Massages:**
 Lymph Drainage & reflexology, Deep Tissue, Sports & Deep Muscle
- **Body Treatments:**
 Body Packs & wraps, Exfoliation, Cellulite, Body Toning, Waxing
- **Aromatherapy personalized for body & face**
- **Aquatherapy**
- **Facials:**
 Cleansing, protective, Anti-stress and Anti-aging Facials
- **Hand and Feet Care:**
 Sea salt rubs, softening and protective cream applications, toning.
- **Nutritional Counseling**
- **Fresh & Healthy Cuisine**

Treatment costs at day spas vary widely, and can range from \$50.00 to \$120.00 per hour (Table 5). The rates shown in Table 5 are the published rates of 14 California day spas. Top end spas set prices at the upper end of this range.

Table 5

CALIFORNIA SPA SERVICE RATES

	Duration	High	Low	Average	Av/Hr.	B.S.S.
	<i>(Minutes)</i>					Av/Rm
Facial	45	80	60	70	93	75
	60	120	60	86	86	
	75	210	105	100	80	
Massage	30	75	50	60	120	90
	60	140	65	90	90	
	90	205	125	140	93	
Body Works	90	170	120	95	63	95
Hand & Foot	30	45	30	35	70	55
	60	50	50	50	50	