



global investor by Jean Pierre Verster **fm**

Turning up our noses

The global market for flavours and fragrances is dominated by four firms that control more than two-thirds of the supply of chemical compounds that stimulate our olfactory and gustatory senses. Whether it is the mint extract in your toothpaste, the vanilla essence in your ice cream, the synthetic musk in your cologne, the citrus taste in your energy drink or the lavender smell of your fabric softener, chances are that one of these four companies supplies the essential ingredients responsible for that distinctive taste or smell. Here are the main players:

Givaudan

Founded by brothers Xavier and Leon Givaudan in 1895, Zurich-listed Givaudan was spun out from health giant Roche in 2000. With a string of acquisitions since, it has become the leading flavours and fragrances firm worldwide, with a market cap of \$32bn. The strategic rationale for Givaudan's acquisition fervour is that the global flavours and fragrances market grows by only about 5% a year. This slow but steady industry growth profile necessitates a continuous focus on operating efficiencies, whether via capturing scale benefits from integrating serial acquisition targets or developing cheaper synthetic

alternatives to natural ingredients. Some of Givaudan's latest acquisitions have been in the area of natural colours. As fast-moving consumer goods (FMCG) companies jostle for market share, Givaudan will be involved in enhancing not only taste and smell, but also the visual attributes of processed foods, personal care products and cosmetics. However, at a p/e of roughly 32, Givaudan shares are a bit too rich for us.

International Flavors & Fragrances (IFF)

Despite a proud history since listing on the New York Stock Exchange in 1964, IFF, more recently, is a cautionary tale of ambitious industry consolidation going off the boil. The group is struggling to digest two large acquisitions it made over the past five years. Litigation linked to unsavoury business practices, implemented by the previous management of Frutarom (which IFF bought in 2018) and a debt hangover induced by the 2019 merger with DuPont's Nutrition & Biosciences business, have resulted in IFF's market cap shrinking to \$25bn. With its share price back at 2014 levels, a new management team has been brought in. IFF is clearly trying to regain its heyday of being the dominant producer of Estée Lauder fragrances and a pioneer in aroma science (the study of how fragrances affect human emotions). While

IFF's normalised p/e of 20 is enticing, we would abstain from buying the shares until catching a whiff that the turnaround is gaining traction.

DSM-Firmenich

Amsterdam-listed DSM (Dutch State Mines, a reference to the company's origins) and Swiss family-owned Firmenich announced last month that their merger will be completed on May 8 2023. The

resulting firm will have a market cap of roughly \$34bn, with the Firmenich family owning a stake of 34.5%. Apart from flavours and fragrances, DSM-Firmenich will be a leading player in animal nutrition and health, with DSM's novel burp-inhibiting feed additive, Bovaer, reducing methane emissions in cows by 30%-45%. Firmenich was family-owned for 128 years, and in this time developed many iconic fragrances, including synthesising hedione, the only perfume compound that has been shown to stimulate a sexual response in humans, from jasmine. The combined group will hold more than 16,000 patents and employ more than 25,000 people around the globe, making DSM-Firmenich an appetising investment proposition. But mergers often leave investors with a bitter taste, so we would rather wait for the estimated p/e of 38 to cool down.

Symrise

With a market cap of \$17bn and an industry market share of 12%, Symrise might be the smallest of the companies mentioned here, but its shares have outperformed those of its rivals over the past three years. Having listed on the Frankfurt Stock Exchange in 2006, Symrise's roots can be traced to the first synthesis of vanillin, the distinct chemical compound of vanilla beans. It also holds a leading position in pet food additives. Like its rivals, Symrise's history is peppered with mergers & acquisitions. At a p/e of 33, Symrise shares might not be worth sniffing out, though.

This industry has all the ingredients required for attractive investment returns, yet the historical share price performance of these four oligopolistic competitors has been decidedly bland.

Two important insights emerge: attractive operating returns can be diluted by overpaying for acquisitions, and an oligopoly can be negated by an oligopsony, as is the case here – where the key customers of these firms, being the giant multinational FMCG companies, keep price increases for flavours and fragrances in check. Rather pass than indulge in the high valuations on offer here. **x**

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