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Flavor and Fragrance Sector Analysis: Everything You Need to Know About This Sector!

Reading Time: 12 minutes

Overview

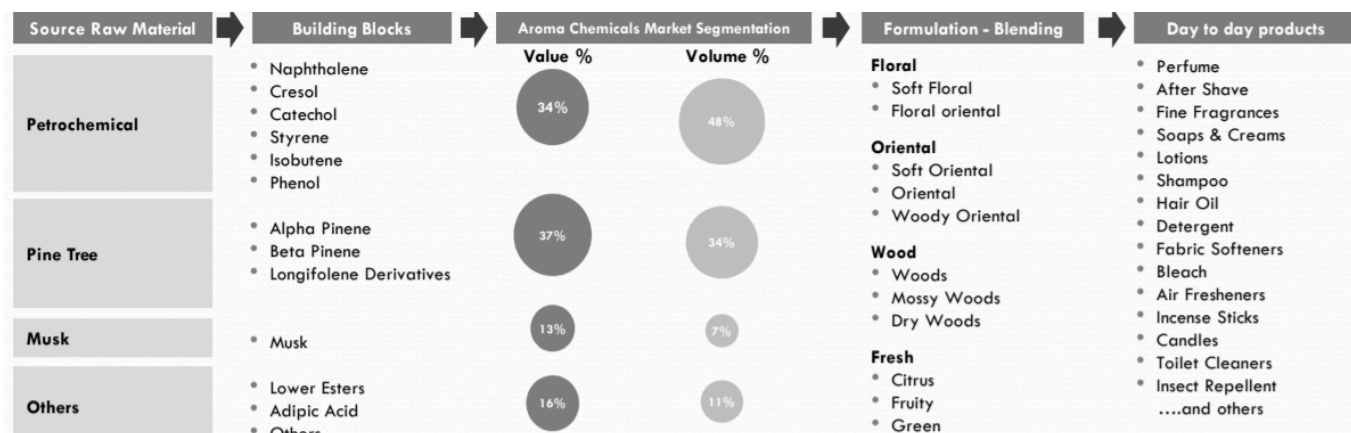
Let's delve deeper into flavor and fragrance sector analysis.

Flavors & Fragrances are an important part of all FMCG products. Despite constituting less than 1% of a product's volume and under 10% of its total cost of production, fragrances are instrumental in creating a distinct product association with the consumers.

Chances are high that the soap, the detergent, the shampoo, the talcum powder, the lipstick, the pan masala and the after-shave lotion you use every day have perfumes and flavours supplied by the companies we are going to discuss. Let's delve deeper.

The Value Chain

Petrochemicals & Natural extracts from a Pine Tree + Strong Chemistry Skills -> Aroma Chemicals (Generic & Speciality: Intermediates) -> Fragrance & Flavour (F&F) Formulations -> FMCG companies [Globally & India]



Even though Natural fragrances are perceived to be safe, healthier and therapeutic. Synthetic ingredients continue to dominate the Indian market as they are cheaper (10-100 times less than of their natural counterparts), long-lasting, emit strong fragrance, and offer greater freedom of creativity to manufacturers.

You might be curious as to why Fragrances & Flavours are allied together?

The answer lies in an apple, the fruit. When we eat or taste an apple, the apple texture & taste is only 3-4 types, like salty, bitter, etc. Can't this be replicated? For sure it can, so what differentiates an apple from a pineapple: It's smell/aroma.

Fun Fact: "Losing enjoyment of food and drink is a common complaint for people who lose their sense of smell."

Adding to this, 60-70% of identical raw materials & similar kind of product development also add to the synergies.

Market Dynamics

Flavours & Fragrances (F&F) industry is a highly fragmented one. There are over 1,000 small, medium and large-size enterprises operating in this industry, both in organised and unorganised sector (ranging from multinational companies and large Indian industrial houses to small-scale industrial units and local manufacturers.)

The global Flavours and Fragrances (F&F) market size was valued at US\$ 29.8 billion in 2019. India is just 3% of it with 20% of the population. The Indian F&F industry is valued at approx. Rs 6,400 Cr.

The current Indian fragrances market is estimated at Rs 3,200 Cr and the flavours, at Rs 3,200 Cr. The Organised Indian F&F market is meant to grow in double digits for years to come.

Growing demand for foods, cosmetics, personal care and household care products is expected to be the major driving factor for the growth of aroma chemicals market.

Top Heavy Industry: An estimated 70% of the organised market in India comprises international players like Givaudan and International Flavours and Fragrances (IFF), while the remaining market is catered to by SH Kelkar & Company, Oriental Aromatics and others.

Tough Competition	
Company	Market-share
Givaudan	23%
IFF	14%
Fermentich	14%
SH Kelkar	12%
Symrise	7%
Others	30%

Higher the experience a company carries in the F&F industry, better it's understanding of the tastes and preferences of the consumers country wise. Talking about experience, the largest player in the world, Givaudan is 251 years old!

Watch: Givaudan's 250-year Odyssey

Givaudan's 250-year odyssey



R&D is the soul of these businesses. Large F&F players spend close to 7-10% of sales in R&D.

- Technology & Process Development of existing products (Intermediates)
- Developing new molecules (F&F space)

Moreover, Unorganised players are supposed to have fewer r&d capabilities and poor quality control. So, growing market share through acquisitions of unorganised players and small organised players is a common practice among this business.

Pros

- **Annuity Business:** Steady business from existing clients with multiple years of close association & sharing of key intellectual property. The existing business will grow if the product for which they supply flavour or fragrance sells more. I affirm while drinking Nescafe for the millionth time 😊

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In a world full of trends, I want to remain a classic.” –Iman

- **Sticky Client Base:** It is practically impossible to replicate completely a particular flavour or fragrance. Also, fragrance & flavour constitutes only a negligible part of the overall cost of a product.
- **High Entry Barrier:** It's hard to get proper certification & licenses and establish relationships with clients. Also, the companies need to retain flavorists, which are a rare breed. There are hardly 500 total flavours worldwide: hard to recruit & retain one.
- **Proxy to FMCG:** It is probably the best chemical proxy to FMCG as all FMCG products need fragrances or flavours. So, the business has a long runway for growth.

Fragrance



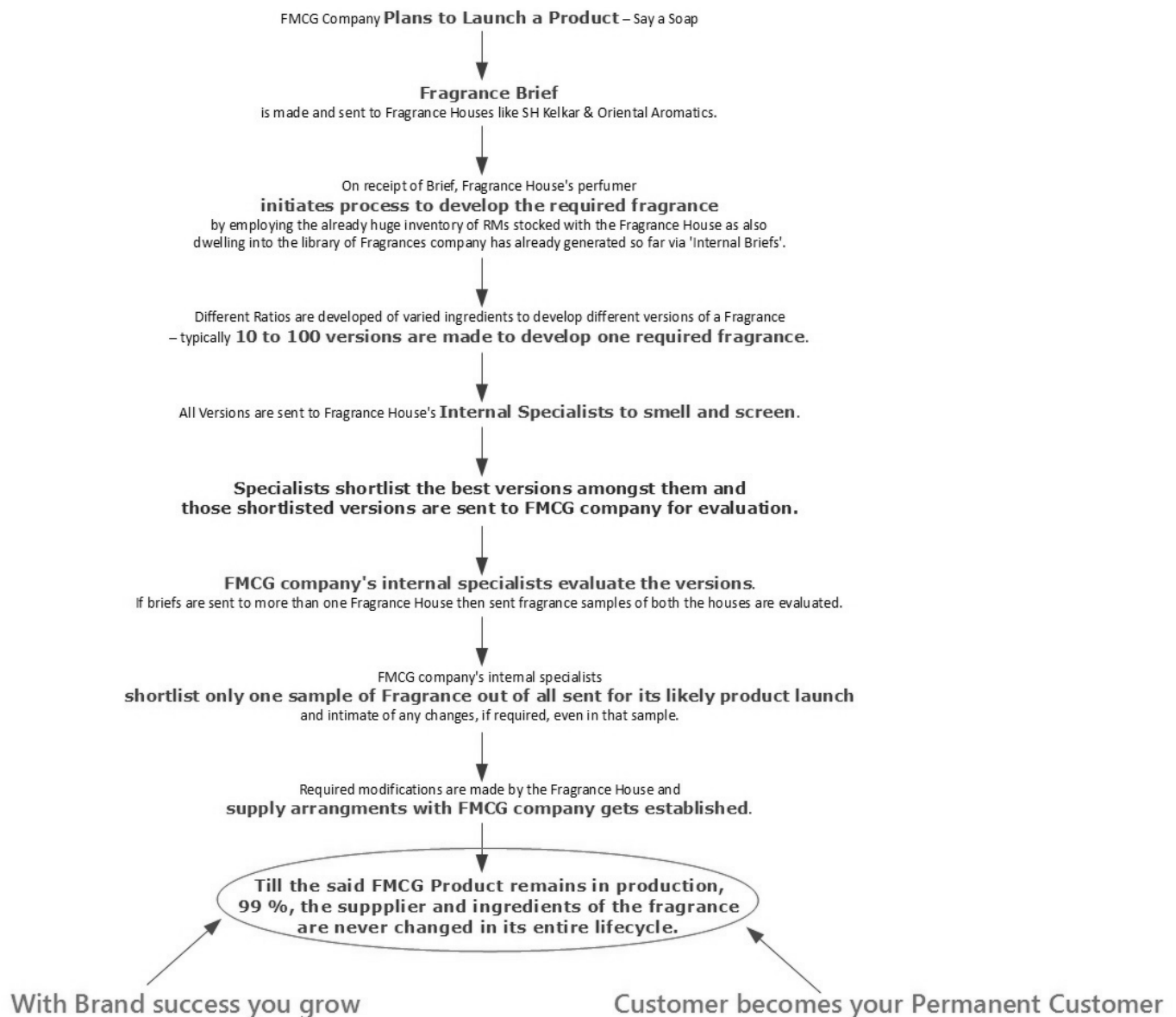
Flavour (for example Coca-Cola flavour aka their most important IP has been unchanged for the last 14 decades, Imagine if you held the shares of the company which supplied it to them!)



- **China plus one Strategy:** Various FMCG & FCF companies are focusing on de-risking their supply chain & established players win due to increased compliance.

Cons

- **Lack of pricing power:** But, it's a B2B business and so the margin is not high and there will always be a lag before transferring RM inflation to clients. They almost don't have any further pricing power.
 - The increase in crude oil prices also leads to an increase in the raw material prices of petroleum-based products like Citral, Phenols, etc.
- **Cost optimisation is critical:** The player with strong backward integration (like Oriental) will have a relatively stable margin.
- **Slow Grower:** Fragrance market is slow-growing. Worldwide it is growing in low single digits. Flavour market is growing in high single digits. It is tough to gain market share.
- **The First sale is as difficult as to 'chew iron':** Price+ Quality+ Winning Consumer testing & then to sell translates to a high failure rate. The Flow chart of it all:



- **Compliance cost:** Regulations are forcing companies to follow compliance, which could affect the market's growth trajectory. For instance, wastewater discharge during the production of various synthetic aroma chemicals consists of many effluents, which need to meet applicable regulations for such discharge.
- **High Working Capital requirement:** While maintaining high Inventory to de-risk themselves, the companies also have to extend open credit or 2-4 quarters to its customers to maintain the competitive position. Cash Flows are the prime indicator.

We discuss 3 Indian companies which are family-run. These companies have very less product overlap among them as the market size is big & chemistry types also differ. We'll discuss the capabilities & Business direction.

SH Kelkar (Keva): Largest Indian origin F&F player



- 90% Rev from Fragrances & remaining for flavours.
- The company has 13% overall organised market share in India. The company has 20% + share in fragrance and is number 3 (100yrs of experience) & flavours market share of <5% share (20yrs of experience)
- In the unorganised market, The company has 25% share in Fragrances & 35% share in Flavours.
- R&D cost: 4-5% of sales. The company has a team of 13 perfumers, 6 flavourists, evaluators and application executives. Further, the group also has a dedicated research team of 32 scientists. The company boasts of having 15+ patents filed across the world.
- The company uses 1500 types of raw materials (from feedstocks to Aroma Chemicals). The company sources raw material from over 200 different vendors across 60 countries, 50% of which is imported while the rest is sourced domestically.
- Exports make 40% of sales. The company has manufacturing plants in India, China & Italy (recent acquisition)
- 4100+ clients from 60 countries: small & medium players which faced a lot of pressure from the demonetisation & GST days are recovering on the back of increased focus. Large corporates which include top Indian FMCG peers like Godrej consumer(Godrej No. 1 Soap), Marico(Parachute Hair Oil), Britannia are showing double-digit growth. The company has told about its inability to penetrate global MNC clients umpteen times but the point to note is that they are approved vendors for most of them.
 - The flavours domestic market saw recent wins from key customers like Bisleri, Future Group, CCD, Pfizer etc.
- The company has 3 brands: SHK, Cobra and KEVA | Cobra is their branded fragrance – 10% Contribution. The company makes aroma chemicals but just for internal consumption.
- The company possess a deep understanding of the consumer preferences of the Asian & African markets. The company is winning one in four/five client briefs, higher than the average.

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Industry fact: More the customers, Merrier. Every customer has high +ve optionality in terms of blockbuster products & future products. For example, The growing E-commerce platforms are being

increasingly & successfully leveraged via smaller consumer segment entrepreneurs to provide customized products across the domestic market.

FRAGRANCES – GROWTH DRIVERS	FLAVOURS – GROWTH DRIVERS
<ul style="list-style-type: none"> • Changing lifestyles: With increasing disposable income, more local consumers are opting to use quality products, especially young consumers. In the wake of the global pandemic, higher focus on hygiene products has pushed demand for new and innovative fragrances used in hand wash, sanitizers, floor cleaners etc. • Emerging markets: Disposable income of people is increasing in the emerging markets, surging their purchasing power, which in turn is leading to increased spending on beauty and personal care products. This is leading to increasing demand for various scents and fragrances. • Rise in use of personal care products: Personal care is a prominent application segment owing to increasing demand for perfumes, deodorants, soap, talcum powder, cream, and hair oil. Also, rising demand for car and room fresheners and growing popularity of aromatherapy is expected to further fuel the growth. Hospitality segment is also witnessing increasing demand for fragrances to create a pleasant environment. • Naturals gaining popularity: One of the drivers of the global natural fragrance market is the increasing number of health issues caused by products containing synthetic fragrances. Natural fragrances which are safer and healthier are emerging as the preferred choice. • Industrial segment: Fragrances are witnessing increasingly growing acceptance for industrial use like ambience-fragrances for the consumer durables and automobile accessories, which hitherto was an unexplored category. 	<ul style="list-style-type: none"> • Food flavours demand on a rise: Increase in demand for processed food and beverages with growth in disposable incomes, rise in the demand for unique flavours in various food applications and surge in popularity of exotic flavours is one of the most important drives of growth for the Flavours industry. • Naturals gaining popularity: Rise in concern among consumers about the long-term health effects of artificial ingredients and additives has increased the demand for natural and healthy flavours in food products. • Technological advancement: Technological advancements not only help to develop innovative flavours to cater to the change in customer taste requirements, but also increase their stability and suitability. Manufacturers are inventing and adopting advanced technologies such as solid-liquid extraction (SLE), supercritical carbon dioxide extraction, supercritical fluid extraction, and others which, in turn, will result in growth in the flavours market.

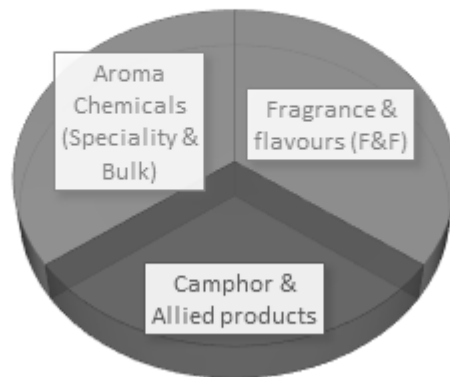
Complex & Dynamic F&F market: Taking the example of India

- Cultural diversity
- Varying climatic conditions
- The influx of foreign influences over various periods of our country's history
- With the current digital revolution, youth is abreast with the latest international preferences and constantly trying to mimic it. This will lead to a higher rate of change in preferences.

Oriental Aromatics: Jack of all trades

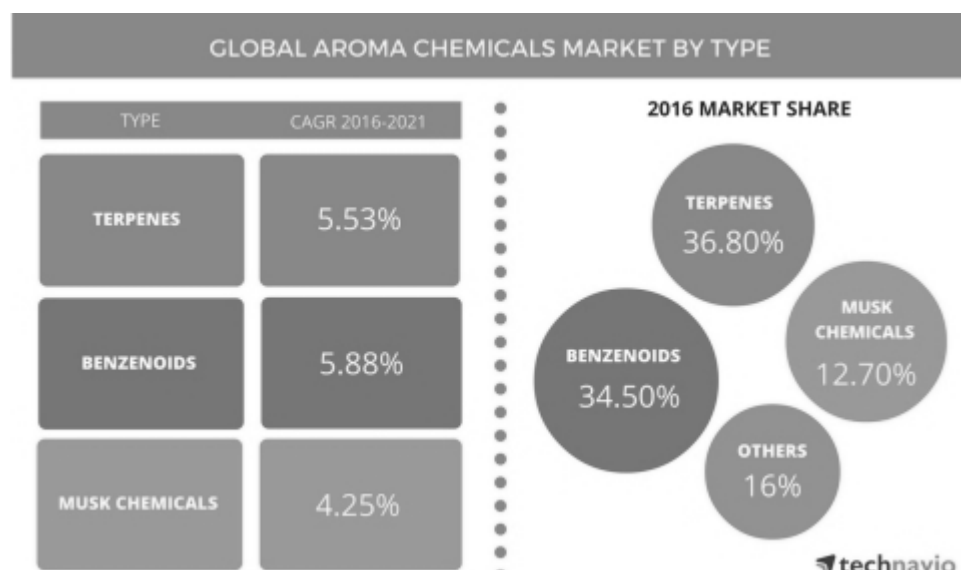
Oriental Aromatics

REVENUE BREAKUP OF ORIENTAL AROMATICS



- While OCL has over 65 years of experience in its F&F vertical, it will focus more on the generic specialty Aroma Chemicals in the next few years
 - 150-200crs capex over the next 3 years could generate incremental revenues of up to 350crs.
 - Will increase supplies to Global F&F giants & better competitive position in core F&F biz due to cost advantage.
- R&D Cost: 4-7% sales in different segments (Will continue to maintain)
- Most of the contracts are 6 months long (lag in pricing changes), caters to 200 customers in 65 countries. Exports are 30% of sales.

The global Aroma Chemicals market size exceeded \$5.10 billion, globally in 2019 and is estimated to grow at over 6.0% CAGR between 2020 and 2026. The Fastest Growing segment within the F&F Industry. The top 4 global players account for ~ 55% share of the global market.



- OCL has experience in Terpene Chemistry, Musk chemicals (Astromusk) & Sandal Alcohol.

Every aroma has a specific need and a unique characteristic. Whether it's going to be used to mask, mimic or maximise a taste or smell, is key.

- The company uses over 21 different chemistries to make 200 out of a possible 5000 molecules (hence, leaving much room for growth) such that OCL is able to maintain margins of 15-17%. Current Portfolio which is 80-85% petrochemicals based includes:



Industry Fact: Key customers always prefer to buy a basket of products from one-stop-shop. More the Intermediates a company has the capability to manufacture, it's better.

- One of the 3 verticals, Camphor business, OAL has 35% market share in India: Commodity business, have to take whatever price the market decides.
 - The application primarily into (1) religious space & (2) Healthcare & Pharmaceuticals (Their plant is USFDA & Camphor is WHO & GMP certified as well)
 - Pharmaceutical was the leading end-user segment with more than 30% share of the global camphor tablets market. The medicinal properties of camphor have led to high demand for manufacturing different types of medicines for different pains and diseases.

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Privi Speciality Chemicals: Demerged from Fairchem Speciality

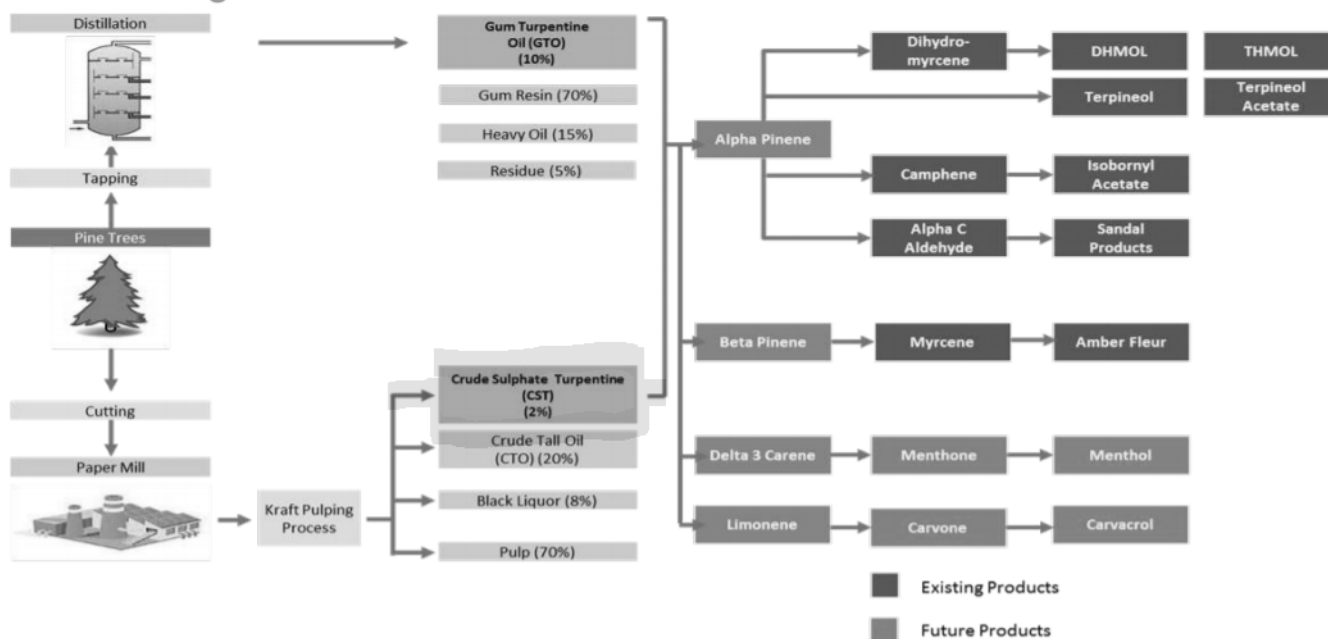


- India's largest manufacturer and exporter of aroma chemicals.
- The company has unique capabilities in the sense it has the technology to process waste products from Paper Mills (who use pine wood cut from the tree for making pulp & paper) to make building blocks. Global sourcing capability – procures waste from over 30 mills in Europe, US & Canada.
- The company has a portfolio of 65 products across four chemical categories – pinene, citral, phenol, and sandalwood. Majority of revenues is derived from Pinene based chemicals.
- The company is the leading producer globally in its intermediates: Dihydromyrcenol, Amber Fleur & Citral derivatives.

Main Product	Purpose of use & Application	Company's Positioning
Dihydromyrcenol	<ul style="list-style-type: none"> ▪ Dihydromyrcenol is known as "God Molecule" of F&F industry because this product has to be used in 99% of the contemporary perfumes. ▪ It is a freshness molecule which is widely used. ▪ The product has grown much faster than the other similar products because of its diffusiveness, performance and price. ▪ The industry expects this product to grow further by 7-8% PA. 	<ul style="list-style-type: none"> ▪ Privi is has reached to the top position in this product. ▪ To maintain its position, Privi has further expanded product capacity. Privi has also done backward integration (Turpentine refinery) to secure material (Alpha Pinene).
Amber Fleur	<ul style="list-style-type: none"> ▪ It is a royal molecule of F&F industry because of its unique "Velvety" nature. ▪ This product is used to impart fullness and subtle strength to fragrances, in other words it acts as a booster. ▪ The industry expects this product to grow by 5-6% PA. 	<ul style="list-style-type: none"> ▪ Privi is the one of the top global supplier of the product. ▪ To maintain its position, Privi has further expanded product capacity to 4,800 TPA. Privi has also done backward integration (Turpentine refinery) to secure material (Beta Pinene).

- The company is one of the few players globally with the capability to manufacture key inputs alpha and beta-pinene from basic raw materials, crude sulphate turpentine and/or gum turpentine oil. Moreover, mastery in the complex & hazardous process to remove Sulphur from CST gives it a competitive advantage.

Pinene segment value chain



- Long-term business relations with Givaudan, Firmenich, IFF & FMCG producers, like P&G, Henkel, Colgate, Reckitt Benckiser. Exports account for 70% of revenues.
 - Trusted supplier (for over 10 years) to all of the Top 10 fragrance companies, which control about 80% of the global fragrance market.
- The company's ability to develop & enter niche speciality aroma chemicals to stay ahead of the competition (Strong R&D team of 80) is a key monitorable. Current products show some speciality products like
 - OTBCHA – PTBCHA where Privi is one of the global leaders.
 - Terpeneol – Pine Oil which also caters to the Pharma Industry due to which Privi acquired GMP status for it's manufacturing site.

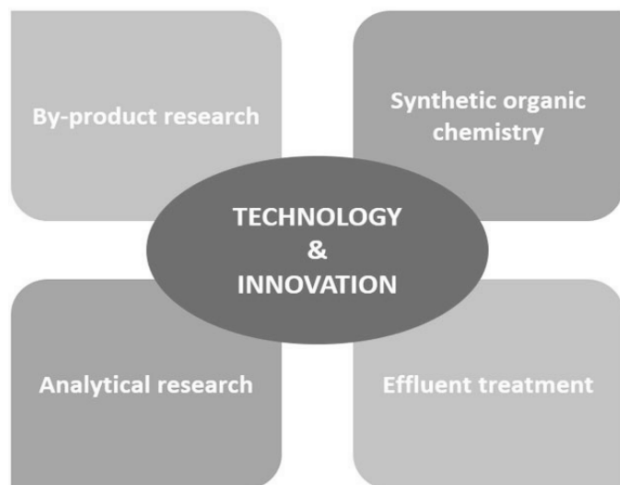
AROMA CHEMICALS

Alpha Damascone
Amber Fleur
Citronellyl Acetate
Florascone
Indian Sandal Core
Nimberol
Santal Fleur Laevo
Tetrahydrogeranyl Acetate
Violetone Coeur

Alpha Ionone
Amber Gamma
Citronellyl Nitrile
Gamma Methyl Ionone
Ionone 100%
OTBCHA
Santal Touch
Tetrahydromyrcenol

Alpha Ionone
Beta Ionone
Delta Damascone
Gammanolene 700
Methyl Ionone
PTBCHA
Tetrahydroflorol
Timber Forte

Alpha Ionone 950
Citronellal
Dihydromyrcenol
Geranyl Acetate
Mugenol
Santal Fleur
Tetrahydrogeraniol
Timber Touch



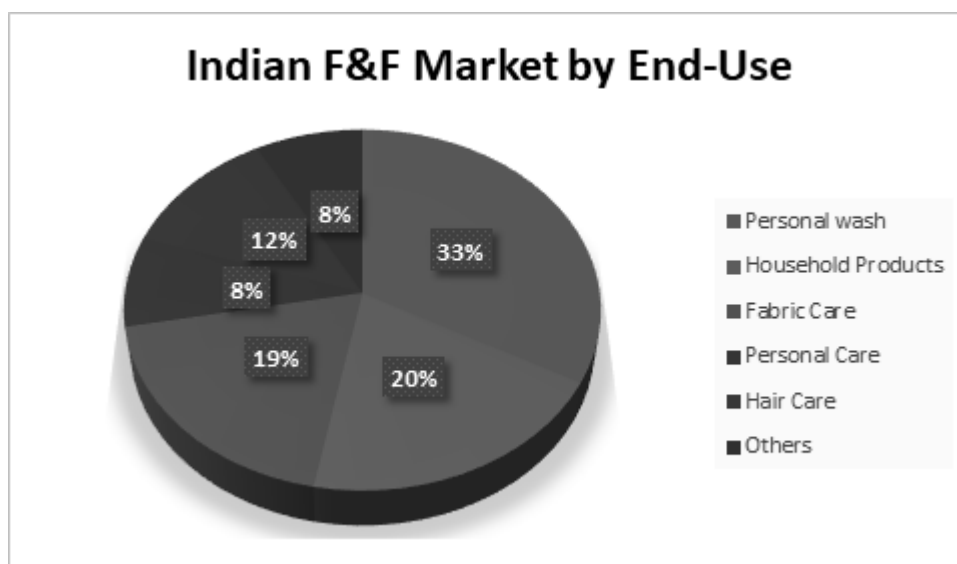
- A talented and dedicated pool of 50 personnel
- Working in collaboration with UICT
- Associations with technology institutions like IIT, NCL
- High importance to by-product value addition
- Complete visualization and resolution of effluent streams
- Resolution of safety and hazard issues
- Results in minimum time for stabilization of plants & lesser pre-operative losses

- The beneficiary of Covid-19 due to increased demand for pine-based aroma chemicals which go into antiseptics, handwash, hand sanitizers, floor cleaners.

The essentiality of the Industry is also quite visible by this: *“Our facilities were back at 70% to 100% production capacity by the end of April 2020.”* ~ SH Kelkar FY20 AR.

What is the COVID outlook?

- In F&F, all products related to hygiene which includes Household products, Personal wash, Fabric Care & Immunity products are doing well.
 - Compensates for Personal care (fine fragrances), Haircare segment which is more discretionary in nature.



- Raw Material cost being largely stable should bode well for the margins.
- An adequate supply of skilled manpower would also be a key monitorable.

- Anyway, The future of the fragrances and flavours industry is secure, as it caters to end-user industries that will remain an indispensable part of global consumers' lives.

"India is at the tipping point of growth in manufacturing of speciality chemicals and aroma chemicals in particular due to favourable government policies for Make in India and the creation of chemical parks. Recent supply chain disruption from China, including events related to COVID and an increase in domestic demand for end-use applications, are acting as significant drivers of growth for the industry," said Mr Shaju C.O, CEO, Best Value Chem (a speciality aroma chemicals maker which was recently acquired by Premji Invest.)

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Zomato Limited: IPO Details	
Type	Fresh Issue (Rs. 5000 Cr.) & Offer for Sale
Size	Rs. 5,875 Cr. (Listing at ₹51.50)
Lead	Rs.72.00-76.00 per Equity Share
Value	Rs.2 per Equity Share
Rate	July 16, 2021 to July 16, 2021
Size	105 shares in 1 lot (in multiple thereof)

Should You Invest in Zomato IPO ?



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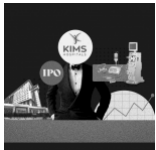
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COMPANIES ANALYSIS



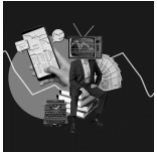
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