SORTINO M&A GROUP

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Royal DSM and Firmenich's Merger

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Source: Food and Drink Technology

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DEAL INTRODUCTION

DETAILS ABOUT THE DEAL

- Announced on 31 May 2022 that DSM and Firmenich would be entering a merger of equals
- Share exchange deal will create DSM-Firmenich with estimated value €40bn
- Co-CEOs of DSM believe DSM-Firmenich will become the "leading creation and innovation partner in nutrition, beauty and well-being"
- Deal will create growth and shareholder value through growth synergies
- Looking to operate on a global-scale as partners
- Merger approved by AFM with Acceptance Period starting Nov 23 2022 and expiring 31 Jan 2023 unless extended
- DSM shareholders can exchange each DSM ordinary share into newly issues DSM-Firmenich ordinary shares
- DSM-Firmenich are expected to have annual revenue of >$11bn
- DSM shareholders will maintain majority control owning 65.5% of DSM-Firmenich / Firmenich shareholders will own 35.5% DSM-Firmenich

INDUSTRY OVERVIEW: NUTRITION AND BEAUTY

The industry of nutrition and beauty is an increasingly popular one, where most frequently purchased products include dietary supplements, vitamins, and sports nutrition products. In the beauty industry, skincare, hair care, and makeup products are commonly purchased.

The nutrition and beauty industry has seen significant growth in recent years due to consumers' growing focus on health and wellness. The global wellness industry was valued at $4.5 trillion in 2019 and is projected to grow to $6 trillion by 2023. This growth can be attributed to an increase in consumer awareness about the importance of a healthy diet and lifestyle, as well as the rise of beauty and wellness products that promote natural and organic ingredients.

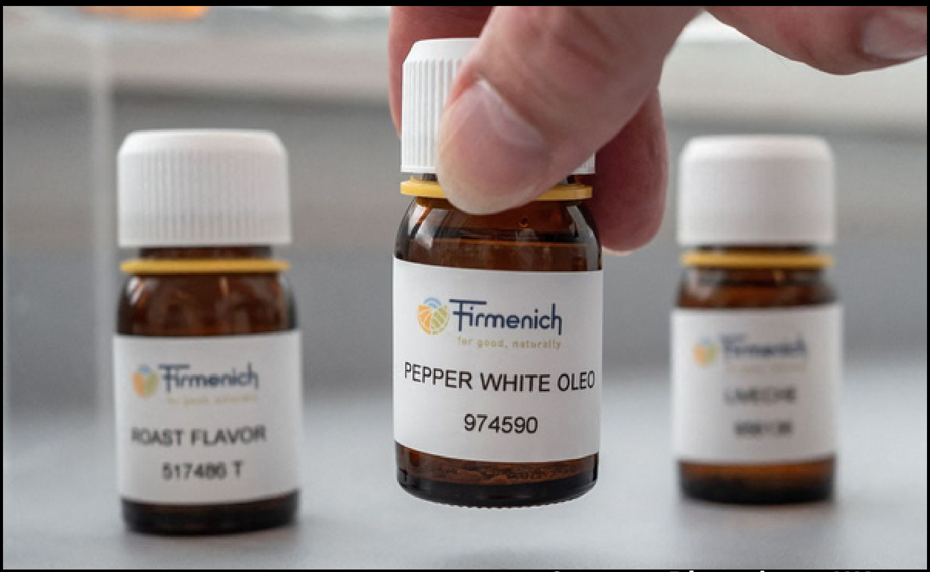
In 2022, the industry was impacted by an increase in interest rates, which made it more difficult for companies to obtain financing for expansion and investment in research and development. The increase in interest rates made it more expensive for companies to borrow money, which reduced their ability to invest in growth initiatives. As a result, many companies had to reconsider their expansion plans and focus on cost-cutting measures.

To stay competitive in the long run, mergers and acquisitions are becoming increasingly necessary in the nutrition and beauty industry. Companies are combining forces to gain access to new markets, technologies, and talent, which can help them to stay ahead of their competitors and grow their businesses. For example, in 2020, Unilever acquired Better Choice Company, a pet food and treat company, to expand its presence in the pet food market.

Similarly, in 2021, Nestle acquired the rights to sell Starbucks coffee and tea products, which helped the company to expand its offerings and reach a wider audience. Thus we can see that companies are using mergers and acquisitions as a strategy to remain competitive and grow their businesses in the long run - one of the big motives behind DSM and Firmenichs merging too.

REASONS FOR M&A

1. Establish global presence and market to expand production
2. Help DSM towards 20-yr transition away from petrochemicals and materials
3. Expand product line with Firmenich's Swiss flavour and fragrances group
4. Draw on Firmenich's strengths in organic chemistry and process engineering



Source: Bloomberg UK

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ACQUIRER OVERVIEW

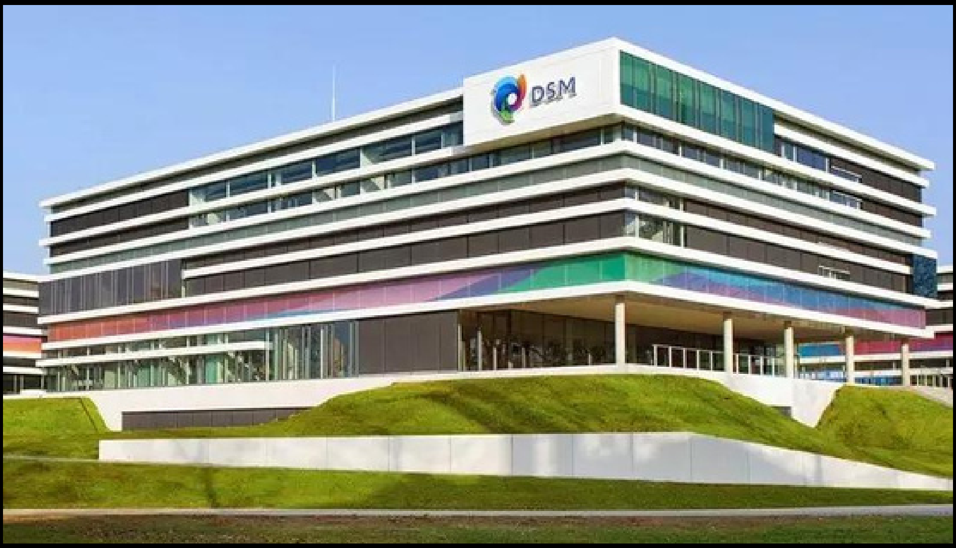
TICKER: DSM N.V.

ROYAL DSM

- Dutch multinational company - fields of health / materials / nutrition
- Stock price €118.70
- Produce products for: animal nutrition and health / human nutrition / care and health / food and beverage / automotive and electrical / materials

BUSINESS MODEL

- Applying bioscience to improve health for people/animals/planet
- Aim to develop products that address world's biggest challenges while also creating value through the economy, environment and society



Source: edie

ESG PRACTICES

- **Incorporated 5 sustainability goals: zero hunger / good health and well-being / affordable and clean energy / climate action / responsible consumption and production**
- **Vision for nutrition and to enable diets for all, tackle malnutrition, sustainable proteins, combat food waste**
- **Improving own carbon footprint and enabling low carbon economy**
- **Closely manage their absolute Greenhouse Gas emission reduction, efficiency and energy efficiency**
- **Conducted €1bn revolving credit facility to link interest rate of the facility to their greenhouse gas emissions**
- **New farming methods to improve low-carbon efficiency**
- **Moving to circular and bio-based economy to reduce waste and move beyond recycling efficiency**

Source:Pet Food Processing

TARGET OVERVIEW

Ticker: SASF

FIRMENICH

Firmenich is a Swiss-based, privately-owned company that specialises in the creation, production, and innovation of fragrances and flavours. Operating in over 130 countries, Firmenich's products are used by over 4 billion consumers each day.

Firmenich's lead financial adviser for this transaction is Goldman Sachs.

BUSINESS MODEL

As the world's largest fragrance and taste company, Firmenich's products can be found in a variety of day-to-day products, food, beverages, fragrances, home, and body products. With an annual revenue of 4.3 billion CHF in FY2021, Firmenich generates its income through the sale of its leading portfolio of complex-flavoured compounds. However, Firmenich's business model relies on the research conducted in 6 research centres which continue to output new, innovative aromatic ingredients using plant biology, organic chemistry and even material physics to power innovation.

With 4000 patents, 450 scientistic and over 480 botanicals, innovation has always been a major aspect of Firmenich's growth and revenue generation; more recently, sustainable innovation. For example, Firmenich aims to accelerate the transition to plant-based diets by emulating the taste and smell of meat in natural ingredients to encourage healthier eating without loss of taste. Extending this, Firmenich's focus growth categories revolve around sugar-reduction, natural foods, and plant-based protein foods.

ESG PRACTICES

Firmenich regards its 125 years of growth as excellence in sustainable science, fusing nature and science, and states its R&D resources are used to advance to 'new frontiers' with sustainability and the highest environmental standards in mind. Firmenich aims to achieve absolute carbon emissions reduction and net-zero emissions by 2039 across its direct operations and value chain. SBTi (Science-Based Targets initiative) validated these net-zero targets in August 2022, making Firmenich the first company in its industry to receive SBTi approval. Similarly, Firmenich was awarded a fifth consecutive triple 'A' rating by CDP; only 12 out of 15,000 companies achieved this score in 2022, and only one other has achieved it five times.

Firmenich's 2022 ESG Report reported 36.1% emission reduction compared to 2017, while three manufacturing sites, in Norway, Singapore and South Africa, became carbon neutral in FY22, all operating without the use of offsets. Firmenich also maintains 100% renewable electricity in its operations worldwide. As mentioned, Firmenich's focus innovation lies around creating sustainable products; Firmenich's Smart Protein (plant-based meat) will help save 285 billion litres of water yearly and will reduce C02 emissions by 4.5 million tons yearly, alongside having dietary benefits removing 2.8 trillion calories total from meals by 2030.

KEY FINANCIALS

Revenue: 4.723 billion CHF, up 11.1%

Gross Profit: 1.847 billion CHF.

Adjusted EBITDA: 905 million CHF, up 10.9%.

EBDITA: 798 million.

32.5% market share gain in Fine Fragrance.

DEAL ANALYSIS

STRENGTHS

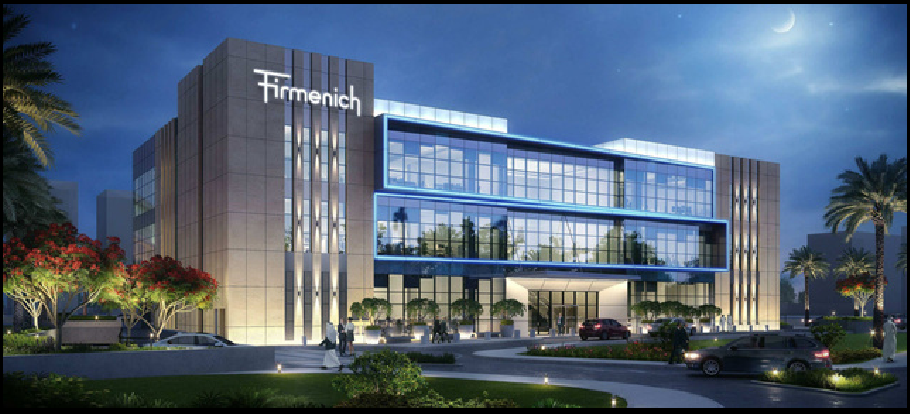
The combination of DSM and Firmenich will lead to further innovation in the fragrance and aroma industry and accelerate growth through their adjoined R&D resources with a global network of 15 research centres and over 16,000 patents.

This merger will build on each company's track record of delivering excellent results, with both companies sharing complementing values and goals with creation, sustainability, and wellness in mind.

This merger is a strategic move to organically raise market share in the Nutrition, Wellness and Beauty industry. As of 2021, four companies including Firmenich held 55% of the market; this merger will facilitate the expansion of Firmenich capabilities through DSM's portfolio of aromatics.

WEAKNESSES

DSM-Firmenich will incur significant transaction and integration costs which may be significantly higher than currently estimated (£213m); there is a small chance that this will lead to failure in successfully integrating the businesses.



Source: Al Ashram Contracting

DEAL ANALYSIS

OPPORTUNITIES

DSM-Firmenich's leadership expects annual sales growth of 5-7% over the medium term and high single-digit EBITDA growth; expected to reach €350m.

The combined synergies are predicted to save the Dutch and Swiss firms £149m through operation costs.

DSM's expertise in biologics and protein separation and Firmenich's expertise in plant-based natural ingredients are great complements for both firms' future goals in plant-based foods, food supplements, and medical nutrition.

THREATS

Analysts are asking questions regarding whether the lack of competition in the food industry, which is currently dominated by a small section of firms such as Kraft Heinz, susceptible to short terms shocks such as the threats from the Ukraine War.

In 2017, the International Panel of Experts on Sustainable Food Systems, warned that the trend of mega-mergers has weakened the food supply chain, especially for farmers who now rely on few buyers, subsequently squeezing their income.

An important question to ask is regarding the health effects of the products produced by DSM and Firmenich, which are all synthetically produced in laboratories.

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VALUATION ANALYSIS

DISCOUNTED CASH FLOW (DCF) ANALYSIS

WACC/GR	1.00%	1.50%	2.00%	2.50%	3.00%	3.50%
8.81%	$544.46	$575.65	$611.41	$652.83	$701.38	$759.06
9.31%	$517.00	$544.55	$575.88	$611.80	$653.42	$702.19
9.81%	$492.46	$517.01	$544.69	$576.16	$612.25	$654.05
10.31%	$470.40	$492.41	$517.06	$544.87	$576.48	$612.74
10.81%	$450.43	$470.29	$492.40	$517.16	$545.10	$576.85
11.31%	$432.27	$450.28	$470.22	$492.43	$517.31	$545.37
11.81%	$415.65	$432.07	$450.16	$470.20	$492.50	$517.49
12.31%	$400.39	$415.42	$431.92	$450.09	$470.21	$492.62
12.81%	$386.31	$400.13	$415.24	$431.80	$450.05	$470.27

Please click on the table to access full model.

In the DCF Analysis, Royal DSM's share price was estimated through the projection of free cash flows. More specifically, when building the assumptions and estimates, our analysts focused on the nutrition division, as it accounted for 90% of DSM's revenue.

As seen in the table above, a sensitivity analysis was conducted, in which the share price of DSM can be seen with varying figures of the Terminal Growth Rate (TGR), and the Weighted Average Cost of Capital (WACC). Our analysts found the most appropriate TGR to be 2% and WACC to be 10.81%, resulting in an estimated share price of $492.40.

This valuation would suggest that DSM is currently undervalued in the market, a situation that could usually motivate firms to repurchase their stock, rather than to merge.

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VALUATION ANALYSIS

COMPARABLE COMPANIES ANALYSIS (CCA)

Nutrition Companies	Low	High
Selected EV Multiple:	14.4x	14.6x
Implied Enterprise Value	25,260	25,754
Net Debt	(1,546)	(1,546)
Implied Equity Value	23,713	24,208
Equity Value per share	**$ 109.23**	**$ 111.51**

Please click on the table to access full model.

Based on the comparable company analysis (CCA), DSM's valuation multiples appear to be in line with the comparable group of companies chosen. Out of the 7 comparable companies, the focus was to obtain competitors within DSM's nutrition line of business, resulting in similar EV/EBITDA multiples.

As a result, the low and high EBITDA multiples were chosen to be 14.4x and 14.6x, giving the implied enterprise values of $25,260m and $25,754m, respectively.

At the end of the valuation, the implied share price was found to be between $109.23 and $111.51, in line with the closing share price of approximately $150 on the day before the announcement, on May 30th 2022.

CONCLUSION

IMPACT ON THE INDUSTRY

A merger between DSM and Firmenich would impact the specialty chemicals and ingredients industry. The combination of these two companies would result in a global leader in ingredients and solutions for the personal care, nutrition, and fragrances markets.

The merger would bring together DSM's expertise in science-based nutrition, personal care, and catalysis with Firmenich's leadership in fragrances and flavours, creating a more comprehensive and innovative offering for customers.

The market share that DSM and Firmenich are expected to capture following the merger is not publicly available. However, the merger would likely result in the creation of a large and diversified company with a significant presence. This could lead to increased market power and potentially higher prices for consumers.

On the other hand, the combined resources and expertise of DSM and Firmenich could lead to more investment in research and development, which could result in the creation of new and improved products for consumers.

Ultimately, the impact of the merger on consumer welfare will depend on a number of factors, including the ability to innovate and bring new products to market, its pricing strategy, and the level of competition in the industry. The projected impact on the industry is difficult to determine, as the merger is a recent development and its effects are still unfolding. However, industry experts anticipate that the merger will drive growth, innovation, and increased competitiveness in the industry.

GLOSSARY

Equity Value: **Total value of a publicly traded company's outstanding common shares owned by the stockholders.**

EV/EBITDA: ***Enterprise Value 'Multiple', gives insight into the value of companies against their cash earnings less their non-cash expenses.***

Free Cash Flow: ***Cash generated by company after accounting for its operating and capital expenditures.***

Premium: ***increased amount paid per share in comparison to the share price at the time of the M&A transaction, often presented as a percentage.***

Sensitivity Analysis: ***The analysis of how a change in assumptions (inputs) can impact the output of a financial model.***

Terminal Growth Rate: ***A growth rate that a company is expected to grow at forever based on the market and industry conditions.***

Valuation Multiples: ***Financial tool providing one metric as a ratio of another; often used to compare similar companies.***

WACC: ***Cost of capital used to represent a firm's after-tax costs from all resources.***