

Flavours, fragrances and nutraceutical ingredients: An overview

INTRODUCTION

India is moving towards becoming a consumption led economy. With rising disposable income and increasing rural penetration, the demand for food & beverages (F&B) and home & personal care (HPC) products is increasing. Consumers are more willing to experiment and moving towards using premium products. This growth in the end-user industry has led to significant growth in the flavours and fragrances (F&F) industry. F&F play a very critical role as they have a strong sensorial impact on the consumer and often lead to positive or negative brand recall.

In our earlier report (March 21) titled 'Speciality Chemicals in India – A sum of disparate parts, segment leaders poised to create value', where we had landscaped the Indian speciality chemicals space, we had highlighted F&F as one of the most attractive segments



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in this space with a high growth rate, healthy margins and a number of scaled up assets. This prompted us to author a report specifically on this segment. We have also included nutraceutical ingredients as a part of this segment due to the significant overlap between the supply chains of the F&F and nutraceutical segments, being manufactured from the same starting blocks.

In this report, titled 'Flavours, fragrances & nutraceutical ingredients in India – Strong growth on the back of indigenous supply chain and increased focus on research and development', we have attempted to landscape the market, outline the key trends shaping the segment and identify the star performers in each of the sub-segments.

Industry overview

The F&F and nutraceutical value chain has four key stakeholders – raw material suppliers, base ingredient manufacturers, functional ingredient manufacturers and end-consumer industries. For the purpose of this report, we have considered three sub-segments of the value chain – base ingredient

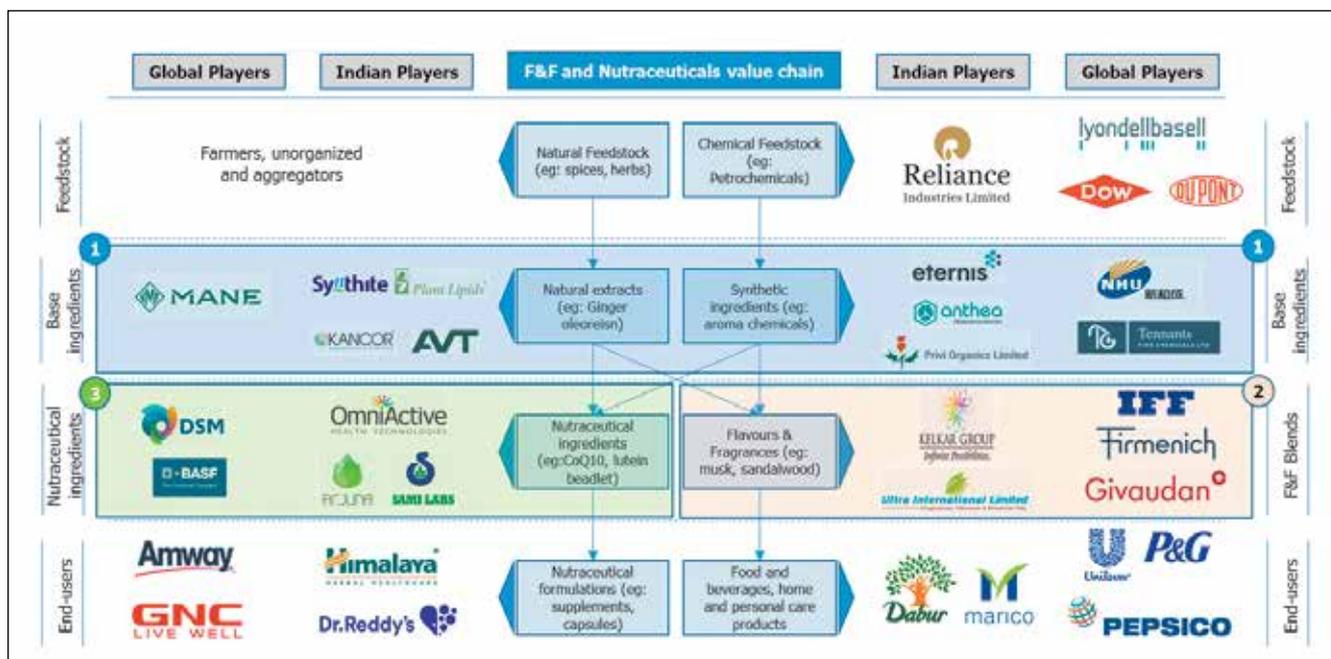


Fig. 1: Interlinkages between F&F and nutraceutical value chain

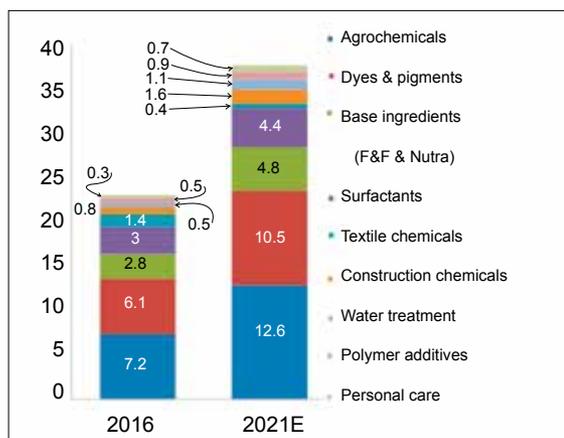


Fig. 2: Indian speciality chemicals market size (US\$ bn)

manufacturers, F&F blenders and nutraceutical ingredient manufacturers.

Base ingredients

Base ingredients are chemicals used in the F&F or nutraceutical value

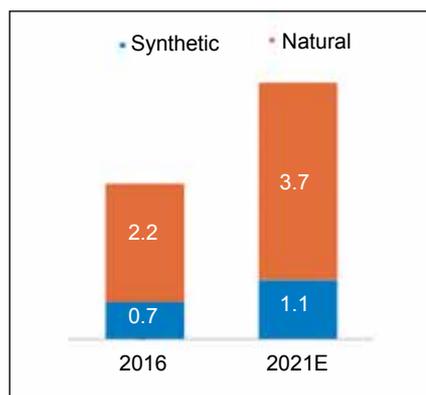


Fig. 3: Market size of base ingredients in India (US\$ bn)

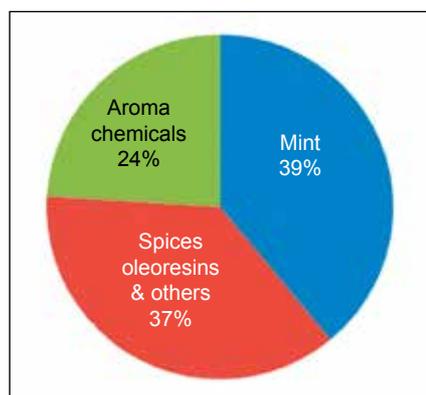


Fig. 4: Break-up of base ingredients market (2016)

chain, obtained either from a feedstock using a synthetic process or from naturally occurring spices, herbs, fruits and flowers using an extraction process. These ingredients are then further processed by F&F blenders or nutraceutical ingredient manufacturers to be supplied to the FMCG or F&B, and nutraceutical sectors, respectively. The global market is expected to grow

at a CAGR of about 6% to reach \$18-bn by 2021.

India is well positioned in the natural ingredients space because of the abundance of raw materials and a rich legacy of using natural products as alternate forms of treatment for several centuries. India caters to 60% of the global spice oleoresin demand and 80% of the global mint extracts demand. It is the top producer in the world for multiple critical ingredients like ginger, chilly, pepper, coriander, etc. Some of

Table 1: Natural ingredients: India's rankings

Ingredient	Global ranking	Production MT	Comments
Mint	1	32,000	India produces 80% of the world's mint oil.
Ginger	1	703,000	Indian dry ginger, known in the global market as 'Cochin Ginger', is considered the best in the world.
Chilly and pepper	1	1,299,940	The world's hottest chilly "Naga Jolokia" is cultivated in the hills of Assam in North-East India.
Spices	1	1,496,990	India contributes 70% of the global spice production.
Anise, Fennel and Coriander	1	537,330	The essential oil from star anise is used to flavour soft drinks, bakery products and liquors.
Lemongrass oil	1	1,000	This oil is used in imparting scent to soaps, detergents and insect repellent preparations.
Nutmeg, Mace and Cardamom	3	18,070	Cardamom is the world's third-most expensive spice after saffron and vanilla.
Eucalyptus oil	3	1,000	It is used in small quantities to impart a fresh and clean aroma in soaps, detergents, lotions and perfumes.

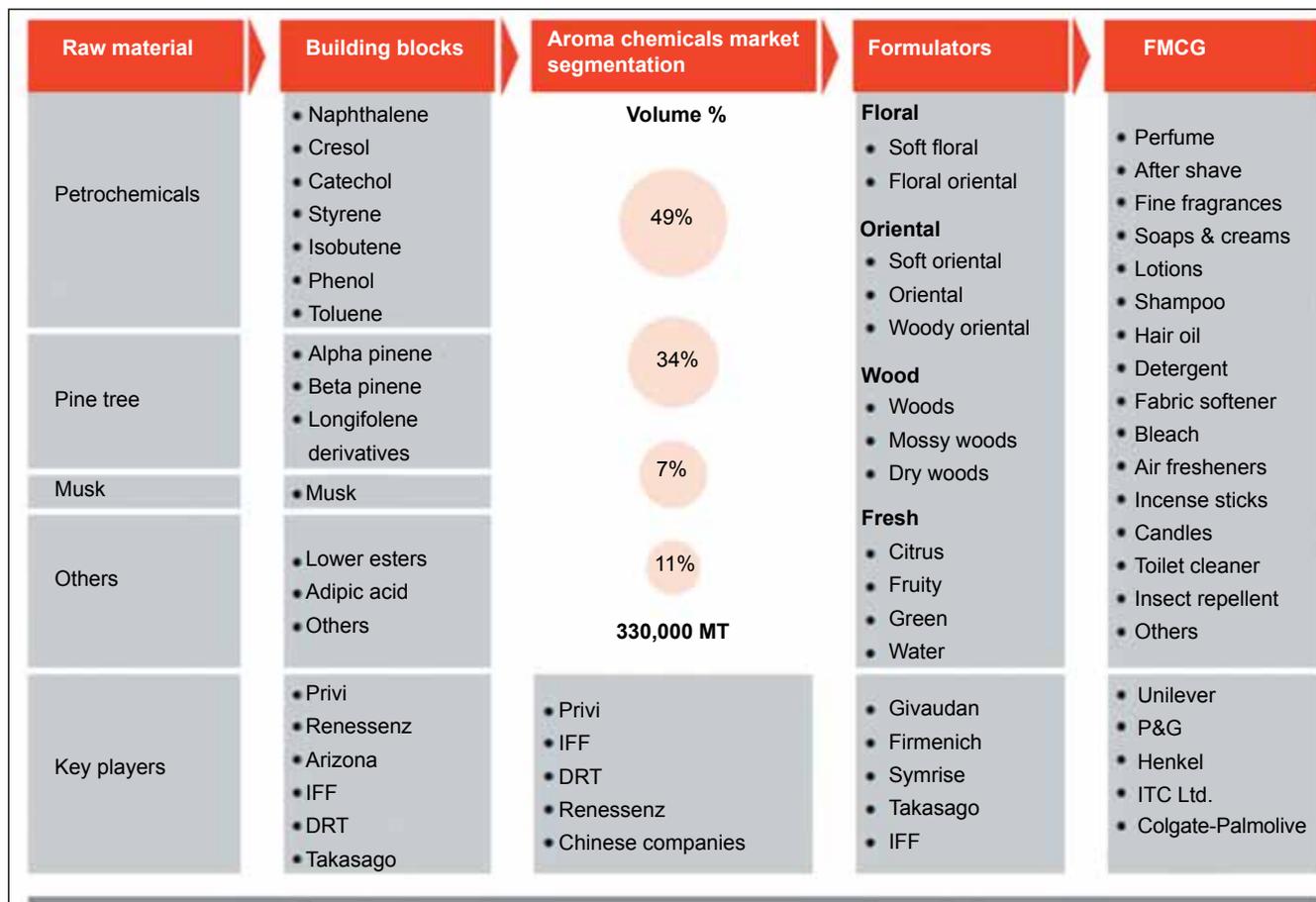


Fig. 5: Synthetic base ingredients value chain in India

the leading companies in this space are Synthite, Plant Lipids and Kancor.

At the same time, several Indian synthetic ingredient/aroma chemicals manufacturers, such as Eternis and Privi Organics (now a part of Fairchem) and Athea Aromatics, have chosen specific niches and molecules within them, and mastered the chemistry, created a robust supply chain, and optimised processes to become leading players in these chosen molecules globally.

Overall, these strengths have played out well for the Indian base ingredient players, with some very large and attractive businesses having been built in this space. These businesses are expected to grow significantly going forward, at a CAGR of 11% over the next five years. This growth will mostly be driven by growth in the end-user industries both globally and in India.

Globally, increasing acceptance of Indian products is a major growth

driver for the base ingredient manufacturers, with an increasing amount of products being exported. The Indian market is currently sized at \$2.8-bn, expected to reach \$4.8-bn by 2021, with about 75% of the production being exported. Within this segment in India, spice extracts and oleoresins are the fastest growing sub-segment, growing at a CAGR of 16%.

Flavours and fragrances

F&F blends are critical components



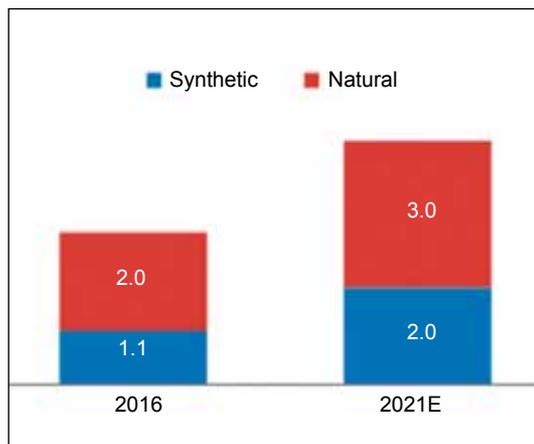


Fig. 6: F&F production market in India (US\$ bn)

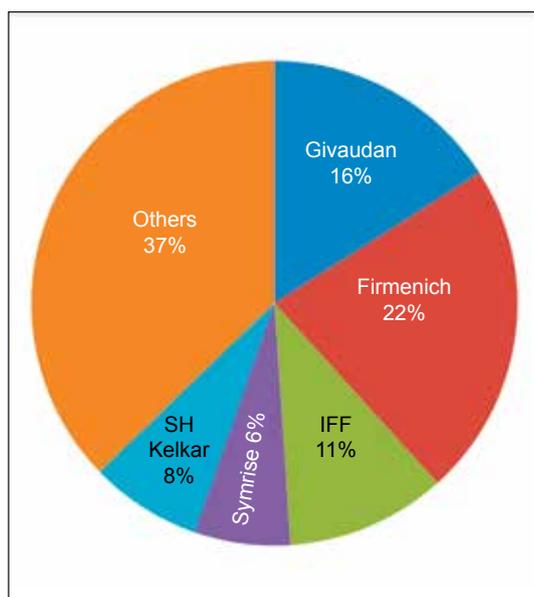


Fig. 7: Indian F&F industry market share

of food & beverage, home and personal care products. Blending involves mixing of different flavours or fragrances to obtain the desired flavour or fragrance. The global market is currently sized at \$27.1-bn and expected to grow at 6.4% to reach \$37.0-bn by 2021. Growth in this market is mainly driven by growing consumption of processed foods, changing consumer lifestyles across the world and an increasing willingness to experiment with new flavours and fragrances.

The Indian market is expected to

grow at a much faster rate of ~13%, from \$1.1-bn in 2016 to \$2.0-bn in 2021 on the back of increasing penetration of FMCG products in rural India, rising disposable income and increasing demand for premium products.

The global market here is reasonably consolidated, with the top 10 players constituting ~80% of the market. The Indian market too is reasonably consolidated, with the top 4 global players (Givaudan, IFF, Firmenich and Symrise) constituting over 50% of the market. SH Kelkar is the only Indian player of scale, with the Ultra group and Oriental Aromatics having created a sizeable business as well. Players in this space invest a significant amount in R&D in order to develop unique combinations of F&F to satisfy the demands of the market. In this space, customer acquisition is a long drawn out process with several customers having stringent vendor selection processes and quality norms, making it extremely important to maintain relationships with customers.

Nutraceutical ingredients

Nutraceutical ingredients are the active formulations that impart functional benefits to the nutraceutical formulation. The global market, currently sized at \$29.5-bn is expected to reach \$42.4-bn by 2021. This will mainly be driven by rising medical costs and a growing focus on preventive medication and nutritional supplementation. As the benefits of traditional medicine are studied in greater detail and supported with clinical evidence, ayurvedic herbs are expected to gain more acceptance. The

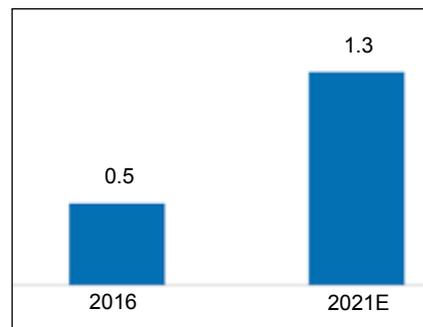


Fig. 8: Indian nutraceutical ingredients market size (US\$ bn)

West is already adopting ayurvedic principles for nutraceutical applications.

The market in India is in a relatively nascent stage, but India's rich history in Ayurveda and abundance of useful herbs and spices make it a strong contender to achieve a leadership position in this market going forward. The market is currently sized at \$0.5-bn, but is expected to grow at a rate of 20% to reach \$1.3-bn by 2021. The Government, through its ministry AYUSH, is taking several steps in order to promote the use of Ayurveda and other traditional forms of medicine. AYUSH helps enforce the quality control of Ayurveda, Siddha, Unani and Homeopathy (ASU&H) drugs and the sustainable availability of raw materials by promotion of medicinal plants in States. The Government of India provides financial assistance to states to develop and promote the AYUSH systems including Ayurveda in the country through different activities.

Apart from legacy and knowledge of Ayurveda, R&D and innovation remain a key success factor for players in this space. Given the fact that the nutraceutical industry is still based primarily in the developed markets and 80%+ of India's production is exported, it is very critical to have a strong R&D machinery to come up with globally acceptable and efficacious products to scale up in



this space. We see R&D and innovation as a strong differentiator for outperformers in this segment. Marketing is another key success factor. Nutraceutical ingredient players need to invest significant time and money in clinical studies to support claims of efficacy and effectiveness. This not only helps to promote branded ingredients, but is also helpful for customers of ingredient manufacturers to promote their products. Larger Indian players like Sami Labs, Omniactive Health Technologies and Arjuna Natural Extracts have built strong portfolios of branded products by investing heavily in clinical trials and R&D.

Key trends

M&A and Consolidation

In the past few years, M&A activity has significantly increased in the F&F and nutraceutical ingredients sectors. Smaller players with strong competence in a single product and limited geographic presence are getting acquired by larger players, giving

access to a broader market and stronger distribution capabilities.

Considering the overlap between the F&F and nutraceutical ingredients value chain, some of these acquisitions have allowed companies to gain access to specific customers and complementary products. Many global F&F players have forayed into the nutraceutical segment inorganically. This has also helped companies build and diversify their product portfolios with multiple ingredients. Several companies have expanded into new geographies and enhanced distribution capabilities through acquisitions.

Increasing regulatory oversight

In speciality chemicals in general, and F&F and nutraceuticals in particular, we have seen a significant increase in regulatory monitoring. Norms for both quality as well as EHS have been raised, and vendors are regularly scrutinised by agencies as well as large, global customers. We feel that the changing regulations would weed out the smaller,

unorganised, non-compliant players, or at least restrict them from exporting to developed markets, or selling to large customers. Regulations related to nutraceutical ingredients vary in terms of classification and specific requirements. As nutraceuticals are different from pharmaceuticals, several regulatory authorities have made it imperative for companies manufacturing nutraceuticals to clearly define their product and its benefits.

CONCLUSION

The F&F and nutraceutical ingredients segment is a large constituent of the Indian speciality chemicals industry. Different components of this segment vary significantly in the industry structure, growth drivers and key success factors. F&F industry will pose scale-up challenges to the Indian players, given the entry barriers, and dominance of the MNCs. Nutraceutical ingredients present an extremely promising opportunity. The domestic market, which is at a nascent stage currently, is also expected to witness explosive growth, in the wake of growing urbanization and rising awareness about nutraceutical supplementation. We think that the Indian players who have scaled up will exhibit strong growth, garnering market share in India and globally.

About Avendus Capital Pvt. Ltd.

Mr. Preet Singh leads the Industrials Practice at Avendus, a leading provider of financial services with an emphasis on customised solutions in the areas of financial advisory, wealth management, structured credit solutions and alternative assets management. Avendus relies on its extensive experience, in-depth domain understanding and knowledge of the regulatory environment, to offer customised solutions that enable clients to meet their strategic aspirations.

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