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By Kelly Kovack and Posted April 7, 2017 In Exclusives, Finance, Insight

ThinkingLinking—the cross-border M&A firm active in cosmetic ingredient market deals—explains the thinking behind all of the linking that it has disclosed. Their M&A study delves into the motivations of buyers behind the 50 deals worth over €2 billion over the last 5 years, on which BeautyMatter reported in Part 1: Cosmetic Ingredient Market Consolidation – The Changing Map and Menu.

The firm's "Alchemists Go Shopping" report look at the motivations behind the buyers and sellers involved in the 50 deals.

The investors fall into three main groups: financial investors, “core” buyers from the cosmetic ingredients sector, and horizontal moves such as by food, beverages, or pharmaceuticals ingredients producers entering cosmetic ingredients for the first time. If such businesses already had a small involvement in cosmetic ingredients, they are not considered horizontal moves but core buyers. The core group are by far the most active.

They are consolidating and rationalizing a sector that was historically limited by ingredient and geography.

Consolidation is a big word, but it doesn’t explain *why*, and while rationalization sounds progressive, it doesn’t explain *how*. What are the detailed motivations?

“Information from buyers about their real motives is rarely useful. Sometimes they say nothing, sometimes just a single line, and sometimes what they say is distorted for stock market or target company employee consumption.”

ThinkingLinking therefore produced a summary of its own sectors’ experiences without disclosing names as a round-up of the prevalent motives it has detected.

The motives and indeed prioritization of motives vary from deal to deal, but the checklist can be split between the three main buyer groups.

Core Deals:

- **Gap-filling for customers’ demands:** M&A allows companies to add new products demanded by customers such as natural, organic, and active ingredients to their portfolios, satisfying customers and growing revenues.
- **Gap-filling to cross-sell:** A broader customer base allows buyers to cross-sell existing products and break into long-term customer relationships hitherto controlled by mid-market producers, as well as benefit by combining both companies’ distribution channels.
- **Know-how:** Acquisitions can provide the research and R&D needed to keep innovating and keep up with the innovating demands of customers.
- **Market entry:** M&A enables buyers to enter new geographical markets that are large or fast-growing. Buyers aiming to expand global footprint through export or setting up production can face barriers and high costs in markets with stringent regulations and high safety standards.
- **Global sourcing**: Some natural ingredients can only be sourced from specific geographical areas and an acquisition is sometimes the best way either to control the

source or expand sourcing where there is a lack of capacity to meet customer demand.
- **Procurement pressure:** Some cosmetics companies are concentrating procurement in fewer, larger producers with vast ranges of ingredients.
- **Negotiating power:** An acquisition can increase negotiating power vis-à-vis mid-market customers and suppliers.
- **Cost synergies:** A combination can reduce R&D, production, admin, and other costs.

Horizontal Moves:

- **Multiple sector sale channels:** Many ingredients can be sold to more than one of the cosmetics, pharmaceutical, food and beverage channels, meaning the horizontal move can boost sales of both the acquirer's and target's ingredients.
- **Barriers to entry:** Regulatory requirements and a research-intensive environment make it hard for companies to enter cosmetic ingredients organically for the first time without suffering heavy costs and delay.

Financial Plays:

Some private equity firms are buying in the hope of consolidating cosmetic ingredients businesses through further acquisitions in the sector while others enter cosmetics ingredients as the first step to horizontal deals such as food and beverages ingredients.

This doesn't mean they find it easy to make follow-on deals. If the pricing isn't right they get stuck with the single deal and try to grow organically till a buyer comes along.

Sellers' Point of View:

Competitive environment: Many of the same reasons encouraging core acquirers to act are pressuring sellers to give up their businesses if they are not willing or able to expand themselves. Even if they remain highly profitable, by "standing still" they won't see the growth they've enjoyed in past years.

Change of focus: a shift in focus by larger players can result in a cosmetic ingredients spin-off.
"Companies are facing a fast-changing world. M&A deals also change the competitive landscape so you can't rest on your laurels. Regulatory hurdles have to be surmounted when you enter new markets. Technology is more and more critical for quality and innovation, while shrinking markets need to be compensated by moving into emerging markets," Mark Dixon, the firm's Chief Thinking Officer, said. "Our selling clients often see challenge where buyers see opportunity in everything from emerging market demographics to what we call the 'track-and-trace-field-to-face' trend."

The evolution of science is changing the definition of the sector with implications for M&A.

Bo Ma, ThinkingLinking's Senior Linker for Life Sciences added, "As the cosmetic ingredients and life sciences/biotech sectors evolve, they are starting to rub shoulders and overlap in terms of science, regulation and consumer perception. We are therefore deploying inter-sector M&A as much as cross-border M&A to exploit synergies in R&D, regulation and product category switches as well as valuation arbitrage imbalances for buyer or seller."

Download the full "Alchemists Go Shopping" report from ThinkingLinking.