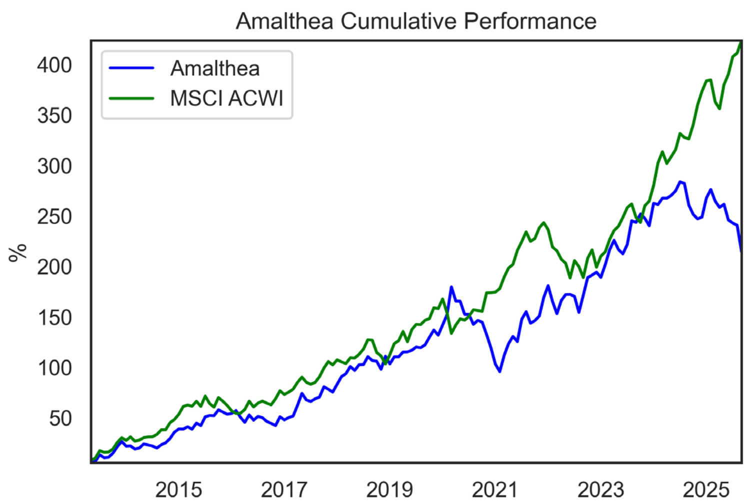
Amalthea Fund – September 2025

The Bronte Amalthea Fund is a global long/short fund targeting attractive risk adjusted returns over the long term, managed by a performance orientated firm with a process and portfolio that we feel is genuinely different. Objectives include lowering the risk of permanent loss of capital and providing global diversification while reducing the market/drawdown risks typical of long-only funds. We believe a highly diversified short book substantially reduces risk and enables profits to be made in tough markets

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FYTD
FY13											5.4%	1.3%	6.8%
FY14	6.0%	-2.5%	0.4%	3.6%	5.7%	4.3%	-3.7%	0.2%	-2.6%	0.9%	3.4%	-0.8%	15.2%
FY15	-0.9%	-1.6%	2.7%	1.7%	3.4%	4.9%	2.3%	-0.1%	1.7%	-1.7%	4.4%	-1.7%	15.6%
FY16	6.1%	0.9%	-0.2%	3.8%	-1.3%	-1.4%	0.5%	1.8%	-4.1%	-3.4%	5.1%	-3.4%	3.8%
FY17	2.5%	-0.8%	-2.5%	-1.3%	-1.5%	6.1%	-2.0%	1.6%	1.0%	7.0%	7.2%	-3.7%	13.6%
FY18	-0.9%	1.5%	1.1%	5.9%	-1.3%	-1.6%	4.4%	4.1%	1.5%	3.7%	-2.0%	2.9%	20.8%
FY19	0.1%	3.8%	-1.8%	-0.4%	-3.9%	6.5%	-3.6%	3.4%	0.0%	2.2%	0.1%	0.7%	7.1%
FY20	1.5%	-0.4%	1.3%	3.4%	3.1%	-2.1%	4.3%	4.2%	11.0%	-5.1%	-0.1%	-4.8%	16.5%
FY21	-0.1%	-3.9%	1.7%	-0.7%	-5.0%	-5.7%	-7.3%	-3.7%	8.2%	5.5%	3.2%	-2.2%	-10.7%
FY22	9.7%	3.0%	-4.5%	1.1%	1.8%	7.3%	4.4%	-5.6%	-4.6%	5.2%	2.2%	0.1%	20.7%
FY23	-0.7%	-5.9%	6.7%	6.5%	0.8%	1.0%	-1.8%	4.3%	4.9%	2.9%	-2.8%	-1.4%	14.7%
FY24	2.9%	7.3%	-0.4%	2.4%	-1.2%	-2.1%	6.6%	-0.3%	1.7%	-0.0%	0.7%	1.2%	20.0%
FY25	2.4%	-0.4%	-5.6%	-2.6%	-1.3%	0.5%	5.4%	2.3%	-3.0%	-1.7%	0.9%	-4.3%	-7.7%
FY26	-0.9%	-0.6%	-7.7%										-9.1%



The Amalthea fund delivered a net return of -7.67% in September, bringing the quarterly performance to -9.07%. These results significantly trailed the MSCI ACWI, which posted gains (in $A) of 2.48% for the month and 6.87% for the quarter. Our comprehensive end-of-quarter letter details the exceptional market dynamics that have challenged our long/short strategy. Additionally, we provide an in-depth analysis of the flavors and fragrances industry, with a specific focus on DSM-Firmenich, a core holding in the portfolio.

Fund Features		*Metric*	*Amalthea*	*MSCI ACWI (in AUD)*
Investment Objective	Maximise risk-adjusted returns over 3-years	Sharpe Ratio[1]	0.64	1.13
Min. initial investment	$100,000 (for qualifying investors)	Sortino Ratio	1.11	1.96
Min additional investment	$50,000	Annualised Standard Deviation	12.48%	10.60%
Applications/redemptions	Monthly	Largest Monthly Loss	-7.67%	-8.00%
Distribution	Annual	Largest Drawdown	-30.01%	-15.97%
Management fee	1.5%	Winning Month Ratio	0.56	0.66
Performance allocation	20%	Cumulative return[2]	214.51%	423.87%
Administrator	Citco Fund Services	1-year annualised return	-12.81%	22.94%
Auditor	Ernst & Young	3-year annualised return	5.05%	21.94%
Custodians/PBs	Fidelity, Morgan Stanley, JP Morgan	5-year annualised return	4.99%	15.38%
		Annual return since inception	9.67%	14.27%

[1] Sharpe and Sortino ratios assume the Australian cash rate as the applicable risk-free rate
[2] Returns are net of all fees

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At Bronte we are optimists …

Regeneron will be capable of reversing severe allergies, which affect hundreds of millions of people worldwide.

Alphabet (Google) will master self-drive. It will also ameliorate the threat to its core business from new artificial intelligence search.

Spirax will sharply reduce energy use for its customers and will get paid for that. It will reduce greenhouse gas production and will even have technologies to bring steam into the post-greenhouse gas world.

The problem is that we are also skeptics —and this trait has led us to stand in front of a fire hydrant of greed that is gushing at the moment in financial markets.

Now this isn't our first fire hydrant — and whilst we pride ourselves on our risk management, it doesn't mean we are immune from losses. We just avoid catastrophic losses. We will be there tomorrow.

We are, however, surprised at the intensity of the current meme stock squeeze. At Bronte we are long quality stocks and short junk. The worst possible scenario for us is a market so crazy that people sell the more reliable blue chips — the ones that are nearly guaranteed to have passable returns in the future — to play the worst junk.

When that happens, we lose on both sides of the book and have to cut positions sharply for risk management purposes.

We used to think really intense "sell the good stuff to buy junk" events — at least on any scale — were rare. The letter we wrote in December 2020 described two notable past events. They were the 1969 "go-go market" and the year 2000 junk tech stock market where people sold Microsoft, Cisco and Amazon to buy JDS Uniphase and i2 Technologies.[3] We had two such total manias in 50 years.

After both manias, a generation of stock investors were so traumatised they never got carried away again. Millions of people incinerating oodles of money on wild speculation was a once-a-generation event.

Alas we have now had two of these total junk rallies in five years. We don't really have an explanation, other than that for a variety of reasons the world has got crazier.

[3] JDS Uniphase and i2 Technologies — stocks most have now forgotten — were the hottest stocks in the world in September 2000. They had peak market caps of over $200 billion, or about half Microsoft at the time. The former broke up and lost 90 percent of its value. The latter more or less ceased to exist. There was plenty of lower market cap junk.

The last mania was retail-led and specifically targeted high-short-interest stocks. The retail-led mania was driven by bored people stuck home and gambling (often with their Covid checks) on their Robinhood app.

This time the retail mania is accompanied by institutional investors piling on. Large stock moves are driven by what we think is very aggressive (and probably ultimately stupid) buying. Moreover, whilst the mania is targeting high-short-interest stocks, it is also targeting things that seem random to us. We tend to try and limit our exposure to high-short-interest stocks — but that limitation has helped us less this time.

If this sort of mania happens every three years forever then we will have to admit that our "long quality/short junk" model is broken. It sure feels broken now. But we doubt the world has become permanently crazy. How many people can suffer life-changing losses speculating in financial markets before a good proportion of the population decide that it might not be a good idea to buy a stock because it contains buzzwords like AI or SAAS?

The opportunity set

Normally we think if the opportunity set on the short side is great, then the opportunity on the long side is poor. In other words, when the market is high people will experiment in junk stocks.

That does not appear to be the case at the moment. The opportunity set is very good both on the long side and the short side. That should be wonderful for us (longer-term), but short term it has been difficult. Longs and shorts in our portfolio have particularly low correlation (which when you are losing money is known as "the hedges are not working").

The short side

At the peak of any mania the opportunity set in shorts is (obviously) going to be salivating. The problem is working out where the peak is and surviving your four incorrect guesses on the way up that "this must be the top".

At the moment, finding stocks that will be down 90 percent within a few years — that is, what should be very good shorts — is like shooting fish in a barrel.

We used precisely that simile in the December 2000 letter — and we appended the tart rejoinder "except that the fish shoot back".

They will stop shooting someday shortly. They are shooting back now — and with just as much intensity as then.

It should end. Until it ends we will have to manage — and we won't be making money unless our longs perform particularly well.

The long side

That said, we think our longs should perform well.

The opportunity set on longs is <u>much better</u> than it was in early 2021.

In early 2021 we thought that old fashioned non-mania stocks were not nosebleed expensive, and were "cheap relative to bonds". That turned out to be about right — but the gap corrected the wrong way: bond prices fell rather than the relative value stocks rising.

This time we think some of our long book — especially the quality European stocks — is objectively inexpensive. Some of it is at 2011 valuations. We have an example attached at the end of this letter. The stock at the end of this letter is not the only really attractive European long.

We would love to get even longer quality European stocks. Alas we are too focussed on our short book (and some of the problems it is causing us) — and, as stated, our long book and short book lack correlation.

The new normal: Fueling the fire

The sharp end of wild bull markets is where Wall Street professionals make the most money. We will share a brief example. It is a story about a stock we have never had a position in — and derivatives over that stock.

The stock is Coreweave, a major operator of AI datacentres.

Before digging in, it is worth explaining the role of accelerants in fueling retail manias. Every retail market mania needs an enabler. These have ranged from 17th-century tulip contracts to margin lending in the 1920s and online brokerages like E*TRADE in the 1990s. The current market bubble has two main accelerants: the ETF and the zero-dated option (0DTE).

ETFs, once a simple index-following tool, have evolved into leveraged, inverse, and single-stock instruments, amplifying exposure to volatile themes like crypto and AI. They simplify complex options for novice investors.

0DTEs, introduced during COVID, are purely for intraday trading, causing extreme volatility as marketmakers hedge aggressively.

These markets are substantial: over 10,000 ETFs exist globally, with 1,300 launched in the first half of 2025. In 2025, 0DTE options comprised over 60% of total S&P 500 options volume. This growth reflects social media's influence, providing an easy way to react to the constant flow of commentary and sentiment from social media platforms, creating distortions and feedback loops.

Back to Coreweave. It started life as a crypto-mining company. They bought Nvidia graphics cards and power agreements and mined crypto expecting to make a return contingent largely on the price of Etherium (which after Bitcoin is the second-most-important cryptocurrency).

It turns out that the equipment they purchased and the power agreements they entered into were very useful for artificial intelligence. Moreover, they had solid orders for Nvidia chips which were on allocation[4].

So they became an AI business. They built data centres and leased the capacity to major players, mostly Microsoft.

They then levered themselves up to buy more Nvidia chips. They paid for some of this by selling equity to Nvidia who — to this day — own roughly 7% of the company.

This was a much-hyped though disappointing IPO. CoreWeave Inc. raised $1.5 billion, 40% lower than its initial target, and ended with a diluted valuation of $23 billion. The marketed price was $55 per share but the sale was at $40 per share.

Whatever. After the IPO it became a retail favourite. One retail investor with a large social media following observed that it was good to buy a stock that had unlimited demand for its product. The stock peaked at $187 a share — amazing given the IPO was dramatically scaled back only a few months ago.

The vendors were (as per usual) prohibited from selling stock for several months after the IPO. Wall Street professionals often short in advance of lockups expiring. And this was probably the most obvious lock-up expiring trade in many years — so there was a massive desire to short the stock.

Because of this the borrow cost in the stock market went as high as 200% and was above 150% for a couple of months. (At pixel time the borrow cost is now only 0.1%.)

You could — if you owned this stock lend it out at 150 percent per annum, or well over 10% per month, for at least a couple of months.

[4] Note that the constraint on AI data centre building was shortage of appropriate GPUs. A Google employee on one of the "expert networks" says this is no longer the constraint. On "Alphasense" the employee stated that the constraint is almost entirely the availability of electricity. This is important because whilst we have no position in Nvidia, these statements are broadly bearish for the most important stock in the current market.

Wall Street financial engineers don't leave coin on the table like that if there is a way of scooping some up. And there was a way. ETF providers started offering 2x levered Coreweave ETFs designed to deliver 2x the Coreweave return to unit holders.

These ETFs raised over $200 million. And they did not hold $400 million of Coreweave stock. Instead they invested in swaps that gave the returns of $400 million in Coreweave stock. Someone in the chain owned the stock — over $400 million worth of it — and they lent it out and hedged their risk by writing the swap to the ETF. They cashed over $40 million per month in lending fees. On our estimate they pocketed about $100 million.

It was an astonishingly profitable deal for the stock-lenders. It makes us wonder if we are in the wrong business. And they pocketed that fortune by providing what the customers really wanted: more leverage on the hottest of the hottest AI stocks.

This is the new normal on the stock market.

We could tell you other stories about the "new normal". The most told one is that OpenAI agreed to buy $300 billion in services from Oracle despite OpenAI having only $13 billion in revenue. That story, though, is plausible; OpenAI at least has a real product and real revenue.

Far sillier is what is going on in Korean stock-trading rooms. Stock and crypto trading is an esport, watched and imitated by adoring fans. This is amusing until you are short a nonsense stock with no obvious short interest that suddenly rises 4-5x because it is the new traded thing.

With 500-plus shorts we get hit by a lot of these arrows. None of the individual losses matter much — but when 40-50 things go wrong at once it can be painful.

The future

As we have stated, this is one of the few times where we find the longs and the shorts in our book simultaneously attractive. This should bode well for the future. One day we hope the lack of correlation in our book is for better and not for worse.

That said, we have to get through to the future — and that involves for the moment quite a lot of risk cutting. This market is actively hostile to us.

Longer term, we would like a better mathematical hedge to ensure that our long book is better correlated to our short book. We have not cracked it yet — but we think we have made some progress.

This hedge will require an active mathematical trading of perhaps a thousand different stocks. It works well in our back-tests but we are unsure of implementation and there is always quite a lot of slippage between back-test and implementation.

We hope and think it will work — but if it does work we will simply tell you what we have done without explaining details to you. We will remain as open as always on other matters of strategy and positioning.

Thanks for your support

John, Simon, and the Bronte team

Background to the flavours and fragrances industry — for the purposes of discussing Firmenich

The flavours and fragrances (F&F) business meets the pattern of many good businesses. It provides what we think of as "the trifecta".

- It provides a small but important part of big things
- It has high switching costs and
- It is a consumable.

Take, for example, the smell of Dove soap. You know it, and if I gave you a bottle of that fragrance you would recognise it instantly, even if you could not describe it. The brand is quintessentially linked to that smell — to the point that the smell is its defining characteristic.

Fragrance is probably only three percent of the production cost of Dove soap. But if it were not there the brand would fall apart.

It doesn't matter very much to Unilever whether the cost of the fragrance is 2% or 3% of the bill of goods. The gross margin is probably about 30%. But it matters terribly to the fragrance house because that is a 50% difference in pricing.

And because the brand is dependent on the fragrance, the fragrance house has pricing power.

In this case the fragrance house is the Swiss-French company Givaudan.

These days the flavours and fragrance business is dominated by the Swiss-French, almost to the point of cliche. What they are selling is the artistry of fragrance and taste, which seems very French. But they are also mass producing it and industrialising it at global scale — something that seems very Swiss.

International Flavors and Fragrances — the American flavour house

F&F has been a good business for a couple thousand years. The definitive luxury good in Europe from Roman times to the early 18th century was pepper. This made relatively bland food (especially in a northern European winter) more interesting. The spice trade was the most important in the world from medieval times until the rise of the Atlantic slave trade. The spice trade was the economic driver of the European age of exploration, and before that drove the Yuan dynasty trade — and later the Chinese "treasure ships".

The reasons are the same: a small but important part of a big thing, hard to substitute, and consumable.

By the mid-20th century, the problem was, packaged food and household goods were boring and needed to be flavoured and scented to sell well. The champion company in the space was an American giant called International Flavors and Fragrances (IFF).

IFF first came to John's attention in the late 1990s when he read his favourite stock market book (*Common Stocks and Uncommon Profits*). This was around the same time IFF was upended by two forces, one general to the industry and the other company-specific.

The general thing was that the growth rate — particularly in the developed world — slowed dramatically. From 1945 to 2000, supermarkets and packaged goods took over the Western world and volume grew at high single digits. By 2000, more or less everything was already "modern trade" and the growth rate slowed to low single digits in the developed world but remained high-single-digit in developing markets.

The second thing was company-specific: IFF had developed several proprietary fragrances (technically tetramethyl acetyloctahydronaphthalenes) and these allowed IFF to win many briefs — especially briefs that required woody fragrances, like a shampoo for men. Frankly, they are just winning products: When IFF licensed the product to another company, whoever they licensed it to won the brief.

These are now out of patent and sold under many brand names (most notably Iso e Super). Because of this winning product, IFF became fat and lazy. Then it was hit by the double-whammy of patent cliffs and declining industry sales growth.

They have spent a long time trying to right the business — but so far it has not worked. The stock is only up about 25% since 1998 when John first learnt about this business.

IFF has gone through eight[5] CEOs over 27 years trying to fix this business. Most CEOs were external hires, and there were many strategic changes in direction as CEOs came and went. Generally it was terribly managed, and had the underlying business not been excellent this level of mismanagement would have bankrupted the company.

We will come back later in this note to one of IFF's strategic changes of direction.

The rise and rise of Givaudan

A Swiss-French company originally spun out of Roche,later merging with the flavours business of Nestle, stepped into IFF's shoes. Givaudan was run for over twenty years by a single CEO (Giles Andrier) who is everything you would want a CEO to be. He is committed to technical excellence, operational excellence, and understanding the needs of clients and sales.

These days there are a plethora of new brands and product variations driven by social media and the endless need to renew and innovate on old brands — and Givaudan has provided the tools necessary to produce this product.

The industry also became increasingly technical. It is now commonplace to make rare or difficult-to-find fragrance ingredients recombinantly (i.e. using genetically-modified

[5] Eugene Grisanti, Richard Goldstein, Arthur Martinez (interim), Robert Amen, Douglas Tough, Andreas Fibig, Frank Clyburn, , Erik Fyrwald.

bacteria). Recombinant ingredients are often much cheaper (and environmentally less destructive) than natural ingredients — but they can also be made without the allergenic properties of some of the natural ingredients. *The recombinant product is cheaper and better*.

Frankincense, for example, is a rare aromatic resin from trees that grow in remote places (often on cliffs where you need to abseil) in arid areas of Somalia and Yemen. It was of such high status that in the Bible we learn that the infant Jesus was greeted by wise men bearing frankincense, myrrh and gold to anoint him as a king.

These days, whilst some frankincense is sourced, the ingredients are now produced recombinantly.

Givaudan diversified into adjacencies. For instance they make hyaluronic acid (HLA) recombinantly. HLA is one of the rare active ingredients in face cream that works — that is, it reduces the visible appearance of wrinkles.

But in all cases they kept to the vision of providing technical products that were small but essential components of big things.

We are a little puzzled by Givaudan lately though. Giles Andrier is retiring and the company is appointing an outsider — in this case someone from Danone (the yogurt maker). Usually you appoint an outsider to shake things up when things are not going well — and there is little evidence that Givaudan is travelling badly.

The stock is not cheap. EBIT margins have been high teens for most of the last twenty five years. Margins have never been above twenty percent. The stock is priced at 4.6 EV to revenue. This makes sense only if you think Givaudan will continue to grow sharply.

Firmenich

Firmenich is another Swiss-French F&F company — and is traditionally the number-three player in an oligopolistic industry. (The leaders are Givaudan and IFF.)

Firmenich, however, was until recently a black box. It was a privately-held Swiss company with several generations of heirs numbering well over 100.

Many of these heirs were dependent on dividends from the family company to support what ranged from moderate to extremely affluent lifestyles.

A bit over a decade ago Firmenich management made the shocking realisation that they were falling a long way behind Givaudan on many technical matters — and that they ultimately needed to solve this or slink into irrelevance.

This involved spending a lot of money. They purchased several technical companies — for example, they purchased Senomyx, a US-listed company that genetically modified human stem cells to mimic human taste buds. This allows Firmenich to see what a flavour tastes like (sweet, sour, salty, umami etc) without tasting it — and allows the development of flavours without testing for safety first.

They also hired serious scientists. The chief scientist is an American, Dr. Sarah Reisinger, who had previously worked at Ginko, Intrexon, and Amyris.[6] She has had a career making rare ingredients recombinantly.

They have demonstrated several products. For instance, they have a recombinant version of patchouli that has removed the key allergens. John, who has a mild reaction to patchouli, can confirm this works. If he sniffs patchouli he has a tingling sensation in his nose and lips for about an hour. If he sniffs the recombinant stuff there is no reaction.

Patchouli is a cheap fragrance, and is the dominant fragrance in the laundry industry because it is cheap, effective, and readily available. There is not likely to be much (if any) cost advantage in making it recombinantly. But it does demonstrate competence.
Going out on a limb though, and with our patchouli-price reservation in mind, we think that Firmenich's spending mostly worked. The company has demonstrated many products like the recombinant patchouli, and has a larger library of scent ingredients than Givaudan and IFF.

The spending did, however, have a negative effect. It restricted the dividends that the then-private Firmenich could pay. Lower dividends impacted the lifestyles of many Firmenich heirs and (understandably) was not popular amongst some shareholders.
This, however, is a key assertion about where the company is: We think it is now the technical leader in fragrances (not flavours) and that this should generate supernormal returns in future.

In the industry, the order is usually assumed to be (for flavours):

1. Givaudan
2. IFF
3. Firmenich
4. Symrise

And for fragrances:

1. Givaudan
2. Firmenich
3. IFF
4. Robertet or Symrise.

[6] For reference, we were profitably short all three companies where Dr. Reisinger had worked. In all cases they were science experiments with real scientists and less-than-wonderful management. The only worthwhile revenue model these companies ever developed was outsourced (often recombinant)manufacturing of products for the fragrances industry.

If you boil the fragrance business down to its biggest component (fine fragrances and laundry), you could argue that the leader is Firmenich. I think if you look at the ingredient palette Firmenich is the leader.

Flavour growth vs fragrance growth

One little background thing you need for interpreting the numbers is that for most of the past 15 years flavours have grown faster than fragrances. There was a reason: it is hard to sell fragrances online. Moreover, the "selfie generation" is very keen on makeup and appearance but less keen on smell. You can't smell a selfie.

This has changed somewhat since Covid. During Covid the fragrance industry started selling fine fragrances online to people who never smelled them. We are not marketing people and can't really explain how it is done but somehow influencers in social media achieved this.

IFF's blunder with DuPont.

Over a quarter-century of mostly mismanagement IFF made many strategic mistakes — the biggest of which was the acquisition of DuPont's Nutrition & Biosciences Business. This sold technical products such as stabilisers and emulsifiers for the food industry. Many were enzymes (proteins which act as catalysts) and were recombinantly manufactured. Some of the manufacturing technologies looked a lot like what was developed at Givaudan.

The acquisition price was $26.5 billion — versus IFF's current market cap of $16 billion, or EV (market cap plus debt) of $22 billion. The market has cast its verdict on this deal <u>and it did not like it</u>.

The elevator pitch at the time was that the new products in the industry were products of social media — as if, say, Kim Kardashian was trying to market breakfast cereal. She could not make the cereal — and IFF would provide a one-stop shop where all the technical ingredients in modern packaged food were assembled. IFF appeared to think the ingredients that prevent the flakes sticking to the oven could be marketed with the same *je ne sais quoi* as the cereal's taste and smell.

Wall Street initially believed in this idea and there was a big push for Givaudan and Firmenich to merge with technical ingredient companies else they be left behind.
We think that Firmenich bought this pitch — at least in part. Givaudan most certainly did not. John shared a meal with Giles Andrier in this period and Andrier argued at length that it was a dumb idea. One business had 30% gross margins, 18% net margins, and highly technical sales; the other had 50% gross margins, 18%net margins and the sales people sold "art". The cultures, he predicted, would not match.

Andrier was right: The management goal of IFF became to reduce debt (often by asset sales) to a level which allowed a permanent separation of the two businesses. The investor relations team at IFF seemed to know nothing (and care less) for the DuPont business.
IFF became a forced seller of assets, some of which we think they would have been better off not selling. For example, they sold the highly innovative Lucas Meyer cosmetics, a

company we rank amongst the best providers of specialty ingredients to the cosmetic industry.

The pricing of IFF stock

IFF's stock has (deservedly) had a rough time of it. The stock now looks inexpensive. EV to sales is now 1.9 times. EBIT margins used to be about 20% (higher even than Givaudan) and the company did worthwhile research. At 1.9x sales and 20% margins — and with a bit of leverage — the stock would be 10 times earnings.

EBIT margins, however, are now high-single-digit. We think that they have been forced to sell much of the crown jewels (e.g. Lucas Meyer) and the stock is not obviously a good buy. We do think that EBIT margins should rise over time, though. The natural margin of both the IFF traditional business and the DuPont business should be well above 10%.

The American stock market slogan may be "buy it if earnings are going up, because the stock will go up regardless of valuation." In that case, long IFF might work for a while because earnings should start trending up — notwithstanding the very real problems IFF has.

Firmenich once may have believed in the IFF-DuPont merger

Whilst Giles Andrier never believed in mixing technical products and artistic products, other people did. Firmenich even reproduced the IFF merger, merging with another technical ingredient maker: listed Dutch chemical conglomerate DSM.

This merger, in turn, made Firmenich a listed company.

There is considerable question about why Firmenich did this deal. Ex-post the stated deal rationale makes no sense. Giles Andrier was right: the cultural differences between these businesses are way too strong to make them sensible bedfellows.

But Firmenich had another reason.

At Firmenich there was a great deal of displeasure in the family — especially because of the above-mentioned dividend cut. And many family members wanted to sell.

The family arrangements, however, required unanimity to sell the company in (say) an IPO — but only required a majority vote to sell the company to another company. So they chose to sell the company to another company.

Whatever. Management telephoned DSM on Friday and had an announced deal on Monday.

Our view is that DSM got a steal — an outright screamer of a buy — and the quality of that deal was precipitated by the Firmenich desire to sell.

BronteCapital

DSM — a note

The stock we own is DSM Firmenich. We were really interested in Firmenich — but as explained DSM Firmenich is how Firmenich got listed.

Moreover, we believe there was no valid rationale for the merger. The merger rationale was as false as the rationale behind the IFF-DuPont merger.

That said, it is necessary to understand what the DSM side of this business is about.
DSM is not the sort of stock we usually own. We tend to own operating businesses run by operating people rather than financial types. At best, we think us financial types are often the wrong people to run businesses. Sometimes we hold people like ourselves in contempt. Finance people think they have all the answers — and regularly don't.

DSM is a business run by financial wheelers and dealers. But for the most part they have been very good financial dealers.

The name DSM stands for Dutch State Mines — a state-owned coal-mining company. They played gin rummy swapping bad businesses for good business, and over time got this mostly right. Had they never played they would have gone to zero along with their coal mines. Everything you can see in the company is a product of financial wheeling and dealing.
By and large there is a trend here. All the companies have been, broadly defined, specialty chemical companies. These sell small parts of bigger things, hopefully with limited competition — and make money.

But specialty chemical as a moniker is a continuum. Some of it is delivered by the truckload and mixed with railcar amounts of chemicals. Some of it is magic pixie dust where a few kilograms produces enormous value. The jest is that good specialty chemical companies say your specialty is my commodity.

We are only interested in the true speciality end of this spectrum — which of course is where something like recombinant hyaluronic acid sits.

DSM has sold businesses and bought businesses moving deliberately towards more speciality products.

Over a long period of time this has worked, turning a truly awful business which should have been bankrupt into a highly valuable company.

To fund the cash portion of the Firmenich acquisition (3.5 billion euro), they sold their engineering materials business to Advent and Lanxess for 3.7 billion euro. This moved both DSM and Lanxess up the specialty-quality continuum.

What was left at DSM was a specialty ingredients business — a smaller competitor to the DuPont business bought by IFF — including an agricultural business and a wholesale vitamin business.

The agricultural business aspired to optimise feedstock for animals. Imagine you had some mush of rejected vegetables, sprouted or poor grain, and other stuff you were feeding to chickens. This mix will not be optimised for meat/weight gain by the chickens. You probably need to add certain amino acids (such as methionine) and some vitamins. DSM would provide you an optimisation supplement.

This was probably sold by the drum or the truckload to large chicken farms. It was somewhere on the "specialty spectrum," but not at the very good end of it. This is no recombinant hyaluronic acid, which could be put in $70-per-tub facecream, allowing L'Oreal to convincingly say that their product reduces the appearance of wrinkles.

It wasn't an awful business, but then again, it hasn't been great lately, either. This business is going to be better when the price of meat is high relative to the price of grain and feed-lot farming is profitable. That is not now, although at pixel time the economics are getting marginally better.

There was a vitamin business there too. Some of the vitamins were sold wholesale to people who packaged vitamin pills. Far more wound up in the optimised feedstock for animals. Either way this business has been commoditised. The Chinese make this product cheaply and well — and competing against them has not been much fun.

So the other businesses of DSM, which used to have high-teen margins, have had falling margins; and the vitamin business has produced losses. Given that the business should produce high-teens margins in good times and mid- to low-teens margins in bad times, it should be worth well over 1x sales and reasonably 1.5x sales. The highest-value bit of this — which was enzymes (sometimes made recombinantly) to optimise feedstock — was sold to their partner Novazymes (now Novonesis). Novazymes is the global leader in making specialty recombinant enzymes.

How do you value DSM Firmenich

We have puzzled over how to value this company because there are so many moving parts. But our instinct is to do it as a sum-of-the-parts.

There is 12.8 billion euro in revenue. Just shy of 4 billion (and growing fast) is the perfumery and beauty business. Remember things have started going right for the perfume business because:

1. People have cracked how to sell perfume online and via social media influencers; and
2. Firmenich now has what we believe is a technical lead.

If you put this on the same multiple of sales as Givaudan (4.6x) you get 18.4 billion. The market cap is only just above this — and the rest of DSM is free.

We think Givaudan is probably overpriced — but we think that Firmenich's perfume and beauty business is sales dollar-for-sales dollar better than Givaudan. We think they have a technical lead and we can measure that. We think over time that will translate into better margins.

On top of this is a flavours business. It is unfortunately aggregated with some texture business (similar to the DuPont businesses at IFF) and it is aggregated as taste, texture and health. The full segment has 3.2 billion euro in revenue — and if you take off the vitamin business (which may be worth very little), there is still well over 2.5 billon euro in high-value revenue here.

There is the animal feed business. We would be surprised if that were worth only 1x revenue — but the business is broadly for sale and the supposed acquirers have been mooting prices that low.

The whole enterprise has an EV-to-sales at 1.6 times and most of the business has traditionally had margins above 16%. No matter how we add it up, this is inexpensive. It will wind up being 11 times earnings or better very quickly.

Moreover, the management seem highly rational. They are high-grading their business, selling some animal products businesses and mostly buying back their own stock. These gin rummy–playing managers from business schools, rather than operating companies, are good for something.

There is almost no debt. The company is very conservatively managed.

We love the stock. We do not see how you can lose from here. Obviously others differ. There are two reasons we can see why people are selling the stock. Firstly, a lot of it is in the hands of Firmenich family members — and many of them are upset with the company and management for reasons discussed elsewhere in this note.

Secondly, the company has a show-me problem on earnings growth. One small segment (vitamins) is a disaster area — and that has polluted the aggregate.

There is a large disclosed short interest in the company. We have made some effort to reach out and learn why they are short, but got no response. We are very happy to talk to them. As noted, we thought this stock was a steal at 2.1x sales and it is now 1.6x sales — so we have not been right so far.

Maybe they are right and we are wrong. So if you know them (they are Ilex Capital in London), please put us in contact.