



# VMS CDMO Market

## Assessing Key Value-Drivers in a Dynamic Market

September 2023

These materials are intended to supplement a discussion with L.E.K. Consulting. These perspectives will, therefore, only be meaningful to those in attendance. The contents of the materials are confidential and subject to obligations of non-disclosure. Your attention is drawn to the full disclaimer contained in this document.



# Within the large and growing U.S. nutritional supplement market, the VMS CDMO market is an attractive investment opportunity with strong market fundamentals

## Market fundamentals



- The U.S. nutritional supplement market is large (~\$61B RSP in 2022) and is expected to continue growing, driven by several factors such as the growing interest from the next generation of consumers (e.g., millennials, Gen Z) and product innovation
- Gummies, liquids and other **non-pill formats** have historically outpaced overall market growth; expansion of formats has increased the need for CDMOs' manufacturing expertise

## Customer dynamics



- VMS CDMOs serve **multiple customer segments**, each with different priorities and propensities to outsource VMS production
- **Outsourcing to CDMOs is expected to increase** due to increased regulations, manufacturing expertise, & speed to market

## Competitive landscape



- The **CDMO competitive landscape is fragmented**, segmented largely by modality type (e.g., tablets, gummies) and breadth of services
- As contract manufacturers aim to gain scale and breadth to better serve customers' needs, the **desire to serve as a one-stop shop has continued to push consolidation**

## Investor implications



- **Investor interest in the space has been high**, contributing to **high deal valuations**, with many recent deals focused on companies that offer format differentiation (e.g., gummy), in-house R&D, customer lists that include access to growth brands, and turnkey capabilities

# The U.S. Nutritional supplement market is large (~\$61B) and grew at record rates during COVID before slowing down in 2022; growth is projected to approach pre-COVID rates by 2024

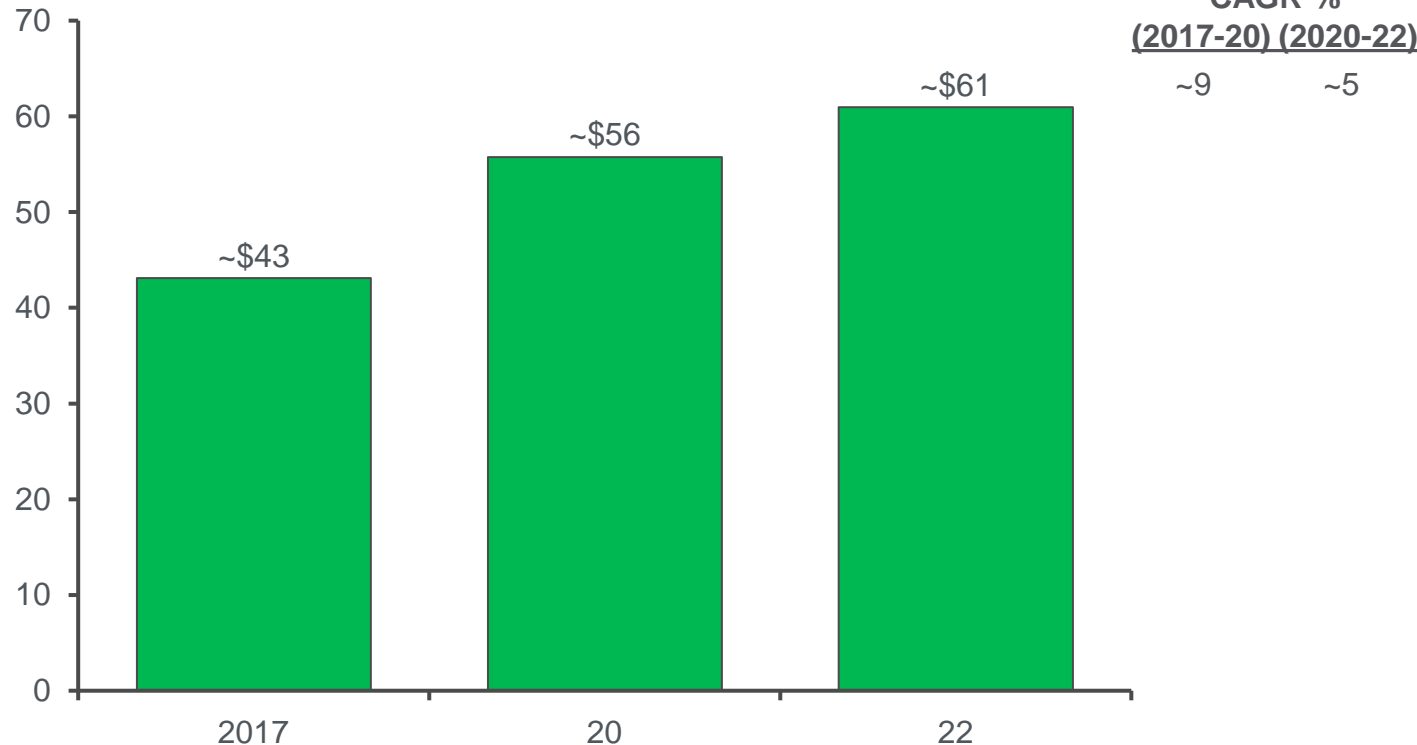


## Market fundamentals

### U.S. nutritional supplement market size\*

(2017-22)

Billions of USD (\$RSP\*\*)



- Nutritional supplement sales in the U.S. have **historically experienced mid-single digit annual growth**; however, during the **pandemic, sales increased substantially** as consumers focused on their health and well-being
- Even after record pandemic-driven growth in 2020, **sales continued to grow in 2021**. However, in **2022, the market normalized**, driven by **inflation** and other economic concerns
- Market participants expect **growth to approach pre-COVID projections by 2024**

“... Coming off the record growth in 2020, NBJ had projected a normalization in 2022, but the reality of the year was a further slowdown than anyone had previously anticipated ... Even with this slowdown, NBJ expects sales will be back on track with pre-COVID projections by 2024 and pulling back ahead by 2025 ...”

- Nutritional Business Journal, April 2023

Note: \*PR Newswire press release based on NBJ data \*\*Retail sale price

Source: NBJ; PR Newswire: “Supplement market more than \$5B higher than pre-pandemic expectations, according to NBJ’s 2022 Supplement Business Report”; L.E.K. research and analysis

# There are several enduring trends that are expected to continue driving U.S. VMS growth

## Market fundamentals

### U.S. VMS market: Growth trends

| Trend                  | Commentary   |
|------------------------|--|
| Secular                | <b>1 Aging demographics</b> <ul style="list-style-type: none"> <li>Older consumers have the highest frequency usage of supplements, and an aging U.S. population (50+ expected to grow at 1.1% p.a. from 2020-30 vs 0.7% p.a. for overall population) will continue to grow at the VMS consumer base</li> </ul>  |
|                        | <b>2 Millennial and Gen Z segment growth</b> <ul style="list-style-type: none"> <li>Millennials have the highest average annual VMS spend and have experienced faster median earnings growth than older generations (4.5% p.a. for millennials vs &lt;3% p.a. for boomers), making them strong contributors to VMS growth</li> <li>Gen Zers are increasingly entering the category driven by the proliferation of digitally native brands and increased social media presence</li> </ul>   |
|                        | <b>3 Growing focus on health and wellness</b> <ul style="list-style-type: none"> <li>The COVID-19 pandemic and increasing prevalence of chronic health conditions are contributing to a shifting consumer mindset towards prevention and purchases of supplements; there was a 7 percentage point increase in percent of the population that consumed dietary supplements from 2020-21</li> </ul>  |
| Consumer trends        | <b>4 Growth of digitally native brands</b> <ul style="list-style-type: none"> <li>Digitally native brands have been growing (Amazon sales of VMS have increased at 25% p.a. from 2019-23), and they have used social media heavily to engage potential consumers and broaden the VMS category's exposure and appeal; this has led to increased awareness of the category, especially among younger generations</li> </ul>  |
|                        | <b>5 Experiential well-being</b> <ul style="list-style-type: none"> <li>Condition-specific supplements, which have become more prevalent broadly within the VMS market, are increasingly permeating into experiential well-being applications, such as sleep, stress, mind and mood, cognition, thus enabling VMS extension to a broader consumer population</li> </ul>  |
|                        | <b>6 Clean label</b> <ul style="list-style-type: none"> <li>Within VMS, consumers are increasing seeking clean label and other health attributes (e.g., organic, non-GMO) and many are willing to pay a premium for these products, driving premiumization within the market</li> </ul>  |
| Product / brand trends | <b>7 Innovation</b> <ul style="list-style-type: none"> <li>Product formats: Consumers continue to seek non-pill formats such as gummies, liquids, and single-serve powders (e.g., stick packs), which are easier and/or more enjoyable to consumers</li> <li>Ingredients: VMS companies are becoming more innovative with their use of natural ingredients such as Ashwagandha, broadening VMS's appeal among consumers looking for more natural or herbal remedies</li> <li>Science-first: Brands such as Thorne and Nutrafol are taking a science-first approach as consumers are increasingly seeking more scientific evidence of efficacy (e.g., clinical trials)</li> </ul> |

Source: L.E.K. research and analysis

# Experiential well-being and women's health segments are among some of the sub-markets that are projected to outpace broader market growth

## Market fundamentals

### Faster growing areas within nutritional supplements

#### Experiential well-being

**Sleep:** A significant portion (~30%) of U.S. adults experience insomnia, leading to higher demand for sleep support

**Mood and mental:** Growing rates of anxiety, depression, and awareness of stress and mood management have been tailwinds

**Brain health:** An aging population coupled with increased awareness of cognitive health VMS offerings has driven demand for this segment

#### Women's Health

Recent interest in women's health has been exacerbated by heightened awareness/education, product innovation, the rise of digitally native brands, a broader preventative health movement, and societal trends decreasing the taboo nature of certain women's health (e.g., UTIs, menopause, sexual health, beauty)



#### Microbiome Health

Tailwinds from increasing consumer awareness/interest in digestive health, innovations in microbial research & digestive supplements, and a shift towards personalized nutrition provide an opportunity to capitalize on microbiome health (e.g., probiotics, prebiotics, immunity support)



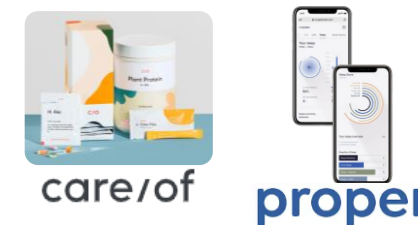
#### Beauty from Within

Heightened demand for organic and natural sources from the health-conscious aging population and a greater focus on holistic skin health has led to a growing interest in nutricosmetic products (e.g., collagen hair vitamins, biotin, Omega-3)



#### Personalized Nutrition

Given a renewed consumer focus on self-care and accelerated awareness of personalized services, brands are investing in the space (e.g., AI driven recommendations, online quizzes, tele-health consultations, digital tracking apps, personalized supplement subscriptions) to create more personalized solutions








Source: Forbes Health, NBJ, Nutraceuticals World, New Hope Network, L.E.K. research and analysis



# CDMO market growth is expected to outpace the broader VMS market as manufacturing is increasingly outsourced to reduce regulatory burdens, increase speed to market, and manage complex products



## Customer dynamics

|  |   |
|--|---|
|  <p><b>Reduces regulatory compliance burden</b></p>   | <p><i>The FDA has increased VMS manufacturing requirements and inspections with the development of the Office of Dietary Supplement Programs which will likely lead to greater outsourcing to CDMOs</i></p> |
|  <p><b>Provides manufacturing expertise</b></p>       | <p><i>For all customer types, CDMOs provide an attractive option with their manufacturing expertise in R&amp;D, sourcing, testing, formulation, and production across modalities</i></p>                    |
|  <p><b>Enables focus on core competencies</b></p>     | <p><i>Outsourcing work to CDMOs frees up internal resources to focus on critical drivers of revenues (e.g., ideation, marketing, sales)</i></p>   |
|  <p><b>Increases speed to market</b></p>              | <p><i>Enables customers to swiftly test product concepts and move quickly from idea to finished product when they lack the robust internal manufacturing capabilities to do so</i></p>                      |
|  <p><b>Allows for excess/spillover capacity</b></p> | <p><i>VMS brands that cannot handle the full capacity of production demands may outsource to CDMOs who can manage larger order quantities</i></p>   |

# VMS CDMOs serve multiple customer types with propensity to outsource differing for each major segment; MLM/specialty and private label brands account for the majority of VMS outsourcing



## Customer dynamics

### U.S. VMS market, segmented by customer type

#### Integrated manufacturers

- Vertically integrated companies that manufacture the majority of their own products
- Typically utilize external CDMOs for a select modality or capacity needs to supplement in-house capabilities

Example brands:



Propensity to outsource:

Low (30-40%)

#### MLM and specialty brands

- Branded companies that outsource formulation, sourcing, manufacturing, and packaging for most/all products
- Value CDMOs that offer order flexibility, short lead times and have robust/innovative R&D capabilities

Example brands:



Propensity to outsource:

High (75-85%)

#### Private label brands

- FDMC/ecommerce retailers that sell their own private label brand alongside branded competitors
- Retailers almost always outsource formulation & manufacturing given their lack of manufacturing expertise

Example brands:



Propensity to outsource:

Very High (90%+)



# Broader market trends such as increasing VMS regulations, growth of digitally native brands, and expansion of innovative formats are impacting brands' higher propensity to outsource to CDMOs



## Customer dynamics

### Trends impacting outsourcing propensity



#### Increasing VMS regulations

- Regulatory agencies are setting increasingly stringent requirements for approval, including the need for independent lab testing apart from the CMO
- International regulatory agencies have also set stricter requirements for VMS products, forcing manufacturers to adapt to these new standards or stop selling to certain global markets entirely

*Dynamic*



#### Growth of digitally native brands

- Digitally native VMS brands have increasingly emerged in recent years, selling DTC/on Amazon, with a focus on brand identity & marketing, and a higher likelihood to outsource manufacturing



#### Expansion of innovative formats

- Non-pill formats (e.g., gummies, liquids) have gained significant share of supplement sales in recent years, increasing the need for brands to manufacture across modalities

- Increasingly complex requirements from governing bodies will make regulatory compliance more difficult, resulting in higher outsourcing rates to CDMOs who have the expertise and personnel to keep up with regulatory changes

*Impact on CDMO outsourcing*

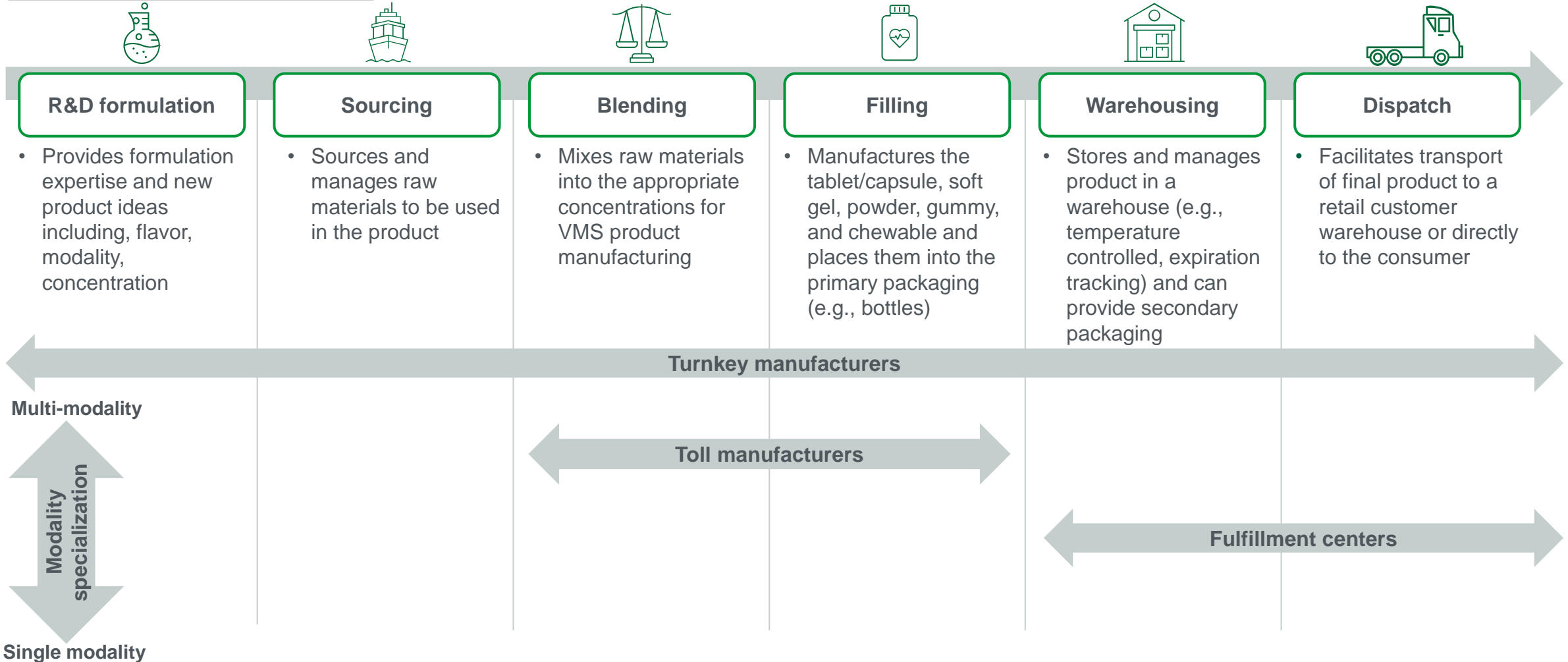
- Digitally native VMS brands often do not have manufacturing capabilities and rely on CDMOs

- With higher demand for emerging VMS modalities (e.g., gummies, liquids), brands have increased their propensity to outsource as they don't have the internal capabilities across modalities

# The VMS contract manufacturer space is very fragmented with most players offering multiple services and modalities to customers, with several of the larger players offering a broad suite of solutions

## Competitive landscape

### VMS contract manufacturer services



Source: L.E.K. research and analysis

# The industry continues to see consolidation, as contract manufacturers look to gain scale and breadth to better serve the needs of customers

## Competitive landscape

### Customer preference for one-stop-shops

- Consolidation has, in part, been driven by customer preference for **working with CDMOs** that can produce products **across various modalities**
- Small brands want to **reduce vendor management time** and **volume risk concerns**, whereas large brands care about **mitigating capacity risk** through a broader supply base

### Consumer demand for innovation

- Consumers are demanding **increasingly sophisticated products** to support their health & wellness goals
- **Many capabilities** around the **latest science**, **access to new ingredients**, **better delivery format technologies** and **improved efficacy** can be **acquired through a CDMO** that has narrow and deep expertise versus created in-house


# Recent transactions of contract manufacturers have primarily been driven by players already in the VMS space looking to gain capacity or capabilities

## Competitive landscape

### Transactions within U.S. VMS contract manufacturing (2021-22)






| Target   | Acquirer  | Date      | Target details   | Acquirer details   |
|--|---|-----------|--|--|
|  USPharmaLab<br><i>Innovative Natural Solutions</i> |  Biofarma<br>group                   | May 2023  | US Pharma Lab is a fast-growing and innovative CDMO that specializes in the custom development, manufacturing and distribution of nutraceuticals (e.g., vitamins, minerals)  | Biofarma Group is a global CDMO with six manufacturing sites and five R&D labs where they develop, produce and package supplements, probiotics and cosmetics   |
|  BEST<br>FORMULATIONS                               |  SIRIO                               | Jul. 2022 | Best Formulations is a contract manufacturer of products including nutraceuticals and dietary supplements; the company also offers services including packaging and formulation development  | Sirio is a global nutraceuticals contract manufacturer for the supplement industry, with global operations, development, and manufacturing capabilities spanning most dosage forms, including soft gels                        |
|  HEALTH WRIGHT<br>PRODUCTS                          |  iff                                 | Apr. 2022 | Health Wright Partners is a contract manufacturer of products in capsules and has been manufacturing IFF's probiotics products for years   | IFF is a multinational conglomerate that merged with DuPont health and wellness divisions in 2020 expanding its offering in Health & Biosciences probiotics and natural extracts/botanicals                                    |
|  bettera<br>brands                                  |  Catalent                            | Aug. 2021 | Bettera Brands is a private label and branded manufacturer of gummy vitamins   | Catalent is a multinational corporation and global provider of delivery technologies, development, drug manufacturing, biologics, gene therapies, and consumer health products   |
|  CAPSTONE NUTRITION<br>LIFE IMPROVED               |  INW<br>(Backed by Cornell Capital) | Jun. 2021 | Capstone Nutrition manufacturers vitamins, supplements, and general wellness products  | INW is a manufacturer of dietary supplements, sports nutrition, and personal care products, providing contract manufacturing, product development, and formulation using automated processes                                   |
|  FoodScience                                      |  WIND POINT PARTNERS               | Mar. 2021 | FoodScience provides formulation and private labeling for vitamins, minerals, probiotics, and other product offerings; the company also provides contract manufacturing for modalities including tablets, soft gels, powders, and creams | Wind Point Partners is an American private equity firm focused on growth capital investments and leveraged buyouts in middle-market companies across the consumer products, industrial products, and business services sectors |

Source: Capital IQ; Company websites; Highlander Partners; Nutra Ingredients-USA; L.E.K. research and analysis

|   |                                    |
|---|------------------------------------|
| <b>Key:</b>   |                                    |
|  | Target acquired by CMO/corporation |
|  | Target acquired by PE              |

## Investor interest in the space has been high, with many recent deals focused on companies with format differentiation, in-house R&D, customer lists with high-growth brands, or turnkey capabilities

### Investor implications

-  **Diverse customer list** with a mix of **long-term relationships** & track record of attracting **emerging brands**
-  **Exclusivity agreements** with customers or **difficult-to-replicate formulas** to minimize churn
-  **In-house R&D** that acts as an **external innovation engine** for customers
-  **Value-add capabilities** (e.g., turnkey, R&D) that enable **strong gross margins** above category players
-  **Track record of growth and stability** with demonstrated ability to **absorb macro shocks** (e.g., input pricing volatility, inflation, etc.)

# The VMS CDMO market has attractive fundamentals and potential value creation opportunities for prospective investors

## Investor implications

### Key reasons to invest

- ✓ **Large and growing** underlying VMS market
- ✓ Segments, such as **non-pill formats** (e.g., gummies, liquids) or **experiential well-being** product categories (e.g., sleep, mind and mood) have **above average market growth**
- ✓ Brands are **increasingly outsourcing to CDMOs** due to factors such as increased regulation, CDMOs' expertise, and speed-to-market
- ✓ The **highly fragmented** competitive landscape **creates opportunity for roll-up M&A**

### Ways to create value

- ✓ Creating **one-stop-shop solutions** for customers across a breadth of modalities and/or service offerings
- ✓ Investing in sales infrastructure to **acquire new customers** as VMS is a dynamic market and having a pipeline of new business as consumer preferences evolve is critical
- ✓ Investing in a team that is focused on **improving efficiencies, capacity utilization, and customer management/prioritization** to maximize gross margins
- ✓ Driving efficiencies through **supply chain optimization** and scaled **back-office operations** (e.g., HR, Finance, IT)
- ✓ Introducing **AI-powered solutions** to potentially streamline more manual aspects of business (e.g., quoting, sourcing, QA)

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See subsequent pages to learn more about L.E.K. Consulting and Houlihan Lokey

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**Expertise in:**



Strategy



Commercial growth



Performance improvement



Mergers & acquisitions

 **Established**  
in 1983

 **21**  
offices

 **~200**  
partners

 **~2,200**  
staff





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Worked with **all 3** of the largest **VMS specialty** retailers & brands

# Houlihan Lokey is a leading global advisory firm and the #1 M&A Advisor in U.S. Consumer, Food & Retail



## #1 Global Advisory Firm

### Corporate Finance

- No. 1 Global M&A Advisor Under \$1 Billion
- Leading Capital Markets Advisor Raising Approximately \$25 Billion Over the Past Two Years

| 2022 M&A Advisory Rankings<br>Global Transactions Under \$1 Billion |            |  |
|---|------------|--|
| Advisor   | Deals      |  |
| <b>1 Houlihan Lokey</b>   | <b>381</b> |  |
| 2 Rothschild  | 369        |  |
| 3 JP Morgan   | 217        |  |

Source: Refinitiv. Excludes accounting firms and brokers.

### Financial and Valuation Advisory

- No. 1 Global M&A Fairness Opinion Advisor Over the Past 25 Years
- 1,000+ Annual Valuation Engagements

| 1998 to 2022 Global M&A<br>Fairness Advisory Rankings |              |  |
|---|--------------|--|
| Advisor   | Deals        |  |
| <b>1 Houlihan Lokey</b>                               | <b>1,232</b> |  |
| 2 JP Morgan   | 1,030        |  |
| 3 Duff & Phelps (Kroll)                               | 938          |  |

Source: Refinitiv. Announced or completed transactions.

### Financial Restructuring

- No. 1 Global Restructuring Advisor
- \$3.0 Trillion of Aggregate Transaction Value Completed

| 2022 Global Distressed Debt &<br>Bankruptcy Restructuring Rankings |           |  |
|--|-----------|--|
| Advisor  | Deals     |  |
| <b>1 Houlihan Lokey</b>  | <b>58</b> |  |
| 2 PJT  | 30        |  |
| 3 Lazard   | 29        |  |

Source: Refinitiv.

### Financial Sponsors Coverage

- No. 1 Global Advisor to Private Equity Firms
- 1,000+ Sponsors Covered Globally

| 2022 Most Active Global Investment<br>Banks to Private Equity Firms |            |  |
|---|------------|--|
| Advisor   | Deals      |  |
| <b>1 Houlihan Lokey</b>   | <b>242</b> |  |
| 2 Lincoln International   | 192        |  |
| 3 Deloitte  | 190        |  |

Source: Pitchbook.

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### 2022 M&A Advisory Rankings All U.S. Consumer, Food & Retail Transactions

| Advisor                   | Deals     |
|---------------------------|-----------|
| <b>1 Houlihan Lokey</b>   | <b>21</b> |
| 2 Goldman Sachs & Co      | 18        |
| 3 William Blair & Co      | 17        |
| 4 JP Morgan               | 16        |
| 5 Lincoln International   | 13        |
| 5 Robert W Baird & Co Inc | 13        |

Source: Refinitiv. Excludes accounting firms and brokers.

**14**  
Locations  
Worldwide

**130+**  
CFR  
Financial Staff

**100+**  
Total CFR Deals  
Past Three  
Years

**600+**  
Cross-Border  
Transactions  
Since 2011



Bold denotes Consumer, Food & Retail (CFR) team



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*Transaction Pending*

**Qunol**<sup>®</sup>

has agreed to be acquired by

**sanofi**

Sellside Advisor

**Trufood**  
MANUFACTURING

has been acquired by

**MUBADALA**  
CAPITAL

Sellside Advisor

**LifeStyles** SINCE 1905 **SKYN**<sup>®</sup>

has been acquired by

**LINDEN**<sup>7</sup>

Sellside Advisor

**ARDIAN**

has acquired

**Biofarma**  
group

Financing Advisor and M&A Co-Advisor

**Deerland**  
Probiotics & Enzymes

has been acquired by

**ADM**

Sellside Advisor

**ARCADIA**  
CONSUMER HEALTHCARE

has been acquired by

**Bansk**

Sellside Advisor

**Zesty Paws**<sup>®</sup>

has been acquired by

**H&H Group**  
inspiring wellness

Sellside Advisor

**mommy's**  
**BLISS**<sup>®</sup>

has been acquired by

**SPC**  
SWANDER PACE CAPITAL

Sellside Advisor

**nuun**

has been acquired by

**Nestlé**  
HealthScience

Sellside Advisor

**SMARTY**  
**PANTS**<sup>®</sup>  
VITAMINS

has been acquired by

**Unilever**

Sellside Advisor

**care/of**

has been acquired by

**BAYER**

Sellside Advisor

**ZARBEE'S**  
NATURALS

has been acquired by

**Johnson & Johnson**  
CONSUMER INC.

Sellside Advisor

**Perrigo**

has sold its VMS business to

**IVC**  
INTERNATIONAL  
VITAMIN CORPORATION  
ENRICHING YOUR HEALTH

Sellside Advisor

**CAPTEK**<sup>™</sup> | Softgel  
International  
ENCAPSULATING QUALITY

has been acquired by

**SPC**  
SWANDER PACE CAPITAL

Sellside Advisor

**SANTA CRUZ**  
NUTRITIONALS

has been acquired by

**ROUNDTABLE**  
HEALTHCARE PARTNERS

Sellside Advisor

Note: Tombstones included herein represent transactions closed from 2013 forward

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