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PRESENTATION

Operator

At this time, I would like to welcome everyone to the International Flavors & Fragrances' third-quarter 2011 earnings conference call. All participants will be on listen-only mode until the formal question-and-answer portion of the call. Participants will be announced by their name and company. In order to give all participants an opportunity to ask their questions, we request a limit of one question per person.

I would now like to introduce Michael DeVeau, Investor Relations Manager. You may begin.



Michael DeVeau - International Flavors & Fragrances Inc. - Manager of IR

Thank you, Operator. And good morning, everyone. With me on the call today is Doug Tough, our Chairman and CEO; Nicolas Mirzayantz, our President of Fragrances; Hernan Vaisman, our President of Flavors; and Kevin Berryman, our Executive Vice President and CFO.

This call is being recorded and will be available for playback on our website. Please keep in mind that during this call, we will be making forward-looking statements about the Company's performance, particularly with respect to the fourth quarter and full year 2011. These statements are based on how we see things today and contain elements of uncertainty. For additional information concerning factors that could cause actual results to differ materially from forward-looking statements, I ask that you refer to our cautionary statement and risk factors contained in today's 8-K and 10-Q filings with the SEC, as well as our 2010 10-K filed on February 24, 2011.

Some of today's prepared remarks will discuss non-GAAP financial information, which excludes those items that affect comparability. These items are laid out in our reconciliation to comparable GAAP measures, which are also available on our website.

With that, I'd like to now turn the call over to Doug.

Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

Thank you, Michael. Good morning and good afternoon to everyone. Reviewing our quarterly results, our category, customer, and geographic diversity once again supported local currency sales growth in the third quarter. Our Flavors business, led by our Health and Wellness portfolio and double-digit growth in the emerging markets, continued to outperform the industry and gain market share.

In Fragrances, results were pressured by a challenging year-ago comparison, price-driven volume declines in ingredients, and a general weakening of our more discretionary categories such as Fine Fragrance and Beauty Care. Focusing specifically on ingredients, sales declined 15% year-on-year, as price increases to protect margin had an adverse effect on our volumes. The impact on our top-line performance was pronounced, roughly a 300 basis point drag on fragrance sales and a 150 basis point impact on total Company sales growth, as ingredients accounts for approximately 20% of Fragrance sales and 10% of overall total Company sales.

It should also be noted that while we communicated in early September that we expected Q3 sales growth would be similar to Q2 levels, macroeconomic and global market instability throughout the month hurt overall volume performance in our discretionary categories. Fortunately, from a profitability perspective, the discipline of our organization in the areas of pricing and cost control continued to yield benefits.

While gross margin was under pressure due to higher than anticipated raw material costs, we were successful in achieving sequential improvements in pricing -- over 3 percentage points during the quarter and a gain captured the benefits from our European restructuring. In addition, our cost discipline, including the benefit of lower incentive compensation accruals and favorable foreign exchange, allowed us to deliver a 4% increase in adjusted operating profit and a 2% year-on-year increase in adjusted earnings per share.

While quarterly results are important scorecards, performance over a longer period provides insight into how well an organization is executing its strategy. I would therefore like to provide a few overview comments on the past nine months of 2011.

From a local currency sales basis, all regions and all categories, with the exception of fragrance ingredients, were positive, despite comparing to very strong growth rates in the prior-year period. While gross margin was under pressure due to significant raw material cost inflation, our ability to increase prices and to capture and execute on important cost control initiatives, including



our restructuring savings, allowed us to deliver 12% adjusted operating profit growth and a 70 basis point improvement in operating profit margin. Extending our performance beyond 2011 to incorporate a two- and three-year perspective, including the volatility of 2009 and '10, you will see that our financial results remain strong, as top-line adjusted operating profit and adjusted EPS growth are all in line with our long-term financial targets.

Before we review the full details of our Q3 performance, I'd like to provide an update on our strategic initiatives. As communicated at our Investor Day in March of this year, our fundamental business strategy is predicated on three strategic pillars -- leveraging our geographic reach; strengthening our innovation platform; and maximizing our portfolio. As population growth and wealth creation in the emerging markets continues to increase, our geographic portfolio has not only laid the foundation for our success, it is a key element in our aspirations as a global growth company.

In these markets, strong GDP growth and a significant expansion of the middle class consumer, are driving the demand for our customers' products. As such, through the first nine months of 2011, our top-line performance in these emerging markets has grown high single digits. In addition to the four creative centers we added in Shanghai, Sao Paulo, Moscow and Mumbai over the past years, we are making significant progress on the construction of the two manufacturing sites in China and Singapore, which we announced earlier this year.

In addition, to improve our collaborations with our customers in the Middle Eastern region, we have just announced the opening of a new office and laboratories in Dubai. From an innovation standpoint, our renewed focus has been instrumental in driving new business wins in 2011. Separately, in 2012, we expect to bring to market a new technology in the Flavors business that provides a real improvement in the taste profile of many common applications. Beyond that, in Fragrances, we believe the development and commercialization of new ingredients, as well as innovative delivery systems, should provide a strong pipeline for the future.

Finally, we are having success implementing various solutions, including price increases, supply chain initiatives, and resource allocation to improve the underperforming parts of our organization. As expected, we have also begun to exit some low-margin businesses throughout the first nine months of 2011. While the impact was small, approximately \$4 million in sales, it is an important part of our strategy to focus on advantaged categories. Going forward, we do expect this number to increase as we enter 2012.

Once Nicholas, Hernan, and Kevin conclude their prepared remarks, I will give you some perspective on our outlook for the balance of the year, and then we'll take any questions you may have. With that, I would now like to introduce our Group President of Fragrances, Nicolas Mirzayantz.

Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

Thank you, Doug, and good morning and good afternoon, everyone. Compared to a 15% increase in the prior year period, local currency sales declined 5%, as new business wins and pricing benefits were more than offset by volume declines on existing business. It should be noted that while volume declines on existing business are typical in the fragrance industry, due to the evolution of the portfolio, the year-over-year decrease this quarter was greater than historical averages, as we compared to the 2010 period where volumes were actually up.

In Fine Fragrance and Beauty Care, local currency sales declined 4% against a very strong 24% growth rate in Q3 2010, as new business wins and price increases were more than offset by volume declines with existing customers. Our EMEA and Latin American regions were once again pressured the most, as we cycled with 20% growth rate in EMEA and a 54% growth rate in Latin America in 2010. Volume growth on existing business in these regions was very strong in Q3 2010, causing significant year-over-year pressure this year, particularly in Latin America where volumes were up an unprecedented 20%.



Functional fragrance results were similar to a year ago level, as new business wins, the realization of price increases, and continued success in the Home Care and Fabric Care categories, balance out volume declines. From a geographic perspective, North America continued to perform well, growing 3%, as Home Care achieved very strong double-digit growth. Fragrance ingredients was most challenged, as we took strategic price increases to protect margin from rising raw material costs. Unfortunately, the adverse effect on volume was greater than historical correlations, and therefore, had a greater impact on our results. It should be noted that top-line performance for our Fragrance compound business, which excluded 300 basis point drive up in volume pressure, was similar to Q2 levels.

Looking at our performance over the course of the first nine months of 2011, incorporating the pressures of Q3, five of our seven subcategories were positive despite very strong double-digit comparables. Both Fine Fragrance in Beauty Care and Functional Fragrance were up 2% on top of a 25% and 9% growth rate, respectively, reported in the prior-year period. The area where we have seen pressure has been ingredients. However, we fundamentally believe that our strategic price increases are best for the long-term health of our business.

From a geographic perspective, the emerging markets continue to outperform the developed markets. Countries such as Brazil, Indonesia, Vietnam, Poland, and the Africa region, all reported growth on top of the very strong results they delivered last year. From a profitability standpoint, adjusted operating profit declined \$12 million, and adjusted operating profit margin fell 330 basis points to 15.7% versus the year-ago period.

We have made very good progress driving margin improvement initiatives such as price increases, restructuring savings, strict cost control, increased productivity opportunities, favorable mix in exiting low margin businesses; but unfortunately, the unprecedented rise in raw material costs and lower volumes have masked our performance. It is my belief that once we exit the inflationary period, however long it may last, we will be better positioned to drive our strategic initiatives and deliver profitable growth.

Looking ahead, we do expect top-line performance in the fourth quarter to remain under pressure, as we continue to experience price-driven volume declines in ingredients, and softness in our more discretionary categories such as Fine Fragrance and Beauty Care. However, we continue to be encouraged by our level of new wins and believe that our pipeline of new business, resulting from greater access to co-listings and large projects, as we partner more closely with our customers, should position us well as we enter 2012.

With that, I would like to introduce our Group President of Flavors, Hernan Vaisman.

Hernan Vaisman - International Flavors & Fragrances Inc. - Group President of Flavors

Thank you, Nicolas. Good morning and good afternoon, everyone. Marking [this as the] fifth consecutive quarter of growth, I'm happy to report that local currency sales in the third quarter grew 8%, led by a double-digit increase in Savories and a high-single digit increase in beverage. In North America, our capabilities in sodium and strict modulation once again drove high-single digit growth, a trend that has been ongoing for six straight quarters.

For the seventh consecutive quarter, our EMEA region continued to achieve at least mid-single digit growth. Once again, within the region, Eastern and Central Europe, Africa and the Middle East, all grew strong double digits. Western Europe also posted growth, as our innovative Naturals portfolio continued to provide us with a competitive advantage to win key new business.

In Latin America, all categories were positive, led by double-digit growth in confectionery and savory. On a country level, it is worth noting that we have seen trends in Mexico deteriorate, reactive to first-half performance, as consumers are being impacted by the economy. Fortunately, our results continue to be strong, led by our geographic diversity, as countries like Brazil, our largest Latin American market, grew double digits.



Last but not least, our best-performing region with the most dollar growth and percentage change was Greater Asia. Performance in this region sequentially improved from the second quarter, growing 10% as every category reported strong growth. Highlighted by beverage, we will achieve high-double-digit growth. Consistent with the previous two quarters, the impact of exiting low-profit business in the third quarter was approximately \$1.5 million. Going forward, it will be noted that we plan to exit additional businesses, specifically in 2012, as we believe exiting certain underperforming businesses is our best option to maximize shareholder value.

I expect the impact of exiting these businesses will be greater than what we exited throughout 2011. And therefore, believe that the quality of our sales growth going forward will be better, as we further develop our more profitable businesses. For the eighth consecutive quarter, our emerging markets business continued to grow double-digits. This performance was driven by the BRIC countries, including one extra I for Indonesia, where each country achieved a double-digit growth rate.

Turning to profits, third-quarter operating profit increased 13% or \$8 million to \$71 million, as accelerated sales, including volume growth and pricing, as continued cost discipline drove results. Operating profit margin declined 10 basis points versus the previous year to 20.9%, as pricing actions and cost control initiatives [virtually] cover the impact of higher raw material costs.

Looking ahead, we have started the fourth quarter well, led by strong new business wins. Pricing initiatives should help to reduce the impact of raw material costs, and we expect that our focus on controlling costs should allow us to sustain momentum and finish 2011 with a strong operational performance.

With that, let me turn it over to Kevin.

Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

Thank you, Hernan. Good morning and good afternoon, everyone. Third quarter of 2011 sales totaled \$714 million, an increase of 6% from the prior-year period, as the impact of foreign exchange contributed positively to our top-line growth. The emerging markets continue to perform well, up 4% on a local currency basis.

Adjusted operating profit grew 4% or \$5 million to \$128 million, while gross margin contracted 330 basis points as a result of the significant increases in raw material costs. Adjusted operating margin only declined by 40 basis points to 17.9% versus 18.3% in the year-ago period. As we continue to exhibit strong cost control and benefit from lower incentive compensation accruals. The end result was adjusted EPS grew 2% year-over-year to an even \$1 figure.

Evaluating our gross margin performance in greater detail, I thought it would be helpful to discuss the drivers of year-over-year change relative to our Q2 results. It was our expectation on our Q2 conference call that gross margin would remain under pressure, although to a lesser extent than what we experienced in the second quarter. Our forecast was predicated on raw material cost increases being similar to Q2 levels, and when combined with greater pricing benefits, would reduce the margin gap and show sequential improvement in gross margin versus the second quarter.

The shortfall to our expectation can be attributed to higher-than-expected raw material costs in the quarter and a reduction in volume, which reduced the benefits of expected absorption in our factories. The combined impact of these items resulted in a shortfall in gross margin of approximately 200 basis points versus our original expectation.

Pricing benefits did accelerate as expected, rising from 2% in the second quarter to over 3% in the third, as the team was successful in securing pricing actions to help reduce the impact of rising raw material costs on gross margin. While we anticipate that pricing actions in our Fragrance ingredients business would have an adverse effect on our ingredients volume, the downside pressure was, in fact, greater than historical correlations, and therefore, had a greater impact on our financial results than what we had anticipated.



Analyzing the P&L in more detail, I'd like to further discuss input costs, RSA costs -- or Research, Selling and Administrative costs -- and currency. As expected, we continue to see raw material cost pressure in the third quarter. However, we did experience an acceleration in Q3 versus Q2, as raw material costs rose 13% versus the year-ago period. While the percentage change versus the second quarter was relatively small, from 12% in Q2 to 13% in Q3, it did have an impact on gross margin -- approximately 60 basis point headwind versus Q2 levels.

While both businesses faced significant cost pressure, it was most pronounced in Fragrances, where strong increases in naturals, petrochemicals, and feedstock ingredients such as turpentine, drove very strong double-digit percentage increases. Flavor costs, which were up high single-digit percentages, continue to be impacted by sharp increases in items such as citrus oils, and mint and menthol.

While we expected raw material costs to rise high-single digits for the full year, given the recent developments in the third quarter, it is becoming more clear that raw material inflation for the full year will reach a 10% figure. That said, we continue to expect less pressure on Q4 gross margins versus the year-ago period than what we have seen in Q3.

Looking ahead to 2012, while we are still evaluating our raw material costs, we are now projecting to see modest increases in certain parts of our input costs portfolio. At this point, current market rates associated with several raw materials, while off their market highs, remain above our 2011 contracted levels. This requires additional pricing discussions with our customers. Given the volatility in these markets, we plan to provide greater details on our Q4 conference call when we discuss our outlook for 2012.

From an overhead cost standpoint, RSA expenses as a percentage of sales decreased 300 basis points year-over-year to 21.1%, reflecting lower incentive compensation provisions and continued cost discipline. Within RSA, Research and Development expenses increased slightly, as we continue to make investments to support our strategic growth initiatives.

Regarding foreign exchange, the euro and several other currencies around the world increased in value year-over-year against the US dollar, and had a positive impact on both our top and bottom-line performance. Looking ahead, if currency rates stay where they are today, with the euro at 1.38, we expect foreign exchange impacts to be modestly favorable in the fourth quarter. We have hedged approximately 80% of our Q4 euro/dollar cash flow exposure at rates near year-ago levels. Beyond 2011, we have also been proactively instituting cash flow hedges for 2012 and have hedged nearly two-thirds of our euro/dollar cash flow exposure at rates which average above 1.40.

From a cash flow statement perspective, our strong profit growth through the first nine months provided a 16% increase in net income. As a short reminder, and as communicated on our Q1 and Q2 conference calls, we did see a rise in working capital earlier in the year, driven by -- one, a large reduction in payables associated with our 2010 annual incentive compensation payout; and two, tax payments -- both a result of IFF's strong 2010 financial performance. When combined, they resulted in a decrease in payables of approximately \$130 million versus the same period a year ago, which have resulted in cash flow from operations declining \$126 million in the first half of 2011 versus the same period year-ago.

However, as expected, our cash flow from operations was strong in Q3, improving by \$35 million year-over-year in the quarter, including an operational improvement in inventories versus the same quarter a year ago. This resulted in our cash flow from operations improving from \$2 million in the first half of 2011 to \$117 million through the nine-month period ending September 2011. From a use of cash standpoint, we are on track with our capital expenditure estimate of 5% of sales in 2011, and plan on continuing to make a \$24 million payment on our Japanese yen senior notes at the end of this month.

With that, I would like to turn the call back over to Doug for his perspective on the balance of 2011.



Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

Thank you, Kevin. Looking towards the fourth quarter, we expect the Flavors trends to remain strong, driven by our Health and Wellness portfolio and the emerging markets. Fragrance sales are expected to remain under some pressure as we continue to experience price-driven volume declines in ingredients, although improved versus Q3, and some softness in our more discretionary categories such as Fine Fragrance. While we continue to expect greater pricing benefits in the fourth quarter, the gap between raw material costs and price increases is expected to remain. When combined with the reduction in our Fragrance volume outlook, gross margin in the fourth quarter is expected to decline versus Q3 levels.

Nevertheless, we will continue to focus on controlling costs in quarter-four to drive operational performance above our 7% to 9% operating profit growth target, which is expected to lead to a year-over-year improvement in operating profit margin. It should be noted that despite our strong profit performance, Q4 earnings per share will be challenged, as we will compare to a lower effective tax rate of 21.1% in the prior-year period.

On a full-year basis, given our year-to-date performance plus our more cautious outlook for Q4, we now expect local currency sales and adjusted earnings per share growth to approach the lower end of our long-term ranges. Despite the headwinds previously mentioned, we continue to believe we can deliver adjusted operating profit growth above our long-term targets, driven by our efforts in pricing, the benefit of previous restructuring activities, and cost control initiatives.

In summary, we are pleased with our year-to-date performance in light of the challenging operating environment and the exceptional base period established last year, where we grew 14%. Upon entering 2011, the environment in which we conducted business was very different relative to where we are today -- unprecedented raw material costs increases, consumer concerns, global economic uncertainty, and foreign exchange volatility. As such, I would like to acknowledge the IFF team's ability to adapt both strategically and operationally during difficult times to deliver these solid results.

As we look forward, we are cautiously optimistic and confident that our business, supported by a culture of excellence, will remain strong, and that our financial results will provide strong returns for our shareholders longer-term. In times such as these, diversity is a compelling characteristic. Fortunately, the wide variety of products that we sell across many countries around the world, to the thousands of customers we have, helps us remain confident in our ability to deliver our financial targets longer-term.

We expect that we can continue to enhance our performance as we make progress against the strategic plan. By leveraging our geographic reach, strengthening our innovation platform, maximizing our portfolio, we believe we can drive commercial performance that will lead to greater shareholder value.

Thank you for your attention. With that, we will be happy to take any questions that you may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mark Astrachan, Stifel Nicolaus.

Mark Astrachan - Stifel Nicolaus - Analyst

So, on fragrances, the fragrance trends seem to be getting substantially worse on a two-year basis. And even if the fourth-quarter results improve slightly, it seems it will worsen still. So I guess the question is, it seems there's something wrong here beyond tough comparisons. I'm curious if you can elaborate on the competitive dynamics in the category and what seems to be the cause of IFF's seeming underperformance here?



Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

Mark, it's Nicolas. How are you? As I said in my prepared remarks, our Fragrance business has been impacted by price-driven volume decline in ingredients, which is really one of the key areas where we saw the pressure. It's an area where we took strategic and proactive pricing to project margins long-term.

While we anticipated these pricing actions would have an adverse effect on our ingredient volume, the downside pressure was greater than what we have seen historically, actually it's 3 points of volume for every point of price. In the rest of our business, we have seen volume on existing business slow, due to weaker volume trends associated with a very strong [year] growth volume comparison, especially if you look at Q3, but if you bring it down to the first nine months, we still have a positive dynamic.

And we see also some customers which are more cautious in their stances, really talking about the uncertain economic environment and being also cautious about inventory. And also potential impacts from a higher pricing. So if you look at the two-year period, we're still in a positive position -- some pressure in Q3 but otherwise -- in my remarks, if you look on the compound for the first nine months, we're positive in the compound business against very, very strong comparables.

Mark Astrachan - Stifel Nicolaus - Analyst

I guess just to build on that, in all due respect, we're mostly through earnings at this point and from an HPC universe standpoint, you haven't really heard any company's talk down expectations in terms of their own ordering or inventory levels or anything like that. And on top of it, the Flavors business, maybe it's taking less pricing, but it seems that Hernan and his team are taking pricing there as well, and you're still seeing pretty positive results in the business.

So I guess I'm still not quite clear what's going on from a competitive standpoint here. Is this something unique to IFF? Or basically your competitors took a lot less pricing, and since you're losing share and maybe, at some point, that reverses itself. But beyond the comparisons, it's not getting better.

Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

Mark, this is Kevin. Just to augment some of the things that Nicolas talked about, we did take, as you suggested in your question, the pricing fairly proactively in the first initial stages of 2012 -- excuse me, 2011. And certainly that has impacted the ingredients business that Nicolas has already referred to in his commentary and in his response to the question. So there clearly is a dynamic there that is affecting the volume characteristics of that business.

At some point in time, we will get through the pricing implications as it relates to that, and we do fundamentally believe that the price stances that have been taken for that business are holistic and appropriate, as it relates to ensuring we have the appropriate margin profile going longer-term. So that's one point.

I also think that if you look at the two-year, we still are at rates that are above the growth for the category. And so, yes, while we're seeing a deceleration versus the very strong numbers that we saw a year ago, that's just a natural, from my perspective, at least, a portion of it is a natural progression of working through the numbers that were so strong year-ago. So the two-year numbers still are indicative of, on a year-over-year basis, that we'll be able to gain share versus the overall industry. And we'll have to see how we play out over the course of the balance of this year and through 2012.

Mark Astrachan - Stifel Nicolaus - Analyst

Thank you.



Operator

Ed Aaron, RBC Capital Markets.

Ed Aaron - RBC Capital Markets - Analyst

I was just interested in your commentary about a new flavor technology that might be coming for 2012. Just -- how would you manage your expectations around that potential impact that we might see in that business over the next year or two?

Hernan Vaisman - International Flavors & Fragrances Inc. - Group President of Flavors

It's Hernan here. While we are in the process of reevaluating this technology, we will be launching officially in the first quarter. We see really very good and positive -- we have very positive expectation that we will see ramping up the business more strongly in 2013.

Ed Aaron - RBC Capital Markets - Analyst

Okay. Thank you. And then just wanted to follow-up on just incentive compensation. It was obviously a pretty low number this quarter. Just trying to think through to 2012. What type of headwind do you anticipate for next year, assuming you hit your plan next year in terms of your headwind to growth in 2012, as a result of the light incentive comp payments this year?

Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

We're not going to comment a lot on 2012 at this particular point in time. We will see, if in fact, if things don't materially change, we'll see a headwind as it relates to the reset of incentive comp next year. We'll provide more details on that when we give the specifics relative to our final Q4 numbers, as well as the outlook for 2012, though. Yes.

Ed Aaron - RBC Capital Markets - Analyst

Thank you.

Operator

Lauren Lieberman, Barclays Capital.

Lauren Lieberman - Barclays Capital - Analyst

I don't want to beat a dead horse, but I think the question that we're trying to ask about the fragrance business at this point is not really about ingredients. I think there are questions there, but we kind of get the volume and pricing issue. But on a two-year basis, there was a very significant deceleration in both Fine and in Functional this quarter -- still positive, yes, but definitely a deceleration. So, while the nine months are great, I'm more concerned about going forward.

So, looking forward, should we expect things to continue to decelerate? If so, why? Are win rates decelerating? Or the existing volumes falling off more quickly than would typically be the case, because maybe the commercialized products aren't getting the kind of market share and performance that was the case a year or two ago? I mean, there's -- something does feel different and that's what I'd love to get some help understanding.



Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

Lauren, let me make some additional commentary on that, hopefully to help you look. There is clear that the volume on our existing business has shown some incremental softness versus what we have seen in the past. That's clear. Our wins continue to hold up consistent with the levels that we've seen in the first -- over the last couple of quarters, as a matter of fact.

So what it really is, is some volumes that we have seen in terms of our existing business. And so, certainly, as Nicolas talked about, some of that is relative to the strong comparables. Some of it could perhaps be about some of the pricing actions we took and various other things that Nicolas has already talked to. But I think that's what we can comment on at this particular point in time.

Lauren Lieberman - Barclays Capital - Analyst

Okay. And is there anything that -- since, Kevin, you mentioned pricing -- is there anything that should suggest whether you're not seeing -- I know it's not direct comparisons to competitors when you get into the compound business -- but you guys have been talking about pricing with your customers for a very long time at this point.

In theory, getting ahead of the curve on cost inflation or at least getting your customers more ready for the pricing. And yet maybe it feels like there was a little bit more openness to pricing where there's more elasticity than you would have expected, even outside of ingredients. So does that alter your thought processes, Kevin or Doug, on the go-forward plans you guys have for pricing and improving the profitability of those underperforming parts of the portfolio via pricing?

Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

Lauren, it's Doug. A couple of points just touching off the final -- another point on the Fragrancing business. We've not seen any material changes in core listing, and in fact, we've had some gains, which gives us more confidence going forward. So some of your questions, issues are well-founded. We're digging into the facts too. But as you drill down the various elements that could be a part of it, certainly, the opportunity for core listing is key and there's only good signs there.

On your other point and the more important one, I think we were ahead of the curve on both pricing actions, but at the time we took some of that pricing actions — these conversations now going back better part of 12 months — they were all earmarked around pricing — or cost expectations in the mid-single digits. And the creek continued to rise, if you will, throughout the year, necessitating follow-up rounds of pricing.

And as Kevin mentioned a few moments ago, we now expect that for the full year, the cost impact for raw materials perspective on the Company is going to be 10% or roughly double what we first envisioned. So that has necessitated taking pricing, so -- and we will continue to do so. And against the expectation of margins to enable us to invest in the business, we will need to continue to come back and take pricing -- not only on those parts which may be disadvantaged in order to rectify the situation, but also on the core product portfolio. So if prices continue, if ingredients continue to go up next year as we expect they will modestly, we will need to engage our customers through price to recover that.

Lauren Lieberman - Barclays Capital - Analyst

Okay. Thanks, I'll get back in the queue.

Operator

Jeff Zekauskas, JPMorgan Chase.



Jeff Zekauskas - JPMorgan - Analyst

You spoke about your raw materials being up 13%. If you look on the fragrance side and you break things up into your feedstocks, your naturals, and your petrochems, were they all up roughly 13%? Or was there a real variance between the different components?

And for your ingredients business, which is most important -- the petrochems, the naturals, or the turpentines?

Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

Hi, Jeff, it's Nicolas. (multiple speakers) When we look at the different dynamics in our input costs, you have great variations. So with the numbers you were related to was really the aggregate of everything. So we had some parts of the feedstock where we saw greater pressure than the 13%. And to come back to your second question for ingredients, obviously, turpentine is a key component of it but also petrochemicals also are key drivers.

Jeff Zekauskas - JPMorgan - Analyst

So basically, what's happened over a short period of time is that benzene costs have really come down; propylene has really come down; just a wide variety of petrochemicals. So do you read the fall in your volumes, which seem incommensurate with general industry numbers, as customers are saying, oh, we see raw materials coming down, what we want to do is we want to buy in the future at lower prices.

Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

If you look at the portfolio, there is key above the previous periods, so we still see additional pressure, as Kevin was mentioning, going into next year. And I think that we need to look at which are the key leading indicators to understand what is the movement on feedstock. Some have been showing maybe some reduction in the increase, but still above the level of 2010, 2011. So we see continued pressure going into this.

Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

Just a few additional comments. What we are seeing is the numbers for input costs, while they're slightly up versus where we have been talking -- and certainly, as Doug suggested -- significantly up versus 12 months ago, and what our expectations would have been back then, what's happened is that the costs have remained relatively elevated. And versus where we are in the markets, that's what has surprised us -- ultimately, which is translating into the input costs being a little bit higher. And I think that, as Doug has suggested, we'll look to take the pricing necessary to continue to cover those incremental costs.

Jeff Zekauskas - JPMorgan - Analyst

And then, lastly, from the consumer products companies, there seems to be some sort of voicing of the idea that they should reduce the number of new products that they put out. And normally, volume growth in Flavor and Fragrance, or in Fragrances, really coincides with new product introductions by your customer base. Can you talk about whether their volume of new product introduction seems to be accelerating or decelerating or staying the same?



Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

We have not seen a deceleration actually worsening sometimes maybe a few of our brands but bigger brands. We're seeing brands trying to expand into new geography or brands trying to expand into new categories, representing additional opportunities for us. So we've not seen on the aggregate a deceleration. As a matter of fact, we have gained access to more business available to us by gaining access to new co-lists. And now we're seeing the amount of projects on which we're working moving forward, the absolute dollar value being greater than last year at the same period.

Jeff Zekauskas - JPMorgan - Analyst

Okay. Thank you very much.

Operator

John Roberts, Buckingham Research.

John Roberts - Buckingham Research - Analyst

Do you have any gut feels for at least if any of this is inventory or channel correction in the Fragrance business? And do you think the strength in the past several quarters was some inventory building?

Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

I think that we saw an acceleration in Q1 where we're above the market, we're above the category or market growth. So it is possible that people have built to -- built inventory for the year. But lately, what we're seeing is that people actually are more cautious for the future, and they want to make sure that they are managing their inventory, managing their working capital. It's probably affecting some categories more than some others. And that's what we're seeing across the portfolio.

John Roberts - Buckingham Research - Analyst

And typically, how long will an inventory correction last?

Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

I mean, I think it's very difficult to see because we're coming from two extreme years -- 2009, where you have so many destocking; 2010, when we saw restocking. So it is very difficult right now to make any assumption in terms of the different cycles.

John Roberts - Buckingham Research - Analyst

Okay. And then last question was -- Doug, I thought the exiting of products was the last of your plans. The first was the price increases -- if customers didn't take pricing, then you would offer them reformulated or lower-cost alternative product. And then as a final option, exiting. So does that mean you've exhausted the pricing and reformulation lower alternative options and exiting is what's left?



Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

In a couple of cases, John, that has been the case for the \$4 million that we've mentioned now. You're right in terms of the gradient of trying to work with the customer to understand the situation and the profitability, and then reformulation -- we'll continue to do those. And I expect that there's going to be ultimate outcomes on each of those options. But they're including option three, where if it is a low value added and we don't have a competitive advantage, and the customer has a cheaper opportunity that's not giving us the margin that we need, there will be some businesses that we would readily exit.

John Roberts - Buckingham Research - Analyst

So how much of the \$50 million that was targeted has been captured so far in the first two options?

Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

Well, the \$50 million was a holistic response to the strategic options. And it's -- we've said it's a small part at this time. But the exiting the business and so on, that is a very small, small part of that total profitability improvement.

John Roberts - Buckingham Research - Analyst

Okay. I'll get back in the queue.

Operator

Mike Sison, KeyBanc.

Mike Sison - KeyBanc Capital Markets - Analyst

In terms of the product rationalization efforts heading into 2012, Doug, could you give us an idea -- it was \$4 million this year; is it double, triple, quadruple, as we head into next year?

Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

A lot of that's going to come from the Flavors business, so I'll ask Hernan to talk to that.

Hernan Vaisman - International Flavors & Fragrances Inc. - Group President of Flavors

Hi, Mike, how are you doing? (multiple speakers) At this point in time, we will not open this kind of information. But as I mentioned in my script, I believe that we will be much higher than we have today. We not open at this time because we are still negotiating with customers, and we will finalize -- I mean the decision of exiting or not. But I can tell you that it was much higher than what we have so far in 2011.

Mike Sison - KeyBanc Capital Markets - Analyst

Okay. And then, Kevin, the 15% decline in ingredients local currency, was that pretty much all due to pricing? Or was it half? Was it three-quarters? Could you give us an idea of the degree of the hit?



Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

Well, at the end of the day, if you have a volume decline, it's not exactly clear what's going to be driven by your price. But we took a very proactive stance on those pricing initiatives. So as we've talked about, there was a 3-to-1 ratio as it relates to our pricing versus volume. So it certainly was a big part of it.

Mike Sison - KeyBanc Capital Markets - Analyst

And that would continue -- that degree would continue in the next couple of quarters unless you lower the price to get the business back?

Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

It would depend upon other players in the industry and what their pricing stances are. We feel good about our pricing, as it relates to the holistic perspective of ensuring we have the appropriate margin profile going forward.

Mike Sison - KeyBanc Capital Markets - Analyst

Got it. And then, Nicolas, when you think about 2012, how is the backlog of project wins and in the major areas, Fine, and Beauty, and Functional, as you head into next year, is the backlog pretty good? Is it smaller or bigger?

Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

The backlog is very good. And also not just for 2012 but also for 2013, where we've been able to already secure some significant projects that will flow into 2013. So I see the win rate is still very strong. And not only is it still very strong, but we have access to more business by getting access to new core listings and getting access to brands we're expanding.

Mike Sison - KeyBanc Capital Markets - Analyst

Right. Thank you very much.

Operator

Erik Sjogren, Morgan Stanley.

Erik Sjogren - Morgan Stanley - Analyst

It's Eric from Morgan Stanley here. Just a quick question on the pricing. Is there a point where you would start rolling back the pricing? Or is it simply that your peers are not following, so you feel that the volume declines have become too big, so to say? I think you seem to be saying that you will be taking pricing also in the fourth quarter. But is there a point where you would start to reevaluate then?

Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

Certainly on ingredients, Eric, I think that's a possibility, depending on the feedstock implications and the input costs. Certainly on where we talked a lot about the need for further pricing, it's conceivable it's in that area; but it's more conceivable on the more traditional formulas we have in Flavors and in Fragrances, where the key ingredients there would necessitate pricing. So,



where it's a function of commodity, we'd have to recognize the market and that's what we did in our initial pricing actions. But on our core formulas with products, we would continue to take pricing.

And then there's just one little caveat I'd like to go back and touch upon, and that was really in response to the softness and so on. We lost some business to competitors that were pricing at lower levels in anticipation of their ability to get the product supply. In some cases, that's now appearing perhaps not to be the case in some of the business that we lost to lower-priced competitors. Some of those customers are now coming back and inquiring about the availability of supply. So, we stand by the strategic moves we've made, and because they're pricing and shareholder-driven; but if we have to adjust prices on some of the items which are commodities, we'll certainly consider that.

Erik Sjogren - Morgan Stanley - Analyst

Thank you very much.

Operator

Alec Patterson, RCM.

Alec Patterson - Dresdner RCM Global Investors - Analyst

I guess I'm just trying to get a little bit of a handle on the amount of pricing that you guys were targeting sort of mid-summer-ish, where I think you talked about it was the second round of pricing that you were going into with your customers. And you had sort of a visibility on higher raw materials, certainly double-digit levels running through the second and third quarters.

And did you get the level of pricing that you expected you needed to sustain an improving gross margin trend? Or did it end up coming in less, maybe because you recognized greater elasticity than you thought or --? I'm just wondering to what degree you were able to actually capture your original goals on your original pricing assumptions?

Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

Good morning. This is Kevin. I'll take a crack at that. Look, I think we certainly have taken pretty significant pricing over the course of the year. And as discussed, we have a 3% number in the period. But keep in mind -- in the quarter, excuse me -- keep in mind that we did see a slight elevation in the input costs that flow through the P&L in Q3. So we lost a little bit there and I've already described that in the presentation.

The only other point that I think is important to note is, you would have originally thought that in the first -- when we were talking around the midpoint of the year, that we'd get some additional pricing that would flow through in Q4. Some of that is actually happening, and some of it will end up benefiting us in Q1 of next year. That's probably the change from where we were at the mid-year point.

Alec Patterson - Dresdner RCM Global Investors - Analyst

But the pricing that you had in the second round, was it sufficient to cover the level of raw materials that was evident as of the second quarter, the second quarter where you had a 12% increase? In other words, were you able to at least get the pricing to cover that in this second round?



Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

We were very close to having pricing in place by the end of the year, relative to what our expectations on input costs were at that point in time --- I would say 90%-plus. We're a little bit light of that, given the higher levels of input costs. And consequently, some of the pricing actions that we've been discussing are going to end up occurring in the first quarter of next year, to ensure that we have the ability to cover those incremental costs.

Alec Patterson - Dresdner RCM Global Investors - Analyst

Okay. I mean, I understand that because, obviously, pricing for everybody has been a challenge. And I was just wondering, as you've re-calibrated the elastic response, your elasticity models must be coming up with new results, given this new set of data that's come in. Is this having an impact, do you think, on how you look at your long-term financial targets, given the potential volatility of raw materials over time?

Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

I'll take a crack again. I don't think that we would necessarily see that as an issue at this point in time. We certainly are in a volatile situation, given the input costs dynamic that we've been facing and the strong pricing that we've taken, specifically on the ingredients business. And I think Doug has already addressed how we would see ourselves addressing pricing going forward on the ingredient business. And I think that if we saw some reductions in input costs, we certainly would consider that within the ingredients business on some of the lower value-added items that are in the portfolio.

Alec Patterson - Dresdner RCM Global Investors - Analyst

Okay. But the trade-off on pricing versus volume on the breadth of the portfolio has not changed significantly enough, given this recent experience, to alter your longer-term sales growth outlook?

Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

That would be correct.

Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

That's correct.

Alec Patterson - Dresdner RCM Global Investors - Analyst

Okay. Thank you.

Operator

Mark Astrachan, Stifel Nicolaus.

Mark Astrachan - Stifel Nicolaus - Analyst

On your full-year outlook, it sounds like you're anticipating a bit of an improvement in the fourth quarter, particularly from a sales standpoint. I guess I'm curious why that's the case, given September trends seems to have worsened from July/August?



And then curious if you could give some color on what October looked like. And if you could sort of parcel it out by pricing, because we know that's obviously going up, and what the impact would be on volumes, that'd be helpful, too.

Kevin Berryman - International Flavors & Fragrances Inc. - EVP and CFO

I think as Hernan has already talked about, October started strong in the Flavors business. And I would say that we haven't seen any worsening through October as it relates to the Fragrance top-line. And we'll obviously continue to monitor that. I think that what we said is that the full-year number of 4% is pretty close to our year-to-date figures as it is. That doesn't imply a big swing one way or the other as it relates to what Q4 might look like. We're in rounding numbers here, Mark.

Mark Astrachan - Stifel Nicolaus - Analyst

Okay. Thanks.

Operator

Lauren Lieberman, Barclays Capital.

Lauren Lieberman - Barclays Capital - Analyst

Just on ingredients, our understanding is that one of your larger competitors has started to raise pricing in ingredients. And I know that we all talked about second quarter, there being that lag, and that was probably part of why some share was lost there.

So why -- I mean, you may not have done this digging in yet, but why do you think it seems that the, I guess, the relative performance of your ingredients business versus theirs -- it got worse this quarter. I would have thought that share losses would have stabilized if everyone is now operating with a similar price list. But it seems like it's gotten worse.

Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

Lauren, it's Nicolas. First of all, it's important to underscore that we have a very, very different portfolio. So the makeup portfolio is very different and portfolio as to also be related to input costs. And therefore, some of our portfolio required a greater level of increase in the marketplace. We have also very different competitors in the different portfolio in which we compete. So it's very, very difficult to go for like-for-like. We are sometimes in very, very different types of portfolio.

Lauren Lieberman - Barclays Capital - Analyst

Okay. And that's -- Nicolas, thank you -- and that's particular to the ingredients portion of the business?

Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

Correct. That is correct. And also if you look at some other dynamics in what has captured some of the specialty ingredients also include some flavors ingredients. So the numbers are also more difficult to compare.



Lauren Lieberman - Barclays Capital - Analyst

Okay. So with the -- what you can see, I guess, and what I can't see in terms of competitor activity and more comparable -- with more comparable portfolios, do you have the sense that your competitors have now followed or put the pricing through, so that that rate of share loss should stabilize?

Nicolas Mirzayantz - International Flavors & Fragrances Inc. - Group President of Fragrances

It's very difficult to have visibility and difficult to comment on what they're planning to do. I think that as we can read in the industry all across, everybody is facing the same input cost pressure. So you expect people to adjust and adjust their strategy according to it. But it's very difficult to comment on what other people would be doing.

Lauren Lieberman - Barclays Capital - Analyst

Okay. All right, great. Thank you.

Operator

John Roberts, Buckingham Research.

John Roberts - Buckingham Research - Analyst

I wanted to come back to this \$50 million profit improvement program again. So if exiting products is a relatively small part of that, again, I would have guessed you'd taken much of the actions on price and reformulation already, but it doesn't sound like you've achieved a significant part of the \$50 million yet.

Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

That would be correct. And certainly some of the pricing that we had taken in anticipation of improvements was taken. And it was, frankly, subsumed, by then, raw material cost increases that were higher than we first thought. So to a degree, we took one step forward and we took one step backward, and have to revisit all those discussions with customers. And we're doing so.

But the other parts of the profit of that improvement plan really flow out of some of the strategic initiatives we are taking in R&D and in penetrating new geographies and new markets. And those will be the catalysts for the lion's share of that growth.

John Roberts - Buckingham Research - Analyst

So the pricing that you still have to take on those products that are underperforming, do you still feel good about being able to achieve that? Because, obviously, those were ones that it wasn't just the raw material cost increase; that was something where you were trying to get your margins up on the business. So those customers, you think will take more price?

Doug Tough - International Flavors & Fragrances Inc. - Chairman and CEO

Well, I think the challenge we will have, John, and it will be a challenge, but it's a challenge that we have to take up, is to go to those customers, and explain with fax and data and rationale, and specific pricing, where we are in the unacceptable position we are in and the need to negotiate those prices. So, that challenge, which was there last year and was taken up positively with



the team, then the benefits of that were lost to the higher pricing that we encouraged in the year. So we go back and take a swing at it again.

John Roberts - Buckingham Research - Analyst

All right. Thank you.

Operator

There are no further questions.

Michael DeVeau - International Flavors & Fragrances Inc. - Manager of IR

Thank you very much for your participation today. We are adjourned.

Operator

This concludes today's conference. You may now disconnect.

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