

FINAL TRANSCRIPT

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John Roberts

Buckingham Research - Analyst

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PRESENTATION

Operator

Good day, everyone. At this time, I would like to welcome everyone to the International Flavors & Fragrances second quarter 2009 earnings conference call. Today's call is being recorded. All participants will be in a listen-only mode until the formal question-and-answer portion of the call. Participants will be announced by their name and company, and 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.

Michael DeVeau - *International Flavors & Fragrances - Manager, IR*

Thank you, operator, and thanks to everyone for joining us this morning. With me on the call is Rob Amen, Chairman and CEO, and Kevin Berryman, Executive Vice President and CFO. Our call today is being recorded and will be available for playback on our website at iff.com. We are also broadcasting the call live on our website. Please keep in mind that during this call we may make forward-looking statements about the Company's performance. These statements are based on how we see things today so they may contain elements of uncertainty.

For additional information concerning factors that could cause results to differ materially from the forward-looking statement, I ask you to refer to our cautionary statement and risk factors contained in today's press release and on IFF website at SEC filings. Some of today's prepared remarks will exclude those items that affect comparability. These items laid out in our non-GAAP reconciliations which are also available under the website of IFF. With that let me turn the call over to Rob.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Thank you, Mike, and thank you, Miranda. Good morning, everyone. I'm pleased to have a couple of new IFFers with me today. You just heard from Michael DeVeau, who recently joined us in the Investor Relations job. We're happy Michael has joined us. Equally I'm pleased to have with me Kevin Berryman, our Executive Vice President and CFO. Kevin joined IFF in May after a



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25-year career with First Carnation and then Nestle. During his career at Nestle he served as CFO of Purina and served Nestle at corporate office as group controller. Kevin brings tremendous talent, energy, and experience to IFF. Kevin, welcome.

Let me turn to comments on our second quarter. Kevin will follow with a more in-depth analysis of the financial results and then I'll wrap it up at the end. First turning to our flavors business. While the flavors business unit progressed nicely this quarter, sales were up only slightly versus a year ago. However, the sales increase in the second quarter 2008 was up 8% in local terms. The largest quarterly increase of any quarter since the business unit was established in 2007. I believe being up only slightly is very positive in this setting. Growth was reported nicely in Asia, Latin America, and in North America. Europe was the only region not reporting growth.

The sales growth importantly was driven by new wins and higher volumes in existing products. With Europe's weakness being generally offset. Very importantly, operating margins in this business improved 60 basis points as a result of the wins, price adjustments, cost containment, and offset for higher material costs and a weaker product mix. I'm certainly pleased with the progress our flavor team has made, flavor has been and remains on a path to success.

Fragrance business, well, it's struggled in the past couple of quarters and struggled this quarter with local currency sales down 7%. This was caused by the significant erosion in the global fine fragrance market and related sales of ingredients to that market. Yes, luxury goods continue to suffer in negative comparisons as consumers refrain or defer from discretionary spending. It's important to note that the functional fragrance and beauty care fragrance sales were positive. Kevin will provide more details on all this later.

Our fragrance team is doing a good job both in meeting customer needs and adapting its cost structure to this environment. The staple related fragrances are showing positive momentum. However, fine fragrance remains a serious drag. We do not foresee a meaningful recovery in the fine fragrance market this year. Will there be some improvement? Yes, undoubtedly. But I don't want to characterize it as a strong recovery. Kevin will address the drivers to the margin declines in the fragrance business and what's being done to improve that later in the presentation.

So what are the key takeaways for the quarter? Well, first, the flavors business continues to deliver with good results. It's doing well and has a lot of good momentum. The margin expansion seen in the second quarter is important. Secondly the fragrance business is a tale of two markets. In functional fragrance we are progressing where we have targeted -- in fabric care and personal wash. However, the fine fragrance continues to suffer from weak retail demand and inventory correction. This is a significant to the top line as well as down through the P&L. Third, our margin improvement initiatives are gaining traction. All the initiatives we've spoken of in the past, price recovery, formula shifts, overhead reduction, and more are helping to offset the foreign exchange and materials cost pressures we suffered in the second quarter. Yes, we're improving. But we have more work to do to meet our goals.

Lastly and importantly, our customer project pipeline is 5% to 10% greater in number and value than this time last year. This is encouraging in terms of the growth potential. However, it's also a burden on our current period cost structure. All in all, I believe we're headed in the right direction. We've also announced a restructuring charge. And this charge basically reflects a streamlining in our fragrance business. We regret losing these talented people but need to adjust our cost structure to the current and expected environment. We continue to study options to reduce costs further and improve our efficiencies. We see additional opportunities to improve. But now let me turn this over to Kevin for him to share his analysis. Kevin?

Kevin Berryman - *International Flavors & Fragrances - EVP, CFO*

Thanks, Rob. Good morning, everyone. I'd like to start out by saying I am very excited to be here at IFF. While the environment is a challenging one, I'm encouraged by the actions that Rob and his leadership team have taken over the last 12 months that are now beginning to show traction. I look forward to building on their achievements by adding value through business partnering, providing transparency, improving discipline in our processes and providing strong leadership to the finance



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organization. Having spent a long time in the food industry, I understand the value proposition that IFF can provide to the consumer package goods companies. As a result, I am convinced that the organization will continue to manage through the current environment and be even better positioned for future growth and margin expansion.

That said I would like to spend some time this morning providing you with additional insight into our second-quarter performance. To start, it is clear that our financial results are indicative that we are operating in a tough business environment. Our top line sales were impacted resulting in local currency and reported sales growth of minus 4 and minus 11% respectively. The resulting pressure on margins was very real as our operating profit margins fell by 140 basis points to 15.1% on an adjusted basis. However, our increased focus on costs and productivity initiatives has helped provide a sequential improvement in both operating profit and operating margin versus the first quarter. We have seen controllable costs decrease, which will help support improved margin leverage as we look to see future growth.

This more focused effort against cost discipline has allowed us to help mitigate some of the short-term margin pressures, but more importantly, it has provided the Company additional flexibility to maintain the necessary level of growth investments that is so very important for our future. These steps are resulting in the Company being able to realize improved operational performance. Which not only helped address the short-term challenges but lay a stronger foundation for future success.

Let's start by looking at the recent sales trends in our business. Looking at the last four quarters of local currency sales growth, it is encouraging to see that the majority of our business segments have remained stable despite the challenging environment. Over the last four quarters, both our flavors and functional fragrance segments have continued to realize positive local currency sales performance. More recently, we have seen significant weakness in our fine and beauty care business. This weakness is entirely driven by the fine fragrance portion of the business as we continue to see sharp declines in retail purchases as well as supply chain contraction. In the second quarter, these pressures in fine fragrance intensified resulting in finer beauty being down 16% in local currency sales.

Within this category, our developed country positions were hit the hardest. The fact that fine fragrance was weak also had a dampening impact on the associated fragrance ingredients business. Which, as you know, provides many materials to the fine fragrance business. The ingredients business ended up being down 13%. It is important to note that excluding the fine fragrance portion of the fine and beauty care category, beauty care showed positive local currency growth. Our Latin American greater regions also showed solid growth while the European region was quite weak. The key takeaway here is that a large portion of our product portfolio is exhibiting stability, and it is fine fragrance and ingredients which continue to most hamper overall results. Going forward as customer destocking issues subside and our fine fragrance business becomes more stable, we would expect more positive results. In fact, we can say that we saw improving trends in the business as we ended the quarter.

Before leaving this slide, I would like to remind you that these figures now include our revised and updated figures of local currency growth. Which incorporate the impact of foreign currency fluctuations versus the dollar in the calculation of local currency growth from certain Latin American countries. We have made this change as it has become evident that a greater portion of our business in Latin America has been transacted in currencies other than the US dollar. Note that this revision does not result in our previously reported consolidated local currency growth rates, changing in any of the quarters of 2008. And only a minor change in the consolidated results of the first quarter of 2009. For your benefit I have also provided mother nature details in a backup to this presentation.

Transitioning to individual business performance, flavors results were solid especially when considering the challenging environment. Looking at the top line, local currently sales growth was slightly positive. This marks the 16th consecutive quarter of local currency sales growth. We believe that this accomplishment provides a clear indication that IFF is winning in the flavors industry. We saw good commercial performance in North America as our savory business showed strong double digit sales growth. Latin America also showed strong 8% local currency sales growth, and greater Asia growth was less pronounced but still positive. Overall our savory business was the strongest segment on a global basis.



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The European region was the weakest performing region which is attributable to lower end use consumption and further inventory contraction by our customers. Higher input costs of over \$7 million and weaker mix did negatively impact profitability. However, margin recovery efforts including price increases and cost reduction initiatives more than offset these negative impacts. In fact, gross margin percentage improved year over year. This helped support the flavors operating profit margin, increasing by 60 basis points to 20.2% with an additional sequential improvement of 30 basis points versus the first quarter of 2009. Overall, we are very pleased with the performance of our flavors business. And looking forward as Rob noted, our project pipeline remains very healthy. Interestingly we are seeing an increase in new briefs that are focused on innovation that provides cost reduction opportunities for our customers.

Turning to our fragrance business. As noted earlier, our fine fragrance and ingredient business continues to negatively impact overall results. While not discounting the pressure that this has placed on our top and bottom line performance, we do believe that our strong new win performance is actually driving our performance in fine fragrance to levels that are above the overall performance of the category. As for the other categories, the positive local currency growth for our beauty care business mentioned earlier was driven by solid hair care performance. Toiletries was also positive. Functional fragrances grew 3% as new product wins and volume gains in fabric and personal wash offset any erosion. Both fabric care and personal wash exhibited solid growth. This was somewhat offset by weakness in home care, specifically air fresheners. From a profit basis, operating profit margins decreased by 460 basis points to 11.7% in the quarter. Including the gross restructuring costs of \$5 million that is related to the fragrance business.

Excluding this charge, our adjusted operating profit margin would have been 13.3%. The decline in margin was driven by lower volume and unfavorable mix due to the falloff in fine fragrance, higher input costs, and the impact of the strengthening in value of the dollar. Mitigating these pressures, margin recovery efforts including price increases and cost reduction initiatives gained traction. We are also executing against the targeted restructuring effort to adjust our business model in light of the current weakness in the industry.

In this current operating environment, our fragrance team is making progress. The focus on reducing costs has not diminished our efforts to win in the marketplace. Our new win performances at record levels and our creativity is being recognized by industry professionals. Most recently at the end of May, IFF graciously accepted five out of eight Fifi awards including the top two awards for best new fragrance of the year for men and women.

While the figures are not great for our fragrance business we are proud of the team's performance in light of challenging conditions. We are confident that we are taking the necessary steps in order to be stronger in the future. To provide a greater contextual understanding of our performance I would like to deep a little deeper on input costs, richer sales and administrative costs and currency. My hope is to give a better understanding of how our operational performance is trending and that our steps being taken now will lead to improvements and performance in the future.

Turning to input costs. We still are seeing a year-over-year increase in the P&L driven primarily by the fluctuations in raw material cost. Our costs have also increased sequentially over the last four quarters. This has had a large impact on the gross margin of the business as around 70% of our total cost of goods sold is raw materials. In the second quarter, our input costs increase has represented another strong mid- single digit increase to cost of goods. Adding \$15 million to our cost base. While this increase has been mitigated to some extent by margin recovery efforts, again including pricing, and cost reduction initiatives, gross margin did fall from year-ago levels. Albeit at a lesser rate than we saw in the first quarter of 2009.

Importantly we are seeing our current purchases of raw materials that are flowing into inventory at lower price levels. So it is clear that we will realize some improvements in this area in the quarters to come. Nonetheless our input costs will continue to remain at levels above those which we saw before the increase is seen in 2008.

From an overhead cost standpoint, we are also making progress. In the quarter, research, selling, and administrative expenses which we call RSA decreased \$19 million year over year reflecting benefits of ongoing cost reduction efforts and the impact of a stronger US dollar. Both of which accounted for about 50% of that reduction. Please note that our second-quarter includes



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\$1 million related to employee separation costs compared to \$3 million in 2008. Excluding these one-time costs and the impact of the stronger dollar, RSA expenditures were still lower as a percent of sales versus the prior year quarter. In an environment where top line sales fell 4% and 11% respectively on a local currency and reported basis, this accomplishment is an indication of our prudent approach to managing costs.

Within RSA, research and development expenses as a percent of sales dropped slightly to 8.6%. This was primarily driven by tight cost control on applied research and development and basic R&D. The largest absolute reduction in costs in RSA, however, came from the selling and administrative pours of the organization. Which accounted for nearly two-thirds of the noncurrency-related reduction in RSA.

Moving to currency, it is important to note that the strengthening dollar had the single largest impact on our second-quarter EPS. Looking at the table to the left, it is clear that the second quarter was our most difficult comparable from a foreign currency perspective. From a sales standpoint, currency had a negative \$44 million or 7 percentage point impact. From an operating profit standpoint, it represented \$12 million negative impact. And it represented a \$0.16 negative impact on EPS. As a material portion of the portfolio is zero based, the 15% year-over-year weakening versus the US dollar had a material impact on the P&L.

Looking ahead to the balance of the year, our comparisons should become more favorable going forward. If rates stay where they are today, our third-quarter results should be less negatively impacted by this issue. Importantly the foreign currency pressures we are seeing are masking a fundamental improvement in the operations of the business. I have tried to illustrate this issue by highlighting the drivers to the changes in operating margins in Q1 versus year ago and comparing that to the change in operating margin in Q2, also versus year ago.

Looking at the first column, in the first quarter of 2009 our operational performance excluding the impacts of currency resulted in our margin falling 160 basis points versus the prior year. Currency impacts accounted for another 60 basis points of margin loss or less than 25% of the total margin erosion. In the second quarter of 2009, this ratio was reversed. With currency now representing the primary driver to the margin falloff. Importantly, the margin falloff due to operational performance in the second quarter of 2009 versus year ago was reduced significantly to 50 basis points as our margin recovery efforts gained traction. In the second quarter the currency impact now accounted for 90 basis points of the margin falloff or 65% of the margin reduction. The key takeaway here, the trends in comparable margin performance are fundamentally improving.

Turning to our EPS reconciliation, we start from a reported base of \$0.83 and deduct \$0.02 benefit relating to favorable tax settlements, net of employee separation costs that we're seeing in the second quarter of 2008. On a comparable basis, our second-quarter 2008 EPS was \$0.81. You may also recall that our Q2 EPS results last year represented the highest ever recorded levels of EPS for IFF. Verse us that record performance, our net commercial performance resulted in a minimal negative \$0.01 impact to our EPS as volume softness and mix issues were mitigated by new wins, margin recovery efforts, again including pricing and operational efficiencies. Input costs had a \$0.13 negative impact, and the reduction in RSA cost base added \$0.10 to EPS.

While we are never happy with the reduction in EPS versus a prior-year quarter, it is clear that operational actions were taken to mitigate the impacts of the current environment. These actions have allowed the Company to limit the impact to our reported results. At the end of the day, the operational performance of the Company resulted in EPS falling only \$0.04 from the record results of last year. As we evaluate further the drivers to our EPS variance, we again see that foreign exchange played a key role, reducing EPS by \$0.16 versus the year-ago period. Tax and interest partially offset this foreign exchange issue as a lower effective tax rate of 26.1% for the quarter, and lower interest cost of \$4 million added \$0.04 to EPS. Finally, our second quarter 2009 adjusted EPS was \$0.65 excluding the net \$4 million restructuring and employee separation costs. Including these net restructuring costs, reported EPS was \$0.61.

Relating to the above noted restructuring, we recorded a net pretax charge of \$4.1 million in the second quarter. This amount includes \$6.6 million for severance and related costs associated with the elimination of approximately 70 positions globally. Less a \$2.5 million reduction to our previously recorded provision. The reduction of prior reserves is attributable to lower



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estimated benefit costs on severance paid as well as fewer position eliminations requiring severance as attrition was greater than expected.

The current reserve is being established to cover reductions primarily related to our fragrance business. The position eliminations are expected to generate approximately \$9 million in annual savings once completed during the third quarter of this year. This is another example of our commitment to continuously evaluate our business model within the context of the current business environment. We believe that taking these actions now will allow us to more effectively compete longer term.

Lastly, turning to our cash flow. We continued to strengthen our financial position as we ended the half with \$164 million in cash and \$30 million in free cash flow. Note that I am using a rather restrictive definition of free cash flow after recognizing dividend and capital expenditure funding requirements. We consider those obligations to support both our business and our shareholders. We saw a reduction in the growth of working capital over the first six months versus year ago as internal supply chain process improvements began to pay dividends. Inventories fell nearly \$50 million over the course of the six-month period. As a result, operating cash flow increased \$9 million year over year from 79 million to \$88 million. Excluding the \$18 million gain related to an interest rate swap benefit in 2008, operating cash actually grew \$27 million versus a year ago. Importantly, I think it is important to recognize the group was able to more than offset the \$28 million decrease in net income.

Leveraging off of this initial success, we are going to put a much greater focus on improving working capital going forward as we believe that there are additional efficiencies to be realized in all aspects of operational working capital. The key takeaway here is that the organization's ability to generate cash remains strong, and we believe that we can still improve upon it going forward.

Wrapping up our discussions on the second quarter, it is clear that there are substantive headwinds that we are managing through and which are impacting our results. However, we are confident that we are taking solid steps to improve our operational performance. Our cost and productivity initiatives are delivering results and aiding the bottom line. And there is certainly more to be done. And as a result, we will continue to focus on margin recovery and working capital management going forward.

So where do we go from here? We believe that we will begin to see an improving local currency sales trend going forward. Not a substantive turnaround but certainly an improved picture. We also believe that we have more runway on our ability to improve margins. Some of that will be driven by our continued internal focus to reduce costs, including the elimination of 70 positions discussed earlier, and certainly some of it will come as the raw material pressures that we have seen over the last four quarters begins to soften. Offsetting this to some extent, we will be comparing to our Q3 2008 results that had no incentive compensation booked in the quarter.

As you'll recall an adjustment was made in Q3 of last year to better align the expected incentive compensation with the results through the first nine months. This resulted in EPS being \$0.05 higher than usual. As a result after adjusting the prior year number, a more comparable EPS figure for Q3 2009 would be \$0.70.

We also continue to actively evaluate all aspects of our business model and global footprint. Including our supply chain, within the context of our growth strategies and the current business environment. Our restructuring reserve in the second quarter is an indication that we will continue to evaluate opportunities here. And we believe that there are further opportunities to improve. As always, we will continue to challenge all aspects of our cost structure.

Finally, while we do not venture to guess what may happen relative to the strength of the US dollar versus other currencies, we do know that our foreign currency comparables versus year ago are certainly less onerous going forward. As a result, we believe that it is likely that foreign currency headwinds versus year ago periods should ease.

Wrapping up, all of these trends which suggest that we are looking for an improved outlook on EPS and we would expect to see sequential improvement in the third quarter versus the second quarter of 2009. With that, I would like to thank you for your attention and return it back to Rob who will provide you with his closing thoughts.



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Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Thanks, Kevin. The external environment has been tough for a long time. Really since the end of 2007. And that environment has presented us with many challenges. Inventory corrections and weak demand in fine fragrance, sharp product in materials and input costs, volatile and adverse currency shifts.

These are the drags on margins we've suffered for several quarters. Our margin recovery initiatives have come along. Perhaps with an unattractive lag most especially in pricing, but they have come. It is clear these initiatives are now having a positive impact which we will continue and become increasingly positive. I'm pleased with the balanced progress we're making. We continue to attract and develop the best talent, we continue to demonstrate our commitment to our customers by investing in greatest facilities and production capacity needed to consistently supply them with the flavor and fragrance creations they desire. And we have done this while reducing costs and improving internal efficiencies. I believe we're on the path to deliver improved sales margins and earnings over the coming quarters. That said, we will continue to look for additional opportunities to improve our performance. That job's not over. Now Kevin and I will be happy to take questions. Miranda, if you could help us with the questioning.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). We'll hear first from Jeff Zekauskas with JPMorgan.

Silke Kueck - *JPMorgan - Analyst*

Good morning, this is Silke Kueck in for Jeff. In terms of the local currency trends, what was sort of noticeable in the quarter is that on a sequential basis pretty much in all regions with the exception of greater Asia the trends really have become worse sequentially. When I look at local currency growth particularly in the fragrance area that they've just become weaker which is sort of different from what your larger competitor reported. Are there things that we should keep in mind why that is and why there's such a disconnect, and whether you discuss -- improving local trends going forward, does that mean positive local currency growth or just a reduction at a slower rate?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

I'm sorry. Silke, let's back up and try and handle the first question. Let me paraphrase it. Why the difference in our local currency versus a competitor's particularly in fragrance?

Silke Kueck - *JPMorgan - Analyst*

Yes. And the sequential weakening.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Well, we are going to be different. It's not lockstep. I haven't, to be honest with you, I haven't spent the time and analyzed exactly what they've done in each region. I think ours -- there's a difference in product mix and market share that's going to drive things. I mean that's an element of it. But I don't understand what's going on there in numbers so I can't tell you why we're different from them. I know what's going on with us and our customers. You asked second part to your question?

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Silke Kueck - *JPMorgan - Analyst*

The second part of the question was does improving local currency trend in the future quarters for the third and fourth quarter, does that really mean positive local currency growth, or would that mean that things -- that growth is slowing, not at as steep a rate?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Well, I mean, we don't give firm guidance, and we've struggled with this. And we said it for a while. On balance when we take a look at the total enterprise, and we take a look at the orders in hand, as Kevin alluded, we did see some improvement as we came to the close of the fourth quarter, and seeing and knowing what we know today for the third quarter, we think that local currency sales largely, plus or minus a little bit, should be flat for the enterprise for the third quarter. There's a chance it will be little positive. There's a chance it could be a little lower than that.

Silke Kueck - *JPMorgan - Analyst*

Yes.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

And that would be the first local currency flat or nonnegative comparison in 2009. There's still a lot this quarter left and a lot of uncertainty in the world. But we are feeling like our local currency sales are on a more positive trend.

Silke Kueck - *JPMorgan - Analyst*

That's helpful. Thank you for clarifying.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Okay. Thank you. Miranda?

Operator

We'll hear next from John Roberts with Buckingham Research.

John Roberts - *Buckingham Research - Analyst*

Good morning, guys.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Good morning, John.

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John Roberts - *Buckingham Research - Analyst*

In the flavors area you commented on two specific trends they was hoping you could elaborate on. The deceleration in North American flavors seem to be beverage related. What's specifically going on there. And then the European deceleration, they were down 1 last quarter and they were down 5 this quarter in local currency. You talked about inventory destocking, I think, and I don't know if there's less in a recession, is there less processed food consumption or packaged food consumption. I would think we'd be seeing the same trend in the US as we are seeing it in Europe.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Let me be sure we're on the same pages. Flavors in North America?

John Roberts - *Buckingham Research - Analyst*

Flavors in North America I thought was up 1%. It was up 6% last quarter. So it decelerated?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Yes. Again, it was also versus a pretty good quarter a year ago. So I mean, it -- one quarter variation, it's hard -- hard to tackle that. I think the flavors unit has been a superb job in North America if you look back over several quarters. They've done very nicely, and I don't think there's -- I'd read too much into a change in trend. I think North America -- there had been some inventory corrections. We did see early in the quarter some drawdown by customers in April. And then a very nice recovery in May and June. So I wouldn't read -- there's no -- no significant change in North America current.

John Roberts - *Buckingham Research - Analyst*

The press release talks specifically about volume weakness in the beverage category?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Beverage broadly, yes. Beverage has been weaker for us than the other parts of our mix. We clearly in savory and dairy those were stronger. Beverage was weaker.

John Roberts - *Buckingham Research - Analyst*

Is that weather -- I don't coverage the beverage companies themselves. But--?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

It's a combination. I think it's total beverage unit consumption in North America as well as the external impact of the cooler, damper weather. But I think if you read a number of reports from the big beverage players, total consumption in North America was off a meaningful amount.

John Roberts - *Buckingham Research - Analyst*

Okay. I'll get back into queue.



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Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Okay. Thanks, John.

Operator

We'll go next to Lauren Lieberman with Barclays Capital.

Lauren Lieberman - *Barclays Capital - Analyst*

Thanks, good morning.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Good morning, Lauren.

Lauren Lieberman - *Barclays Capital - Analyst*

First question was just on customer mix given how much stronger Latin America and Asia were than -- than the developed markets. I was just curious if the source of strength there was largely multinational customers, or if it was more regionals where -- where those players may actually be gaining share?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

The performance overall does shift region by region. In Latin America we did see very strong performance on the part of the key -- the regional players. They did a nice job in both businesses. In other parts of the world, the global did quite well.

Lauren Lieberman - *Barclays Capital - Analyst*

So Asia it was more the global, Latin America was more the regional? You had to--?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Yes. The key drivers to our growth was the performance of some of the key regional markets.

Lauren Lieberman - *Barclays Capital - Analyst*

The regional players--?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

The regional players.

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Lauren Lieberman - *Barclays Capital - Analyst*

Okay. And Asia was more the global?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Yes.

Lauren Lieberman - *Barclays Capital - Analyst*

That's still a big percentage of your business in Asia is with the global players?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

I've got to think about it. India, China, Japan, I would say yes, the global's probably more than half.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. Is that the same in Latin America, that it's -- or is it reverse again, the regionals are a bigger percentage of your business?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

In Latin America the regionals would be the more dominant share of our mix.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. Great. And then the other thing I wanted to follow up on was -- because I have noticed R&D down as a percentage of sales. I know the goal long term was to get closer to that 8% level. But with top line down both local currency and including currency this wouldn't have really been the quarter I'd expect to see positive leverage on that line. And that coupled with the comments of the pipeline or at least the new briefs you're working on is bigger than ever and that the negative, for your cost structure now, that doesn't really fit with what we're seeing on the R&D line. Is that delayed, is that pipeline worth something we'll see reflected more in the cost structure in the next two quarters, or was it absorbed this quarter, as well?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Well, well the me break it down for you. In terms of the big R, that's largely the United States, there's a little bit done in a couple of centers in Europe. There's some FX impact but not material. And we continue to be dedicated to our big R. A substantial part of R&D is the applications and development work. Now that's -- you're right. We have the dichotomy of an increased project pipeline that we're working on. But what we've been working on is how do we deal with that and do it more efficiently. So we've tried, we've delayed a little bit, we've taken out some positions, we're trying to reduce some of the external purchased services, but we're trying to do more and spend less while we're doing it. And actually I have to compliment the two business leaders. I think they did a great job with a heavier pipeline for actually achieving that with fewer people and at a lower cost. Kevin, want to?

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Kevin Berryman - *International Flavors & Fragrances - EVP, CFO*

Just another comment, Lauren, back to your regional question. Actually if you start to look at the total mix of the portfolio today, Lat-Am is actually becoming a player and challenging the North American region as the second largest or -- the developing areas, greater Asia excuse me is challenging for number two regional position behind Europe. So we're starting to see a blend of the portfolio more aligned with where the growth areas are.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. Great. Thanks so much.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Thank you, Lauren.

Operator

(Operator Instructions). We'll heard from Edward Yang with Oppenheimer & Co.

Edward Yang - *Oppenheimer & Co. - Analyst*

Thank you, good morning.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Good morning.

Edward Yang - *Oppenheimer & Co. - Analyst*

My first question on interest expense, it was a bit lower than I expected, and so what would be a good run rate for the third quarter? And on the CapEx side, that was a bit below, as well, and is the \$80 million guidance still good for that?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Good morning, yes. Thanks for the question. I would say that the interest expense were kind of in a -- in a figure that is relatively close to our second-quarter figures. So 14 -- \$13 million, \$14 million is a good run rate going forward. We eliminated swap in the end of the first quarter so effectively that has enabled us to reduce some interest cost. Certainly rates are to the extent that there is some short-term moneys out there, that is certainly working in our favor, as well. As it relates to kind of the capital, we had talked an \$80 million figure in the past. I think we're thinking at this particular point in time it's going to be lower than that. I would say probably somewhere \$70 million, maybe a little bit higher. But I think that's probably the direction we would give you at this particular point in time.

Edward Yang - *Oppenheimer & Co. - Analyst*

Okay. And thank you, Kevin, for that. And on the fragrance side, you noted that you saw improving trends in fine fragrances as you were leaving the quarter. Could you elaborate on that. And also just as a reminder, that business first started showing



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negative local currency growth in 4Q '07 and then it started improving and then it got worse again. What was behind that? Was that just all economy related and so again, just would appreciate some color around that.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

When you take a look at fine fragrance, you have to put it in longer context. The Christmas season of 2007 was very weak which third and fourth quarter fine fragrance in '07 was actually pretty strong. And that led to a substantial inventory correction that was noted in the first and second quarters of '08. It somewhat flattened out in the third quarter and was slightly positive, I think, that's strictly off the top of my head be flattish in the fourth quarter. We again, obviously, in 2008 had a very disappointing Christmas retail season. And that triggered another massive inventory correction. The decline you're seeing in fine fragrance is a combination of reduced retail demand and a substantial contraction on the part of this entire supply chain from our customers and distributors. So we are starting to see evidence that one might conclude that inventory correct is over. But you never know that until you've gone far enough to see that it's bounced.

Inventories at many large fine fragrance companies are extremely low. However, I think it's impossible to estimate what the retailers' demand is going to be for this coming Christmas season. And that's going to have a big part in the demand over the next few months. So yes, we saw improvement in the -- at the end of June, and we're seeing it currently. But I'm really hesitant to read too much into it because of the risk to the Christmas season and the volatility on that to the total demand.

Edward Yang - *Oppenheimer & Co. - Analyst*

So Rob, which quarter sees the most inventory reorders for the upcoming Christmas season? Is it the third quarter or the fourth quarter for you?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Third quarter. It's all -- very, very little opportunity to get things shipped out from us in October because of the long supply chain, glass, packaging, et cetera. To get it packed, get it to a retailer and get it sold. So most of the Christmas material is done late second quarter into the third quarter.

Edward Yang - *Oppenheimer & Co. - Analyst*

Thank you. That's very helpful.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

You're welcome. Miranda?

Operator

Thank you. We'll take a follow up question from John Roberts with Buckingham Research.

John Roberts - *Buckingham Research - Analyst*

Thanks. The deceleration that you saw in the fragrance ingredients area, North American down 9 and it was up 13% I think last quarter. And you saw declines in both Latin America and Asia where they were up before. How much of that is related to the fine fragrance end markets that's there? So is it the same effect we're seeing only in the ingredients side?

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Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

We -- I can't tell you with great certainty because we sell it to fragrance companies. They don't always tell us what they're using it in. And you heard me in the past. I always look at ingredients over a longer period. One quarter alone, I think it was last year, the first quarter was weak, the second quarter was strong. And you kind of take a look at it. If you look at ingredients in total over the six months this year being down around 9%, that deal's about right with the overall market. I do think there has been some inventory correction on the part of all of us. Just as we reported our inventories are down I believe other fragrance houses are doing the same thing. It's not all consumption. I think there is a supply chain adjustment in there.

John Roberts - *Buckingham Research - Analyst*

Okay. Secondly, in the fine and beauty care business in Asia, you saw 7% growth, but I think that's the lowest level you've seen in years. In any quarter. And it was down from what had been a teens growth rate in even the prior quarters which were recessionary. And I don't think you have much Japanese exposure there. I don't think the fine fragrance business is very big in Japan. I'm surprised at that quick a deceleration. China I wouldn't have thought would have decelerated for example.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Well, I'm looking -- second quarter was up 10% in local currency. Fine and beauty for which is -- given the economies, I think that's pretty respectable. That's China, that's Japan, that's India, Indonesia, I think the 10% growth in those economies given what's going on, that's fine, but that's a lot of hair care, toiletries, that's -- actually I think that number's impressive.

John Roberts - *Buckingham Research - Analyst*

Okay. And lastly, I thought you had lost some business in North America in the fabric softener area and then regained it. Should we see -- is that enough of a switch that in either the third or fourth quarter we'll see North America functional fragrance flip to a positive comp?

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

I'm not sure we'll get to positive comp in North America in the third quarter. It's going to take a few things. The North American market right now is not being influenced by the fabric as much as being hair care and some other things where the end use -- consumers are viewing that in a more discretionary way. You can see that in some of our customers' reports. Hair care business has been soft. That has had a big impact. So there's a couple of different things going on in North America functional.

John Roberts - *Buckingham Research - Analyst*

Thank you.

Operator

(Operator Instructions). We'll take a followup from Jeff Zekauskas with JPMorgan.

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Silke Kueck - JPMorgan - Analyst

Yes. Good morning. Can you break out in the quarter what volume mix and price was out of the local currency growth for the Company as a whole?

Rob Amen - International Flavors & Fragrances - Chairman, CEO

I don't think we've done that, and I don't think we're going to start on this call, Silke. That sort of gets us into a whole nother issue. But as you might imagine, volume was a slight negative. And mix net, net, net was probably when you combine what we talked about in beverage and fine, mix was probably negative for the enterprise. So pricing and other initiatives were positive.

Silke Kueck - JPMorgan - Analyst

Are prices sequentially increasing, are they up year over year, and should they continue to increase? How should that trend?

Rob Amen - International Flavors & Fragrances - Chairman, CEO

Prices would be up year over year.

Silke Kueck - JPMorgan - Analyst

Yes.

Rob Amen - International Flavors & Fragrances - Chairman, CEO

And gently rising sequentially.

Silke Kueck - JPMorgan - Analyst

Yes.

Rob Amen - International Flavors & Fragrances - Chairman, CEO

Go ahead, Kevin?

Silke Kueck - JPMorgan - Analyst

Thank you very much.

Kevin Berryman - International Flavors & Fragrances - EVP, CFO

It effectively -- there's about 2.5%, 3% in terms of pricing. Now that varies by the category and what's going on specifically relative to materials. But that is a number that is somewhat consistent with kind of the first quarter.

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Silke Kueck - *JPMorgan - Analyst*

Yes. That's helpful. Thank you.

Operator

And we have no further questions from the phone audience at this time. I'll turn the conference back over to our speakers for any additional or closing remarks.

Rob Amen - *International Flavors & Fragrances - Chairman, CEO*

Thank you, Miranda. Thank you for your time. Clearly now you've been introduced to Michael DeVeau and Kevin. I think all of you have met the two gentlemen. And I encourage you to follow up with them afterwards. And I really do appreciate the time. And I look forward to speaking with you individually in the weeks and months ahead. Thanks very much.

Operator

And ladies and gentlemen, that does conclude today's conference call. We'd like to thank you all for your participation.

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