THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

IFF - Q1 2015 International Flavors & Fragrances Inc Earnings Call

EVENT DATE/TIME: MAY 12, 2015 / 2:00PM GMT

CORPORATE PARTICIPANTS

Michael DeVeau *International Flavors & Fragrances, Inc. - VP, Global Corporate Communications & IR*

Andreas Fibig *International Flavors & Fragrances, Inc. - Chairman & CEO*

Rich O'Leary *International Flavors & Fragrances, Inc. - Interim CFO*

Matthias Haeni *International Flavors & Fragrances, Inc. - Group President, Flavors*

Nicolas Mirzayantz *International Flavors & Fragrances, Inc. - Group President, Fragrances*

CONFERENCE CALL PARTICIPANTS

Mark Astrachan *Stifel Nicolaus - Analyst*

Lauren Lieberman *Barclays Capital - Analyst*

Silke Kueck *JPMorgan Chase - Analyst*

Faiza Alwy *Deutsche Bank - Analyst*

Jonathan Feeney *Athlos Research - Analyst*

John Roberts *UBS - Analyst*

Curt Siegmeyer *KeyBanc Capital Markets - Analyst*

PRESENTATION

Operator

At this time, I would like to welcome everyone to the International Flavors & Fragrances first-quarter 2015 earnings conference call. 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. 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, Vice President, Global Corporation Communications and Investor Relations. You may begin.

Michael DeVeau - *International Flavors & Fragrances, Inc. - VP, Global Corporate Communications & IR*

Thank you and good morning. Welcome to IFF's first-quarter 2015 conference call. Earlier today, we distributed a press release announcing our financial results. A copy of the release can be found on our IR website. This call is being recorded and will be available for replay on our website. Please take a moment to review our forward-looking statements.

During the call, we will be making forward-looking statements about the Company's performance, particularly with regard to our outlook for the second quarter and full year of 2015. These statements are based on how we see things today and contain elements of uncertainty. For additional information concerning factors that can cause actual results to differ materially from forward-looking statements, please refer to our cautionary statement and risk factors contained in our 10-K filed on March 2, 2015 and our press release that we filed this morning.

Today's presentation will include non-GAAP financial measures, which exclude those items that we believe affect comparability. A reconciliation of these non-GAAP financial measures to their respective GAAP measures is set forth in our press release that we issued earlier today.

With me on the call is our Chairman and CEO, Andreas Fibig; our interim CFO, Richard O'Leary; our Group President of Flavors, Matthias Haeni; and our Group President of Fragrances, Nicholas Mirzayantz. We will start with prepared remarks from Andreas and Rich and then the entire team will be available for any questions that you may have. With that, I would now like to introduce our Chairman and CEO, Andreas Fibig.

Andreas Fibig - *International Flavors & Fragrances, Inc. - Chairman & CEO*

Thank you, Michael and good morning, good afternoon to everyone. I would like to start by providing an executive overview of our operational performance this quarter. Then Rich will review our consolidated financial results in greater detail and turn the call back over to me for comments on the balance of the year and some concluding comments before opening the call to your questions.

We are pleased with our operational performance in quarter one. On a currency-neutral basis, we delivered mid-single digit sales growth and double-digit increases in both adjusted operating profit and adjusted EPS. At the same time, we continued to invest in the business to support our strategic goals by bolstering our flavors business with the acquisition of Ottens Flavors, the opening of a new sales and creative facility near Chicago and the expansion of our creative center in South Africa.

Currency-neutral sales this quarter grew 6% on a consolidated basis, primarily driven by new win performance across both businesses. Currency-neutral sales to the emerging markets, which now represent 51% of total Company sales, grew 9%, twice of the rate of sales of the developed markets, which grew 4%. Adjusted operating profit grew 10% on a currency-neutral basis to $163 million and adjusted operating profit margin was 21%. This improvement was driven by strong sales growth, combined with manufacturing and RSA cost leverage.

From a currency-neutral adjusted EPS perspective, we also benefited from a lower adjusted effective tax rate, interest expense and shares outstanding. The net result drove a 13% improvement in adjusted EPS on a currency-neutral basis to $1.45 per share in the quarter.

In fragrances, currency-neutral sales grew 5% in quarter one as most regions delivered mid to high and single digit growth. In the emerging markets, our fragrance compounds business, which includes consumer fragrances and fine fragrances, grew 8%, while the developed markets grew by 4%.

On a category basis, consumer fragrances continue to be our strongest performer, growing 9% as fabric care and skin care grew strong double digits. EAME and Latin America both grew high single digits followed by mid-single digits in North America and Greater Asia. It should be noted that this marks the 14th consecutive quarter of consumer fragrances growth.

Fine fragrances currency-neutral sales declined by 2% against a very strong 10% growth reported in the year-ago period. Our double-digit performance in Greater Asia was more than offset by softness in North America and EAME, both of which compared to a strong double-digit growth in the prior-year period. If you recall, our quarter one performance was our strongest of 2014 as it benefited from a customer prebuilding inventory before implementing SAP.

In fragrance ingredients, currency-neutral sales declined 2% as they compared to their strongest year-over-year comparison. From a profitability perspective, fragrance's segment profit decreased 6% to $82 million and segment profit margin decreased 110 basis points to 20.5% as the unfavorable net impact of price to input costs and currency pressures more than offset productivity and cost control initiatives.

Turning to flavors, for 41 consecutive quarters, flavors reported positive currency-neutral sales growth, increasing 9% in the first quarter. While overall market performance was driven by double-digit growth in the emerging markets, the developed markets also posted gains increasing 7% year-over-year. On a category basis, the strong trends we saw last quarter continued as beverages grew double digits with broad-based growth across all regions. This strong performance was a result of our creative team's ability to provide innovative solutions while satisfying consumer desires for healthier products.

It also should be noted that all other regions within our flavors business achieved solid growth led by high single digit increases in berry and mid-single digit increases in sweet and savory. From a regional perspective, Greater Asia posted 4% currency-neutral sales growth led by a double-digit improvement in beverages and a high single digit increase in savory. Southeast Asia, India and Japan all reported growth while China continues to be soft.

In EAME, currency-neutral sales growth was strong, increasing 9%. Results were driven by strong double-digit growth in beverage and high single digit increases in sweet, all a result of new win performance. In North America, conditions continued to improve versus the middle of 2014, growing a robust 10% year-over-year in quarter one. This improvement can primarily be attributed to strong double-digit growth in dairy, sweet and beverage, all of which were a result of strong innovation and our recent investments to drive consumer intimacy in this key market.

For the sixth consecutive quarter, Latin America grew double digits, up 21% on a currency-neutral basis. This performance continues to be driven by innovation, in particular our successful proprietary delivery system. From a profitability perspective, flavor segment profit increased 5% to $93 million in quarter one. Segment profit margin improved 60 basis points to 24.6% from 24% in the prior year quarter as top-line growth, mix benefits, productivity and cost control initiatives more than offset currency pressure.

Before turning the call over to Rich, I wanted to provide some commentary on our recent acquisition of Ottens Flavors. For those of you who have not heard of Ottens, they were a privately held company headquartered in Philadelphia with approximately $60 million in annual sales and 170 employees. They are all well-known for their diverse flavor technologies, strong talent base and long-term reputation for high-quality customer service.

IFF and Ottens Flavors share rich histories, world-class and complementary R&D capabilities and a strong commitment to innovative quality products with a keen focus on the customer. The deal will strengthen our operations in North America, improving our marketshare in this key developed market and increase our ability to meet the needs of our customers, especially the faster growing strategic accounts. The impact of this transaction is not included in our guidance for 2015. With that, I would like to now introduce Rich.

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Thanks, Andreas. Good morning and good afternoon, everyone. Net sales in the first quarter were up 6% on a currency-neutral basis led by double-digit growth in Latin America and mid-single digit growth in both EAME and Greater Asia. Overall, performance was driven by new wins across both businesses and lower volume erosion on existing business mainly in our flavors business.

While currency-neutral sales were strong, net sales on a reported basis rose 1%, reflecting a strengthening of the US dollar versus most global currencies. Adjusted gross profit margin remained constant at 44.7% as sales growth, cost-savings initiatives and mix benefits were offset by an unfavorable net impact of price to input costs and foreign exchange headwinds.

Our adjusted operating profit grew $4 million, or 2%, to $163 million and adjusted operating profit margin increased 40 basis points to 21% driven by sales growth and expense leverage that more than offset currency headwinds. Adjusted diluted EPS grew 10% to $1.45 driven by improvements in adjusted operating profit, foreign exchange gains on working capital and other income, a lower adjusted effective tax rate and interest expense, as well as reduced shares outstanding.

As I did on our Q4 earnings call, I wanted to show the two-year average currency-neutral sales growth to our [high] quarter to highlight the underlying trend. As you can see, in Q1, currency-neutral sales continued to grow at the upper end of our long-term guidance range, increasing 6% on a two-year average basis. Relative to the market, we believe we are outperforming, which is indicative of marketshare gains. We continue to benefit from our diverse portfolio of end-use product categories with strong growth in flavors and consumer fragrances and in geographies with growth in three of four regions.

Adjusted RSA expenses as a percent of sales declined 20 basis points from 24% to 23.8%. The year-over-year decline was driven by cost control initiatives and a favorable impact from currency, which was partially offset by higher amortization and incentive compensation expense. Maintaining cost discipline and implementing process improvements remain a priority and by doing so allows us to reinvest into R&D and commercial resources to drive longer-term growth. In Q1, R&D as a percentage of sales remained within our 8% to 9% range at 8.2% of sales.

From a currency perspective, Q1 was challenging as the US dollar strengthened against many global currencies. We have a natural hedge given our considerable operations in Europe, along with pricing mechanisms in most emerging markets. In addition, we proactively hedge our net euro exposure through raw material purchases. However, the recent volatility in exchange rates negatively impacted our results. In particular, the weakening of the euro versus the US dollar, which represents our largest currency exposure, had the greatest impact. In addition, several other currencies such as the Australian dollar, Brazilian real, British pound and Japanese yen weakened versus the US dollar further pressuring Q1 results.

We did experience a modest gain from our transactional euro hedging program. However, the benefits of this program are more back-half weighted based on the phasing of the program this year. As a result, foreign exchange movements in Q1 had a 5 percentage point impact on top line compared to a 7 percentage point impact on adjusted operating profit and 3 percentage point impact on adjusted EPS.

For the full year 2015, we remain approximately 70% hedged on our euro exposure at a rate close to the full year average in 2014. And while this significantly reduces our exposure in 2015, based on the April rate of $1.08, we believe it will have approximately a 7 percentage point impact on sales and approximately 4 to 5 percentage points impact on operating profit. This impact is included in our full-year guidance, which Andreas will speak about momentarily.

Our operating cash flow in the first quarter was $31 million compared to $35 million in the prior-year period. Improvements in net income and inventory during the quarter, as well as lower incentive compensation payouts, were more than offset by a $50 million incremental pension contribution, which strengthened the funded status of our largest plans. Our core working capital levels continue to show improvement year-over-year as a percent of sales as our five-quarter rolling average figures through the end of Q1 was down 70 basis points to approximately 29.1% of our trailing 12-month sales.

From a capital structure standpoint, we expect to spend between 4% and 4.5% of sales in 2015 on growth and infrastructure initiatives, specifically our new plants in Turkey and Indonesia. After this year, we expect capital spending to begin to revert back to more normalized levels at 3% to 3.5% of sales for the foreseeable future.

Regarding cash returned to shareholders in the first quarter, we have spent about approximately $38 million on dividend payouts and $11 million on share repurchases. With that, I will now turn the call back to Andreas.

Andreas Fibig - *International Flavors & Fragrances, Inc. - Chairman & CEO*

Thank you, Rich. Looking to the balance of the year, we continue to believe we can deliver attractive returns to our shareholders. On a currency-neutral basis, we expect all of our key financial metrics -- sales, adjusted operating profit and adjusted EPS -- to be in line with our long-term targets. Yet, if global currencies remain where they were in April for the balance of the year, we expect adjusted operating profit and adjusted EPS to grow low to mid-single digits, including the impact of currency, as well initiating investments in R&D and commercial resources based on our new strategy to drive long-term growth, which will be communicated in June. For the second quarter of 2015, we expect currency-neutral sales trends in flavors to continue, albeit a level more in line with our long-term target range.

In fragrances, we expect momentum to improve in our fine business and continue to see good growth in consumer fragrances. And while we expect to see improved volume trends in ingredients over the course of the year, we still expect year-over-year declines in the second quarter.

From a profitability perspective, we expect currency to remain a significant headwind in quarter two, which will pressure our reported results.

In summary, we have started the year well as we have achieved all our key financial objectives on a currency-neutral basis while simultaneously investing for the future growth of our business. In addition, with the acquisition of Ottens Flavors, the new site in Chicago and the renovation of South Africa, we continue to invest in R&D and commercial initiatives to build competitive advantage longer term. Diversity is not only a strength of IFF, it is a source of our stability. It begins in the way we operate, what we offer and where and extends to consumers around the world who have made our customers' products part of their everyday lives. This unique profile provides us with the confidence that we should be able to deliver financial results in line with our long-term targets on a currency-neutral basis.

Before I open it up to questions, I want to take a moment to explain how excited I am about the opportunity to unveil and discuss our refresh strategy with you on June 2 at our Investor Day here in New York City. It will be a great chance for us to share our 2020 aspirations and speak to the opportunities where we can further differentiate ourselves from the competition and provide innovative solutions for our customers to win in the marketplace. For those interested in attending, I ask that you reach out to Michael to register for the event. My hope is that you will not only have a chance to hear Vision 2020, but also provide you with an opportunity to experience some of our excellent R&D capabilities. With that, we are happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mark Astrachan, Stifel Nicolaus.

Mark Astrachan - *Stifel Nicolaus - Analyst*

I wanted to ask about the FX impact to your expectations for the year. So the last time you had talked publicly about numbers, it was mid to late March and now current FX rates are what they are, which is to say actually slightly improved relative to then. So could you talk a bit about the dynamics at play between then and now to the impact? It seems to be more significant than previously expected and specifically talk to anything underlying that within the actual operating results in the business getting worse that would contribute to that?

Andreas Fibig - *International Flavors & Fragrances, Inc. - Chairman & CEO*

Rich.

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Sure. Mark, when we talked in March, at that point in time, we were probably in the $1.10, $1.12 range -- $1.12 to $1.15 range based on the forecast at that point in time. As we indicated in the call, the current outlook is based on a euro rate based on the April forecast and the April period in time, which is about $1.08. So there is a bit of a strengthening. As you said, since the beginning of May, the euro has recovered a bit. That has not been reflected yet in our outlook in the guidance that we just gave. The underlying fundamentals have not changed significantly in terms of where we are across the business. There can be some mix impacts country by country. Also the phasing of the -- as I mentioned in the call, the phasing of our hedging contracts are more back-end weighted and so that's why you are going to see more pressure in the first quarter and the second quarter.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Got it. Okay. And switching to specific geographies, what is causing the weakness in recent quarters in China and what are your thoughts on when and how it could look as we go through this year? Could it improve or what is the impact there?

Andreas Fibig - *International Flavors & Fragrances, Inc. - Chairman & CEO*

Mark, I give this to Matthias.

Matthias Haeni - *International Flavors & Fragrances, Inc. - Group President, Flavors*

In China, in line with what we hear from our own customers, they are cautiously optimistic. We see particularly larger accounts being softer in the overall performance. We see, however, also greater opportunities for smaller sized companies. As you know, we have expanded our footprint in China. We are now closer to smaller sized companies as well and we are cautiously optimistic for the remainder of the year.

Mark Astrachan - *Stifel Nicolaus - Analyst*

So maybe just broadly on China then, cautiously optimistic. What is the base that you are coming from? Without commenting specifically on a country if you don't want to, it seems to me at least that sales may have declined in recent quarters. Is that a fair assumption? And as you say cautiously optimistic, does that mean for a slight positive growth?

Matthias Haeni - *International Flavors & Fragrances, Inc. - Group President, Flavors*

Yes, for slight positive growth, Mark. In China, we did not experience quarter-over-quarter declines with the exception of what we had in Q1, but it was a very modest decline. We also had some discontinued [spaces], which we have started in Q4 last year as we had some (technical difficulty) very profitable, but we are not going to report this separately. Overall, again, we remain positive. We have some challenges and I think we are in line with probably what you will hear from our customers across the categories as well.

Nicolas Mirzayantz - *International Flavors & Fragrances, Inc. - Group President, Fragrances*

Hi, Mark. It's Nicolas. Regarding fragrances, very solid performance in Q1 for China (technical difficulty) remainder of the year with good performance with local, regional and global accounts.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Great. Thank you, guys.

Operator

Lauren Lieberman, Barclays.

Lauren Lieberman - *Barclays Capital - Analyst*

First, I just wanted to know, in the Q, I noticed there was a mention of extra selling days in the quarter, so did that have any kind of financial impact on the local currency sales growth reported?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Yes, Lauren, it had I will call it a modest impact. The estimate is probably about a point impact in growth on the quarter.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. And then did I hear correctly that the Ottens Flavors is not included in the outlook right now?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Correct. It is not in the outlook.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. The 4% to 6% top line is ex-Ottens?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Ex-Ottens.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. And then Latin America on beverages, I know you have broad-based strength everywhere in beverages, but that was the one market where you mentioned a proprietary delivery system, so I was just wondering if some of the wins you've had in Latin America, if that is reflected globally yet with those proprietary systems, or if that is still isolated to Latin American and should we think about that materializing this year or if it's something that would come further out?

Matthias Haeni - *International Flavors & Fragrances, Inc. - Group President, Flavors*

Well, in Latin America, it was one of the first regions where we deployed our new technology. That is why ultimately we had much stronger growth performance versus other regions. We have seen good traction in other regions as well. In Latin America, it is mainly for beverages, but the technology [itself] is also very impactful when it comes to other categories such as gums, for example, where customers constantly are looking for differentiation, but also in savory. We are very positive that we will see good traction going forward also in other regions. Though I have to say, even the last few quarters, the impact of new wins to this technology is material.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. And just in that Latin America business in particular, was there any kind of pipeline sale -- like that up 21%, would you expect that moderates from here, that there was just some initial stocking on that (multiple speakers)?

Matthias Haeni - *International Flavors & Fragrances, Inc. - Group President, Flavors*

I think it will moderate, but it is not that pipeline [ceiling], it's really just a lot of new wins which we have. Unfortunately, I am not expecting the very same growth dynamics of 20% for the quarters to come, but frankly whilst still early in the quarter, we also expect a very solid momentum in Q2 going forward in Latin America.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. And just one last thing, if I may, on the guidance. Where I'm a little bit confused on including FX is that, at least my recollection is that previous guidance was for 7% to 9% operating profit growth emphasizing the low end of the range, but that included a 4% headwind from currency. So you said it was only 4% to 5% from currency, so is 1 point worse, but I don't know why low single digits would be on the table for EBIT growth unless there is something I am missing.

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Yes, Lauren, you are right. It is probably somewhere between a point -- probably a point and a half additional currency headwind based on the current outlook. As Andreas already talked about, reflected in the outlook is initiating some of the investments that we've identified to drive long-term growth associated with the strategy. That has now been incorporated into the forecasts that was not in the outlook at the beginning of the year as the work had not been identified yet. And I think the other part of it is that we are being I'm going to say cautious about some of the pressures that we are seeing in terms of pricing input costs, particularly on the fragrance business, as well as fragrance ingredients top line and a little bit of pressure on fine fragrances. So there is a mixed impact there also.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay. All right. Thank you.

Operator

Jeff Zekauskas, JPMorgan.

Silke Kueck - *JPMorgan Chase - Analyst*

Good morning. It's Silke Kueck for Jeff. How are you? So the Ottens acquisition closed in May and if the average operating margin is similar to what IFF reports, like it could contribute a nickel to your earnings this year. Is that the way you see it?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

No. Silke, you also have to remember that we have to look at it on our basis and basically the purchase accounting related to the price we paid for it. So there is a stepup in the assets and then there is amortization related to that. So I think the impact -- we believe that the impact -- we still have to finish that assessment, but we think the impact from an operating profit standpoint will be a modest impact.

Silke Kueck - *JPMorgan Chase - Analyst*

A modest impact. Okay. In terms of the negative price raw material issue, [it's issue] that the raw material cost curve is sort of flattish and your prices are down. I would be surprised if your raw materials are up.

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

As we talked about on the last call, where we are seeing the greatest amount of pressure is on the naturals in both businesses and then there's things like patchouli, but the biggest part of our portfolio are the natural ingredients and that is where we are seeing upward price pressure, particularly in the fragrance business and that is more than offsetting any potential benefit we see down the road from oil-related derivatives.

Silke Kueck - *JPMorgan Chase - Analyst*

Okay. Are your pricing trends generally flattish?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

There is some pressure on the ingredients business on the commodity end of the business, so it was not significant, but was down slightly in the quarter.

Silke Kueck - *JPMorgan Chase - Analyst*

I guess I have two last questions. So do you expect the fine fragrance business to be up year-over-year on a neutral-currency base for 2015? And secondly, I was wondering whether -- what your share repurchase goals are for the year. Thank you very much.

Nicolas Mirzayantz - *International Flavors & Fragrances, Inc. - Group President, Fragrances*

As you'll remember in Q1 last year, we came out of a very, very strong Q1 performance of 10% and it was our very strong year-ago performance, especially in Europe of 19% and 29% in North America. So Q1 faces a tough comparison. Moving forward, we expect momentum to improve in our fine business.

Silke Kueck - *JPMorgan Chase - Analyst*

Okay.

Michael DeVeau - *International Flavors & Fragrances, Inc. - VP, Global Corporate Communications & IR*

Silke, I think there was one more question you had?

Silke Kueck - *JPMorgan Chase - Analyst*

Yes, I was wondering what your share repurchase goals were for the year.

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

As I said, we repurchased about $11 million in the first quarter. Our authorization to this point is based on a share praise value matrix and so for the time being, I would expect that that rate would continue given the current price levels. I would expect that to continue certainly into the second quarter. We do our annual capital structure review with the Board midyear, but, at this point, I would count on a similar rate than what we saw in the first quarter.

Silke Kueck - *JPMorgan Chase - Analyst*

Thank you very much. I will get back into queue.

Operator

(Operator Instructions). Faiza Alwy, Deutsche Bank.

Faiza Alwy - *Deutsche Bank - Analyst*

So I wanted to ask about fragrance margins. So I think there might be two dynamics at play. One is sort of the weaker fine fragrance performance and then some of it might be ingredients. So I was wondering if there is a way to quantify how much was the impact from both of those factors. And then if there's anything else at play and then how we should view fragrance margins sort of going forward through the rest of the year.

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

I think, Faiza, to your point, I think the year-over-year performance for fragrances is certainly an impact on the fine fragrance side from a mix standpoint. We had very, very strong growth in the year-ago quarter versus negative growth in the current quarter. So I would say that is probably the biggest impact of it. Second is, as I mentioned earlier, there is pricing input cost pressures, which had a negative impact in the quarter. Those are probably the two biggest drivers of year-over-year margins.

Faiza Alwy - *Deutsche Bank - Analyst*

Okay, so as fine fragrance performance improves for the rest of the year, we should see margins improve also?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Yes, I think you also had different comparables in the second -- for the balance of the year last year. Some of that will tend to offset each other going forward.

Faiza Alwy - *Deutsche Bank - Analyst*

Okay, great. And then I just wanted to ask a little bit more about the increased investments that you mentioned in R&D. So should we expect the R&D ratio to be above the 9% range for the year, or if you could just expand a little bit more on that?

Andreas Fibig - *International Flavors & Fragrances, Inc. - Chairman & CEO*

No, you should not expect that because it is early days of our let's say implementing some of the steps for our refresh strategy and it will certainly not go above 9%. That's very clear. But we do a couple of strategic hires for the programs we have selected and that's what we will present June 2 to you, but it is not that this is crazy for the rest of the year.

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

And part of it also, Faiza, is on the commercial side also. It is both commercial and R&D resources.

Faiza Alwy - *Deutsche Bank - Analyst*

Okay. And then just one last question. If you could just talk about currency impact for 2016. I know you told us before how much you were hedged and at what rate for 2016, so I wonder if there is an update on that.

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

At this point where we are, our hedge program has obviously expanded forward from where we talked about earlier in the year. Right now, we are about 40% hedged for all of 2016 at a rate a little bit above $1.10.

Andreas Fibig - *International Flavors & Fragrances, Inc. - Chairman & CEO*

And Faiza, it is so volatile at the moment, the whole market, that I think it would be a bit early to talk already about 2016. Let's talk about it when we are later in the year and we know a bit more, when particularly the euro will develop.

Faiza Alwy - *Deutsche Bank - Analyst*

Okay, great. Thank you.

Operator

Jonathan Feeney, Athlos Research.

Jonathan Feeney - *Athlos Research - Analyst*

My one question is you called out some strength in the beverages business. I guess I know there is some new technology at play, but I wanted to parse how much was that and how much was maybe other technology or innovation versus sort of the base business in your global beverages business within flavors. Thanks.

Matthias Haeni - *International Flavors & Fragrances, Inc. - Group President, Flavors*

Well, I cannot give you an exact rate, but I can tell you that the majority of new wins are the result of health and wellness solutions. We have fantastic proprietary tools, which help [taste] calorie-reduced beverages taste better and we constantly make progress. It's not like we have a few molecules and we only deploy them and we rely on the success of a few of them. Over the last few months and quarters, the teams have made significant progress to come up with additional new solutions and frankly, we feel really excited of, first of all, the opportunities which we have; second, also on the success rate; and third, on partnering much closer with our customers together.

Jonathan Feeney - *Athlos Research - Analyst*

Got you. Thanks very much.

Operator

John Roberts, UBS.

John Roberts - *UBS - Analyst*

The decline in the North American ingredients business, is that sales out of the US or sales into the US that declined? I should know that, but it is a simple question. And how much of the decline is you using more ingredients internally, or is the decline really all external markets?

Nicolas Mirzayantz - *International Flavors & Fragrances, Inc. - Group President, Fragrances*

It is purely external sales and here it is very much targeted towards one specific segment of the market. So we have some visibility into it and what we decided is not to participate in some lower margin business. And as you know, we have been rationalizing both the portfolio and our footprint ingredients, especially in North America. You remember that we had closed our manufacturing end of August last year because we knew that we would be facing some pressure. So it was a decision for us not to participate in some specific contracts.

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

And John, from a definitional standpoint, it's sales in the US market; it's not exports from the US market.

John Roberts - *UBS - Analyst*

Okay. And I thought we were largely through that, so we will have this comp issue now for another three quarters, sort of?

Andreas Fibig - *International Flavors & Fragrances, Inc. - Chairman & CEO*

For the year, you will see some pressure in North America for ingredients and then that will be a new base for the future.

John Roberts - *UBS - Analyst*

Thank you.

Operator

Mark Astrachan, Stifel Nicolaus.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Which quarter will be affected by the extra selling days this year to offset the first-quarter benefit?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Fourth quarter, Mark.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Similar expected impact, roughly 8%?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Yes, that's a great way to think about it.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Okay. And then, Andreas, not to steal your thunder from the strategic refresh event in a month, but I guess you just need to think about FX being incrementally worse than where you were when you joined the Company and then now to use incremental investments as it relates to the refresh, should we be thinking that there will be some offsets to come in terms of efficiency programs and like to basically be able to redeploy some of that?

Andreas Fibig - *International Flavors & Fragrances, Inc. - Chairman & CEO*

Mark, good question. We certainly look what can we do to fund the journey internally so that we will reallocate some of our resources towards our new programs and that's what we are doing. Secondly, we certainly look at let's say our footprint and we already have, I would say, a pretty good natural hedge, but we have to look into it whether we can do some of these programs in areas where we have at the moment a euro exposure like in Europe. And as you well know, we have brought about one (inaudible) employee base in Europe anyway, so that is certainly in the cards to look into it how we do it in the most efficient and effective way for us. So these are the things we are looking into.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Okay. Thank you.

Operator

Curt Siegmeyer, KeyBanc Capital.

Curt Siegmeyer - *KeyBanc Capital Markets - Analyst*

Just a couple more on the fragrance side. You mentioned I thought that you do expect a little bit of improvement on the fine fragrances piece of the business. And is there anything I guess a little bit more tangible, or is it more just a function of easier comps as we move through the year?

Matthias Haeni - *International Flavors & Fragrances, Inc. - Group President, Flavors*

I think it was an easier comp. If you look at the growth of 10% last year in Q1, you know very well that the market did not grow 10% and that growth really was primarily driven by new wins, but also by a customer prebuilding inventory before the implementation of SAP, something that reversed itself over the course of 2014. So factoring that comparison and looking at the business over a two-year period, performance in Q1 2015 actually accelerated on a two-year average. As such, we will expect our performance to return to growth going forward.

Curt Siegmeyer - *KeyBanc Capital Markets - Analyst*

Okay. And then just maybe one more on the margin for the segment as a whole. Are there any other levers you guys can pull, or if you don't see any raw material relief, if it kind of stays at these levels, should we anticipate margins down year-over-year over the course of 2015, or you mentioned productivity in other maybe areas where there might be pricing opportunity I guess? Is there any other levers you guys can pull there to offset some of the raw material pressure?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Yes, Curt, we are always looking at -- I think the levers that we can pull are looking at the spend and trying to be focused in terms of where that spend occurs and make sure it is focused on driving the business, whether it is on the R&D innovation side or on the commercial side to drive and accelerate the growth. From a productivity standpoint, we look at opportunities day to day in our manufacturing operations, whether it is through capital investments or process improvement, to try to gain some leverage and that is inherent in our model. And so I think those efforts will continue. We may have some pressure near term when you combine currency in some of these new investments, but long term I think the model still works.

Curt Siegmeyer - *KeyBanc Capital Markets - Analyst*

So you think then for the year is it going to be tough to offset the hole that we are in after the first quarter in terms of keeping margins flat year-over-year? Would that be too difficult to get back to?

Rich O'Leary - *International Flavors & Fragrances, Inc. - Interim CFO*

Well, we are flat year-over-year as it is in the first quarter. So I think we have always said, look, we are not going to expect to have the kind of margin expansion that we had in prior years. That is not possible. I think we're going to be challenged by some of the mix impacts on the fragrance business. But I think there are some opportunities that we'll look at, but there is some challenges from a timing standpoint.

Curt Siegmeyer - *KeyBanc Capital Markets - Analyst*

Got it. Great. Thanks.

Operator

This does conclude. I will now turn the call back to the speakers.

Andreas Fibig - *International Flavors & Fragrances, Inc. - Chairman & CEO*

Okay then. Let me conclude the call. So we are pretty pleased with our first-quarter performance, very robust in terms of 6%, which is certainly outperforming the market, which we expect 3% growth. We have given you our outlook for the rest of the year, so we expect that in currency-neutral terms we will stick to our guidance and we certainly have an opportunity June 2 to update you on our let's say five-year strategy for 2020. Thank you very much for participating and I hope I see many of you in New York here June 2. Thank you and goodbye.

Operator

Thank you for joining today's International Flavors & Fragrances conference call. You may now disconnect.

THOMSON REUTERS