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IFF - Q2 2017 International Flavors & Fragrances Inc Earnings Call

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AUGUST 09, 2017 / 2:00PM, IFF - Q2 2017 International Flavors & Fragrances Inc Earnings Call

CORPORATE PARTICIPANTS

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

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

Richard A. O'Leary *International Flavors & Fragrances Inc. - CFO and EVP*

CONFERENCE CALL PARTICIPANTS

Adam L. Samuelson *Goldman Sachs Group Inc., Research Division - Lead Analyst*

Brett Michael Hundley *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Faiza Alwy *Deutsche Bank AG, Research Division - Research Analyst*

Gunther Zechmann *Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst*

Jeffrey John Zekauskas *JP Morgan Chase & Co, Research Division - Senior Analyst*

John Ezekiel E. Roberts *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

Mark S. Astrachan *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

PRESENTATION

Operator

At this time, I would like to welcome everyone to the International Flavors & Fragrances second Quarter 2017 Earnings Conference Call. (Operator Instructions) I would now like to introduce, Michael DeVeau, Head of Investor Relations. You may begin.

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

Thank you. Good morning, good afternoon and good evening, everyone. Welcome to IFF's Second Quarter 2017 Conference Call. Yesterday evening, we distributed a press release announcing our financial results. A copy of the release can be found on our IR website at ir.iff.com.

Please note that this call is being recorded live 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 third quarter and full year 2017. These statements are based on how we see things today and contain elements of uncertainty. For additional information concerning the 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 February 28, 2017, and our press release that we filed yesterday, all of which are available on our website.

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.

With me on the call today is our Chairman and CEO, Andreas Fibig; and our Executive Vice President CFO, Rich O'Leary. We will start with prepared remarks and then take any questions as you may have.

With that, I now like to introduce Andreas.



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

Thank you, Mike, and good morning, good afternoon, good evening to everybody. I would like to start as usually with an executive overview of our operational performance for the second quarter. Then I want to provide an update on our Vision 2020 progress. Once finished, I will ask Rich to cover our financial results in greater detail, including specifics on each business unit as well as our cash flow statement and outlook for the remainder of the year. I will finish by providing some closing remarks and then take any questions that you may have.

Our second quarter results finished in line with our expectations with improved trends across several of our key financial metrics. Currency-neutral sales grew 8%, including 11% growth in Flavors and 5% growth in Fragrances. On a consolidated basis, our top line growth benefited by approximately 6 percentage points related to the contribution of our recent acquisitions of David Michael, Fragrance Resources and, to a lesser degree, PowderPure.

Organically, Flavors currency-neutral sales improved 3% as all regions, except Greater Asia, posted solid results.

Fragrance sales were flat as Fine Fragrance and Fragrance Ingredients, including cosmetic actives, was offset by challenging results in Consumer Fragrances.

From a profitability perspective, currency neutral adjusted operating profit grew 6% in the second quarter, principally driven by the contributions from acquisitions, volume growth and cost savings initiatives. Currency neutral adjusted EPS increased 8%, driven primarily by operating profit growth as well as year-over-year reduction in shares outstanding related to our share repurchase program.

From a strategic perspective, we continue to make strong progress against the areas we have identified as strategic imperatives. In terms of innovating first in Flavors, sales of our Sweetness and Savory modulation portfolio continued its trend of strong double digit currency neutral growth across all categories led by Beverage and Savory.

In Flavors Latin America, our proprietary delivery system continues to perform well, contributing to strong double-digit growth in the second quarter.

We also successfully rolled out a new flavor modulator for our flavors to use in formulation development. This technology can enhance mouthwatering perception in snacks and bagged goods and can also enhance the perception of freshness and and citrus-flavored beverages.

In Fragrances, we launched a new fragrance ingredient called Veraspice. This ingredient is a warm, spicy (inaudible) bringing together the opulence of natural white flower with a smooth tobacco leaf undertone. The smart combination between salty and tarragon contribute to the creative differentiation.

I'm also happy to report that our IFF | Lucas Meyer Cosmetics team won the Bronze award at In-Cosmetics Global 2017 innovation zone awards with Siligel. Siligel is a natural gelling agent providing improved skin feel and provides high resistance to electrolytes.

Benefiting from recent strategic acquisitions of David Michael, Fragrance Resources and PowderPure, as well as from strong growth in our organic Flavors business, we saw robust 9% increase in North America in the second quarter of 2017. We also saw robust growth trends in the Middle East & Africa, as second quarter as currency-neutral sales improved strong double digits with the contribution from both Flavors & Fragrances.

We continue to position ourselves to be our customers' partner of choice and go-to supplier. In the second quarter of 2017, we launched Tastepoint by IFF designed to serve as a dynamic middle-market customer in North America. I will speak more about this exciting launch in a moment.

I'm also proud to acknowledge that we are the first and only flavor and fragrance house in the design the World Business Council for Sustainable Development new publication, The CEO Guide to the Circular Economy. The purpose of the guide is to help companies embrace the circular economy mindset. We believe that the circular economy is one of the biggest opportunities to transform production and consumption throughout the value chain. By sharing this information, we can be a vital link to unleash innovation needed to create positive transformational change in the world.



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I'm pleased to report that our 3 recent strategic acquisitions are key drivers of our financial performance. The combination of David Michael, Fragrance Resources and PowderPure contributed approximately 6 percentage points of sales growth and 4 percentage points of operating profit growth in the second quarter.

In addition, Lucas Meyer Cosmetics acquired 2 years ago continued to be a growth driver as Cosmetic Active Ingredients grew strong double digits in the second quarter.

More forward-looking, in the second quarter, we also announced, as we have joined the MIT Media Lab to Accelerate Sensorial Open Innovation. Our membership in the MIT Media Lab alliance is our strategy which underscores how we are committed to innovation as an accelerator of business growth. Since 1985, the MIT Media Lab has combined a vision of digital future with the new style of creative invention. With more than 30 years of innovation and 150 spin-off companies, the Media Lab currently supports 27 research groups and over 450 projects focused on designing the future. We are proud to join this innovation lab and collaborate with the next-generation of research breakthroughs.

I would now like to take a moment to expand on our exciting launch of Tastepoint by IFF. Born out of the combination of David Michael and Ottens Flavors, the new brand was first revealed at the IFT 2017 conference in Las Vegas. Tastepoint is designed to service a dynamic and fast-growing middle-market customers in North America, which we believe will help us to drive growth going forward by combining the long-established and well-regarded relationships of Ottens Flavors and David Michael with the R&D, technology and consumer insight of IFF, Tastepoint offers a new and innovative go-to-market approach that targets the unique needs and expectations of this subset of customers. As a fully dedicated organization within IFF, we believe we are well-established and have a competitive advantage to meet the expectations of our middle-market customers.

With that, I would like to turn the call over to Rich.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Thank you, Andreas. To reiterate what Andreas mentioned earlier, our financial results for the second quarter were good, consistent with our expectations. Currency-neutral sales improved 8%, including approximately 6 percentage points related to our recent acquisitions of David Michael Fragrance Resources and to a lesser extent, PowderPure. Our top line performance, both organically and inorganically, continues to be driven primarily by new wins across both businesses.

Our adjusted operating profit on a currency-neutral basis grew 6% and currency-neutral adjusted EPS improved 8%.

Also I want to take a moment to highlight our first half results. Our currency-neutral sales growth in the first half was strong at 7%, with 11% growth in Flavors and 4% growth in Fragrances.

Adjusted operating profit grew 5% on a currency-neutral basis, driven by contributions from acquisitions, volume growth and the benefits associated with our productivity programs.

Our currency-neutral adjusted EPS increased 9% in the first half, further benefiting from a lower tax rate and a reduced number of shares outstanding.

Looking at our business unit performance for the second quarter. Fragrances currency-neutral sales improved 5%, driven by broad-based category growth and the acquisition of Fragrance Resources. From a category perspective, Fine Fragrance improved 11% on a currency-neutral basis, including Fragrance Resources. Organically, performance was driven by double-digit growth in Greater Asia, EAME and North America, more than offsetting softness in Latin America where we continued to experience abnormally high-volume erosion due to weak economic conditions. Consumer Fragrances grew 1% on a currency-neutral basis, including additional sales related to the acquisition of Fragrance Resources as well as low single-digit improvements in Fabric Care and Home Care. On an organic basis, currency-neutral sales declined as several of our largest household and personal care customers are continuing to experience volume weakness in various end markets, plus continued weakness in Latin America and China. This ultimately impacted our volume on existing business and more than offset contributions from new wins.

Fragrance Ingredients sales were up 9% on a currency-neutral basis, primarily driven by double-digit growth in EAME and Latin America.



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IFF | Lucas Meyers also continued to perform nicely as it grew double digits in the second quarter.

From a profit perspective, Fragrance currency-neutral segment profit decreased 3% on a currency-neutral basis as volume growth and the benefits from productivity initiatives were more than offset by unfavorable price and input costs as well as a weaker sales mix.

In terms of currency-neutral segment profit margin, our profit margin remains strong, yet was under pressure year-over-year, driven by the items mentioned above, plus the Fragrance Resources acquisition, which is inclusive of step-up in purchase price accounting before we fully realize synergies.

Flavors currency-neutral sales increased 11% driven by strong contribution of sales related to David Michael and, to a lesser extent, PowderPure. On an organic basis, we achieved broad-based organic growth across all categories driven by new wins. From a regional perspective, 3 of the 4 regions delivered growth, led by strong double-digit performance in North America, which improved 30%, reflecting additional sales related to the acquisitions of David Michael and PowderPure as well as strong double-digit growth in Dairy and high single-digit growth in Savory. EAME increased 9% on a currency-neutral basis, led by mid-single-digit increases in Central and Southeastern Europe and low single-digit increases in Western Europe as well as additional sales related to the acquisition of David Michael. Greater Asia was soft in the second quarter, decreasing 2% on a currency-neutral basis as double-digit growth in Thailand and India, plus low single-digit growth in China, was more than offset by challenging conditions in Indonesia. Within that market, we are seeing a change in purchase behaviors as consumers limit spending as cost of living increased recently due to lower subsidies and higher taxes. Growth in Latin America continued, improving 11% on a currency-neutral basis, led by double-digit growth in Argentina and Colombia.

Flavors currency-neutral segment profit grew approximately 14% led by volume growth, the benefit of acquisitions and our productivity initiatives. In terms of currency-neutral segment profit margin, we experienced margin expansion year-over-year of approximately 70 basis points to 24.2%.

Moving on to cash flow. Operating cash flow was \$58 million in Q2 on a year-to-date basis compared to \$172 million in the comparable 2016 period. Performance was adversely impacted by the previously litigation settlement, which was about \$56 million. And despite having core working capital level slightly improved due to accounts payable, we were challenged by lower net income, higher incentive compensation payments compared to the prior year period.

From a capital allocation standpoint, we spent approximately \$46 million in capital expenditures or about 3% of sales. And we believe we will spend approximately 4.5% of sales in 2017.

Regarding cash returned to shareholders. In the first half, we spent approximately \$101 million on dividend payouts and \$53 million on share repurchases.

Last week, our Board of Directors authorized an 8% increase in the quarterly dividend to \$0.69 per share. The increased dividend is well aligned with our approach to capital allocation, returning 50% to 60% of adjusted net income as we strategically invest to drive long term sustainable growth, while returning value to our shareholders. We believe this increase underscores our confidence in our continued financial strength and the long-term outlook of our business.

Turning to our outlook. For the full year, we remain optimistic that we can achieve our previously stated currency-neutral financial guidance, recognizing that market volume growth remains soft, particularly with our global and multinational customers. We are reiterating our currency-neutral sales growth projection of 7.5% to 8.5%, which will be primarily driven by the contribution of acquisitions from David Michaels and Fragrance Resources as well as modest organic growth primarily in flavors. From adjusted operating profit and EPS perspective, excluding the impact of currency, we expect to achieve 5.5% to 6.5% and 6.5% to 7.5% growth, respectively.

For modeling purposes, please note that in Q3, we expect to have higher interest expense related to dual carrying cost of our recent \$500 million bond issuance as well as existing private placements that are maturing in late September. Please take note of this when you think about EPS in the third quarter.



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We will also see favorable reduction in interest expense in Q4.

While our currency-neutral guidance has not change, the effects of currency movements on our results have moved. From a top line perspective, the impact of currency improved by approximately 50 basis points to a 1% headwind, primarily driven by an improvement in the euro to U.S. dollar exchange rate. On a profit basis, we anticipate 100 basis point improvement versus the last quarter guidance. And on EPS, a 50 basis point improvement. As a result, on a full year basis, we expect the impact of foreign exchange on adjusted operating profit to be approximately 1.5 percentage points and approximately 2.5 percentage points on adjusted EPS.

For your reference, please note that we remain hedged at approximately 75% on our net euro profit exposure at approximately \$1.12 and our forecast is based on current rates for the second half of this year.

With that, I'd like to turn the call back over to Andreas.

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

Thank you, Rich. In summary, we are pleased that we have achieved currency-neutral growth across all metrics in the second quarter of 2017. Simultaneously, we continue to be focused on the execution of our Vision 2020 as we believe our emphasis on building great differentiation, which in turn should lead to sustainable profitable growth. We are on track to deliver our previously stated 2017 financial goals.

With that, I would like to open up the call to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Mark Astrachan with Stifel, Nicholas.

Mark S. Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

I guess first question is on the sales guidance for the year and specifically for the back half of the year. So what gives you confidence that you're going to be able to achieve the anticipated acceleration that's implied by the numbers which seem like you have to get to at least close to 4% in the back half of the year on an organic basis?

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

Okay. Mark, thank you for the question. First of all, we see in terms of our win performance going forward is one argument. The second thing is that we had at least on the Fragrance side actually a pretty, pretty good and favorable comparison for the third quarter. And we had with all the uncertainties around the third quarter, but we had a pretty good start into the third quarter already. Rich, do you want to add?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Yes, I think a couple of extra comments, Mark, from my side. I think we are we do expect on the Fragrances compound side to benefit from a couple of things. One, some new product launches and wins that are expected to hit in the third quarter or early fourth quarter. We are starting to see signs of stabilization in Latin America. And we do expect to see some reduced headwinds in Greater Asia. And as Andreas talked about, I think we are starting to see signs of stabilization of the inventory levels our customer standpoint, so we're expecting to see less headwinds from a destocking standpoint in the second half of the year versus first half of the year.



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Mark S. Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

Got it. That's helpful. And then on the productivity acceleration in the second quarter, how sustainable is that? And what should we take from the increase in R&D spend? Is there thoughts on increasing that more longer term given just weakness at your customers from a volume perspective?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Let me take the first half and then Andreas will talk to the R&D investments. When we look at our productivity standpoint, productivity objectives for this year, I'd say we are on target through the first 6 months. I would the impact is probably on the range of 3.5 percentage points of improvement in the first half of the year, so somewhere \$10 million, \$12 million roughly. And I think that positions us well to deliver on the full year outlook, particularly as we start to get benefits later in the year related to Fragrance Resources, although the bulk of those synergy benefits are going to come next year.

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

On the R&D front, we certainly invest wherever we think we get a good return. And we have certainly a pretty robust program in place with really different, very differentiating projects here. And we are now basically in the Phase II to look what could be the budget for next year, but it's not decided that we will significantly ramp up the R&D but we certainly put the R&D dollar behind the project where we think we can really create differentiation.

Mark S. Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

Okay. Just to be clear then Rich on your first part. The selling and administrative the piece, is that a reasonable level to use over balance of the year? Or with overall expectations trending to longer term target, is there more of an increase in accrued compensation expense in the back half of the year? I mean, sort of puts and takes would be helpful there.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

I think there's a couple of different dynamics going on in there, Mark. I would say from an SG&A standpoint, there are some of the projects that I have talked about earlier around the corporate projects on particularly in finance area that we will have some increased spending in the second half of the year. On the other side, remember that on a year over year basis last year incentive comp came down as results weakened. And so we will see increased incentive comp spend this year versus last year in the second half.

Operator

Your next question comes from the line of Gunther Zechmann with Bernstein.

Gunther Zechmann - *Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst*

Just on raw materials, can you confirm the 3% cost inflation for this year that you highlighted with Q1? And add on to that, given the currency moves we've seen recently, is this guidance in dollar or in euro terms?



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Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Okay. So for the first one, I think we still are -- we still see input costs in the 3% range for the full year. There'll be obviously be the some timing impacts related to that when it flows through from a P&L standpoint. The increases primarily again primarily driven by naturals on both business units, whether it's vanilla or citrus, those are impacting both business units. From a currency standpoint, it's based on our guidance that I gave you is based on existing exchange rate, the latest exchange rates of call it roughly \$1.18 euro dollar exchange rate is as that flows through, that's embedded in the guidance, and that's on the dollar basis will be what I talked about, net of currency, that will be the reported dollar basis.

Operator

Your next question comes from the line of Jeffrey Zekauskas with JPMorgan.

Jeffrey John Zekauskas - *JP Morgan Chase & Co, Research Division - Senior Analyst*

I was just trying to (inaudible) your results in the Flavor division excluding the acquisitions. So David Michael sort of like \$85 million annual sales and PowderPure like (inaudible) so if you distribute it throughout to the second quarter, your North American business grow or didn't it grow because it looks like it's all acquisition growth, it looks like the underlying growth was negative?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

No. I mean North America I mean remember PowderPure, we only had it for a portion of the quarter had and on a total company basis, negligible impact in terms of sales growth in the quarter, I would say, less than, probably 30 basis points at a total company basis. When you look at North America for Flavors, I mean, the organic business grew mid-single digits and the balance of that relates to the contribution of David Michaels.

Jeffrey John Zekauskas - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Mid-single digits, okay. Where does the growth in Flavors come from on a mid-single-digit range?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

I think it's growth across all the categories, particularly I would say we had double-digit growth in Snacks and Dairy and mid-single-digit growth in Sweet. And it's all driven -- it's primarily driven by new wins.

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

And we are actually pretty, pretty proud because just 1.5 years backwards you saw that we had not so good of an organic performance in Flavors North America and the team has turned this around quite significantly and that has led to the mid-single-digit growth in North America. And on top of it, we had the great performance of Tastepoint here as well. And that makes it actually a very good and sustainable business for us.

Jeffrey John Zekauskas - *JP Morgan Chase & Co, Research Division - Senior Analyst*

And I would ask one question on your cash flows if I may. So and I was wondering if you had sort of like an operating cash flow target for the year. So in the quarter, like I understand even if you strip out the litigation settlement, I think your operating cash flows were at 1 14 versus 1 73 last year. So if you leave all the items in, what is your operating cash flow targets for the year?



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Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Yes. Look, the specific target, I have -- I'd have to get back to you, I don't think we have that said or communicated that. I would tell you that the decrease year-over-year was roughly on a year-to-date basis \$115 million. So \$56 million in dollars of that is the settlement on. We've got lower income, including the there's the gain the noncash gain on the derivative or liquidation of the subsidiary. So that was to combine around about \$10 million -- \$20 million -- \$10 million in incentive comps year-over-year and there's another \$10 million roughly associated with deferred taxes and indirect taxes.

Operator

Your next question comes from Faiza Alwy with Deutsche Bank.

Faiza Alwy - *Deutsche Bank AG, Research Division - Research Analyst*

So if you can try and quantify for us the impact to this quarter from the destocking and how that offset the new win performance, that would be really helpful.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

The specifics, it's hard to specifically identify the impact. I will tell you that we saw a pretty sizable increase in back out in the last week to 1.5 weeks [for] the quarter. I will say that on top of that, we have seen -- we are encouraged by the start to the third quarter.

Faiza Alwy - *Deutsche Bank AG, Research Division - Research Analyst*

Okay. And then could you just remind us your spending CapEx [you said] 4.5% of sales. Can you remind just us on where your building facilities or where that is going?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

It's principally around the facilities in Greater Asia and the deployment of technologies around delivery systems and some of the capacity. But we've got a big piece in China. We've got 2 new facilities that are going on there. We're going to have to continue -- as you know, we've talked that we are going to have some peaks in next year, this year, next year and '19, around 5%, because we not only do we have China, but we've got Indonesia and India that we have to deal with.

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

And in particular, India is important to us because it's a high-growth market for us, and we really have to make sure that we have a state-of-the-art facilities in India, and we will invest in 2 more manufacturing plants in India, and we are well under way to do that.

Faiza Alwy - *Deutsche Bank AG, Research Division - Research Analyst*

Okay, great. And then, Andreas, if you could just expand a little bit more on Tastepoint. So practically what's (inaudible) in terms of how your approaching your high-growth medium-sized customers versus what it was maybe before Tastepoint?



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

Yes. So I would say that our exposure in particular in the U.S. towards this middle-market was not so good before, before we acquired actually Ottens 2 years ago. And we thought with all the changing trends and the struggle of many of the bigger multinational global companies, that we have to change our exposure towards the more dynamic market. And with the entrance of Ottens, we saw that is a very good pop for us. And we have combined this now with David Michael, made the Tastepoint and it's creating actually our outfit in terms of customer segmentation to what exactly that dynamic middle-market. They have the flexibility of a small company, but they can use the great technology we can give them from IFF and that makes them uniquely positioned for that marketplace. And what we see so far is, first of all, the launch of Vegas has been very well, the people are very motivated and our customers are very excited about this opportunity to work with us. What we see so far is probably 2 to 3x growth we have in our organic business. So I think it's really, really important. And I would say, as we always say, it's small enough, but yes, but still big enough to help us with technology.

Operator

Your next question comes from the line of Adam Samuelson with Goldman Sachs.

Adam L. Samuelson - *Goldman Sachs Group Inc., Research Division - Lead Analyst*

Maybe first on the gross margin side. I'm wondering if you can give a little bit more color on maybe the price cost headwinds that you absorbed in the quarter or the gross margin decline would be on a percent basis would be attributable to acquisitions and (inaudible) actually positive later this year as you get (inaudible) cost?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Let me try to answer that in the following manner. I'll talk to the overall return on sales profile for the 2 businesses. Flavors improved by roughly 90 points year-over-year. It's principally driven by productivity cost and volume and price input costs net were slightly favorable and those were offset by unfavorable mix to a certain extent and slightly by FX. When you look at the Fragrance return on sales profile, it went down about 140 basis points. Productivity -- in price input costs and M&A, which is principally related to Fragrance Resources, those were each about a point of headwind year-over-year and mix was probably another I'm going to call it 20 basis points. So those 3 items more than offset the benefits associated with volume and productivity gains.

Adam L. Samuelson - *Goldman Sachs Group Inc., Research Division - Lead Analyst*

Okay. And as you think about those pieces we moving forward, I mean, Fragrance Resources impact (inaudible) for the balance of the year but I presume if there's an expectation of a reacceleration in organic in the back half that you should start to get them some tailwinds on the gross margin line as well, is that fair?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Yes, I think as we look at the second half of the year, we would I would expect to see improvement in Fragrances as again as we have better leverage from a volume standpoint. There are still some volatility associated with sales mix. And then I think the biggest part of the benefit associated with Fragrance Resources, as I said earlier, will come next year as we fully realize we get the bulk of the synergies next year.



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Adam L. Samuelson - Goldman Sachs Group Inc., Research Division - Lead Analyst

Okay, that's helpful. Then maybe just a quick follow up actually on Tastepoint. I'm wondering if this is a model that you see as replicable in the current organization in other regions or you think that has to be done via M&A and specifically on Tastepoint in the U.S. Do you have any growth targets or ambitions for that business that you could share?

Andreas Fibig - International Flavors & Fragrances Inc. - Chairman and CEO

No. Actually, that is a pretty, pretty good point because we see that very works out very well in the U.S. market. And the challenge for our Flavors team or Taste team is basically to look what we can we do in the other geographies as well. But prerequisite for that is a pretty big market because if you just take for example Europe, you have a very fragmented market, so different countries. And if you have an asset, let's say, in Spain, you probably can't service more customer in Germany. And so the challenge for us is right now to pick the right markets, let's say, a market like Brazil, or let's say a market like China, which has enough critical mass to cater for this kind of principle or this kind of model. But we are doing it because we really want to export it because what we have seen so far is really excitement on the customer side and the results are pretty good as well.

Operator

Your next question comes from (inaudible) with Barclays.

Unidentified Analyst

First I was wondering what drove the strong performance in ingredient this quarter, especially in Latin America and Europe? And then I was just wondering if you could also talk a little bit about the unfavorable price input cost dynamic in Fragrances. I know it's been going on for sometime, but just curious if the level of rebates have changed? Or if the dynamic has improved at all since last quarter?

Andreas Fibig - International Flavors & Fragrances Inc. - Chairman and CEO

Okay, let me take the first part and Rich takes the second part. So the Ingredients business, we have done probably a year ago quite some changes how we approach our customers. We have also changed a bit our portfolio, we are working with it. We've changed our sales team, so we've increased the sales productivity here as well. And that has led already to quite significant turnaround of our Fragrance Ingredients business. And then we report the active cosmetics i that as well, which has yielded a double-digit growth for last quarter as well. So all in all, it's actually it's an amazing turnaround story from a lackluster performance for a couple of years to a good growth engine for now and for going forward as well. Rich?

Richard A. O'Leary - International Flavors & Fragrances Inc. - CFO and EVP

Okay, so let me go back to the pricing input, I'll say overall for the company was basically flat, favorable by about a point in Flavors and unfavorable by about a point in Fragrances. Your point about has the dynamic changed from prior -- last quarter? I will tell you that the pricing impact of Q2 for Fragrances compared to Q1 has improved by about 70%.

Operator

Your next question comes from the line of Brett Hundley with Vertical Group.

Brett Michael Hundley - The Vertical Trading Group, LLC, Research Division - Research Analyst

My question was centered on Fragrance in Asia and specifically Fine Fragrance in Asia accelerating during the quarter. And certainly when you do the math, there is a portion of that, that comes from Fragrance Resources in China. But the math also suggests that your legacy business is supplying



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nice gains in the region as well, and I think you mentioned that in your prepared remarks. So I just wanted to delve further into that and understand your organic performance in the region and maybe even China specifically and talking about whether or not that's coming from new wins, improved growth at existing accounts. Any color you can give us there might be helpful.

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

So probably let's start with the general comment is if you look at Asia and the Fine Fragrance business, it's still a very small, small business. And the part of Fragrance Resources we have brought into that was even smaller, and it was actually split between Consumer and Fine as well. So we see some movements in Asia, even in terms of Fine Fragrances, which is good for us to see because, in the past, it was never a market which was very exposed to that Cadbury. We will see how it's going forward, particularly also in geographies like Japan, but certainly also China. So still a small business, a very small piece of it is also Fragrance Resources. And yes, we will see how we are going forward. In general, maybe backing of the just Fine Fragrance part going to the Consumer Fragrance, it's a tough environment we see in Asia and also in China because we see that particularly for some of our bigger customers that the market is changing. And they have to adapt and we have to adapt as well. And here probably also compared with the question we had before on smaller customers that plays a role as well that you have a good standing with some of the smaller or midsized customers in these markets as well. I don't know, Rich, whether you want to add.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Yes. I mean, I'll talk Andreas was talking fragrance compounds for Greater Asia I think keep in mind there was a strong comp prior year, double-digit comp in the prior year. So as I look at it, in an organic basis, it's down mid-single digits in the region primarily driven by China, which is also down mid-single digits. And then some of the same pressures we saw and mentioned regarding Indonesia impacting Flavors also impacted Fragrances.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay. And Rich, just quickly, do you have any update on some of the Fragrance Ingredient plant discussions and actions that you're taking in China this year? I think we are around the timing where you're in discussions with the government on a facility and maybe you have been taking some actions to move around some production there as well. Do you guys have any update there?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

I would say, Brett, we're still in discussions. It hasn't been formalized yet. I think it keeps to be honest it's kind of kicked out a couple of months effectively. So we expected to be in a position to talk about it now, it's going to have to be fourth quarter now.

Operator

(Operator Instructions) Your next question comes from the line of John Roberts with UBS.

John Ezekiel E. Roberts - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals*

I assume there is not a Tastepoint equivalent on the Fragrance side and there are obviously some small dynamic customers there but there's not really any Ottens or David Michaels acquire to serve that market I assume?

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

It's actually an interesting question because if you look at our Fragrance Resources acquisition, that's actually why we did it for, actually 2 markets, one is in the U.S., because they have some of these smaller customers, and we are capitalizing on it. And believe it or not, in my home country, in



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Germany, they are serving a lot of smaller customers out of the Hamburg facility as well. And that is very welcome because we were not very strong in Germany despite a good engagement with Henkel. And so you see Fragrance Resources is a bit an entry into this smaller customer base like Tastepoint.

John Ezekiel E. Roberts - UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals

And then Rich, if you look at your full year currency guidance and compare it to the first half realized currency, at the EPS level, it looks like in the second half, it's roughly neutral year-over-year in currency? And is there a significant difference between third and fourth quarter?

Richard A. O'Leary - International Flavors & Fragrances Inc. - CFO and EVP

As I said, there'll be -- when I look at the second half, keep in mind, we had a favorable in relation to our guidance for the full year for tax rate of call it, 22.5. We were favorable in the first half of the year, that obviously then turns around second half of the year. As I also mentioned that I would see more pressure on EPS growth year-over-year in Q3, particularly related to the interest expensive dynamic that I mentioned earlier. And the...

John Ezekiel E. Roberts - UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst, Chemicals

I was asking about currency. Again, the currency year-over-year in the first half was significantly higher than full year currency effect? Go ahead.

Richard A. O'Leary - International Flavors & Fragrances Inc. - CFO and EVP

Yes. So currency in general will be favorable in the second half of the year, more of that coming in Q3 than Q4.

Operator

Your next question comes from Gunther Zechmann with Bernstein.

Gunther Zechmann - Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst

Yes, I have a spectacular question, you just touched on a little bit (inaudible) . A short one I promise. It's been quite volatile the guidance on tax rate for the last 2 quarters of the year, please?

Richard A. O'Leary - International Flavors & Fragrances Inc. - CFO and EVP

So again I think my guidance for tax rate hasn't changed since the beginning of the year, it's about 22.5. The calendarization of that or quarter-by-quarter, there is volatility in that, depending upon specific items that occur and the mechanics in terms of how we have to record some of the items related to the pretax in the quarter. So in general, the second half will be higher than the first half, but I'm still comfortable with the guidance the full year 22.5.

Operator

Your next question comes from Mark Astrachan with Stifel, Nicholas.

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Mark S. Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

I guess, just broadly, Andreas, what are your thoughts on industry consolidation given slowing customer volumes? And maybe more specifically, how do you think about bolt-on versus larger scale M&A sort of given where we are, you've done a bunch of smaller deals and broader context would be helpful?

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

Sure. Mark, if you look at our M&A strategy, you know that we were not very active for many, many years. We have done now in the last 2 years roundabout 5 acquisitions and they have different, let's say, strategic reasons for it. 2 of these -- or 3 of these acquisitions are basically to look whether we can broaden our exposure to small and midsize customers, to grow on that front. Another one is basically going into adjacent area like active cosmetic ingredients. And PowderPure is a pure technology play because it gives us access to a technology which we had not before which can help us to grow in certain segments of the business. So all of these things we have experience. We are very happy with all of the 5 acquisitions. And we are very happy that they are actually performing at or above the business case we have given, which is actually pretty, pretty good if you look at 5 of these acquisitions. So we certainly, certainly, will go ahead with the bolt-on strategy because it just paid off, and we will make sure that we continue that path. I certainly can't tell you how many and how big these are because it's a bit opportunistic as well, but it's certainly in the cards. And we have to be disciplined here as well how much money we put at work. And for the transformational one, it's, as usually, I have to say, it depends on the opportunity. And if the opportunity arises, we look at it and then we make a call and a decision.

Mark S. Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - Director*

And on the bolt-on piece, just out of the curiosity, so you've done deals as you mentioned for customers in servicing middle-market consumers in some ways, Lucas Meyer was an adjacent category. So as you think about it going forward, if you had a choice, is it that you want more the former or the latter?

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

For me the most important question in here I'm getting Rich already nervous, the most important thing is to create value. Either one we take as long as we see an opportunity for us to create value in the long-term. And that's probably the answer. But I have to say, I hope that we will do some more of these technology plays going forward because now we are geared towards this as well because what we see with PowderPure, with the patented drying technology, which is a very great opportunity with less processed ingredients to go into a market segment which is very natural and very, very organic and even prevent food waste streams, that's something which is exciting as well and gives us exposure even to markets where we were not before like for example, some of the natural color markets because you know, the technology leaves the color metric intact in the ingredient, which is fantastic. And our Flavors team is now looking at different directions and we'll thought-out of it. And we'll have unfortunately some CapEx but it's not too big.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Mark, so let me wrap up from my perspective. I think both the technology side and the bolt-ons are attractive to us. I think we've demonstrated the ability to create value. And I think what is most important is that we continue to exhibit the financial discipline that we have around the targeting and the selection process.

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

Yes.



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Operator

There are no further questions at this time. I'd now like to turn the conference back over to Andreas for closing remarks.

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

Yes, thank you very much for all the insightful question. I guess, we will talk to many of you during our one-on-one calls as well. Have a good day. Thank you. Bye-bye.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - CFO and EVP*

Thank you.

Operator

Thank you for participating in today's conference. You may now disconnect.

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