INTERNATIONAL FLAVORS & FRAGRANCES INC
Form 10-Q
May 09, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2016

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 1-4858

INTERNATIONAL FLAVORS & FRAGRANCES INC.
(Exact name of registrant as specified in its charter)

New York	13-1432060
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

521 West 57th Street, New York, N.Y. 10019-2960
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code (212) 765-5500

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer ¨

Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ

Number of shares outstanding as of April 26, 2016: 79,713,873

1

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
INTERNATIONAL FLAVORS & FRAGRANCES INC.
CONSOLIDATED BALANCE SHEET
(DOLLARS IN THOUSANDS)
(Unaudited)

	March 31, 2016	December 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$528,877	$181,988
Trade receivables (net of allowances of $8,477 and $8,229, respectively)	609,587	537,896
Inventories: Raw materials	292,942	282,181
Work in process	15,832	17,450
Finished goods	291,922	289,388
Total Inventories	600,696	589,019
Prepaid expenses and other current assets	152,369	146,981
Total Current Assets	1,891,529	1,455,884
Property, plant and equipment, at cost	1,839,244	1,812,283
Accumulated depreciation	(1,105,305)	(1,079,489)
	733,939	732,794
Goodwill	951,177	941,389
Other intangible assets, net	302,088	306,004
Deferred income taxes	160,990	166,323
Other assets	122,737	119,060
Total Assets	$4,162,460	$3,721,454
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Bank borrowings and overdrafts and current portion of long-term debt	$133,692	$132,349
Accounts payable	276,929	302,473
Accrued payroll and bonus	39,603	48,843
Dividends payable	44,640	44,824
Other current liabilities	217,884	213,639
Total Current Liabilities	712,748	742,128
Long-term debt	1,369,955	937,844
Deferred gains	42,557	43,260
Retirement liabilities	243,690	242,383
Other liabilities	157,950	160,849
Total Other Liabilities	1,814,152	1,384,336
Commitments and Contingencies (Note 13)		
Shareholders' Equity:		
Common stock 12 1/2¢ par value; authorized 500,000,000 shares; issued 115,858,190 shares as of March 31, 2016 and December 31, 2015 and outstanding 79,777,759 and 80,022,291 shares as of March 31, 2016 and December 31, 2015	14,470	14,470
Capital in excess of par value	143,642	140,802
Retained earnings	3,678,219	3,604,254
Accumulated other comprehensive loss	(606,999)	(613,439)
Treasury stock, at cost - 36,080,431 shares as of March 31, 2016 and 35,835,899 shares as of December 31, 2015	(1,598,968)	(1,555,769)

Total Shareholders’ Equity	1,630,364	1,590,318
Noncontrolling interest	5,196	4,672
Total Shareholders’ Equity including noncontrolling interest	1,635,560	1,594,990
Total Liabilities and Shareholders’ Equity	$4,162,460	$3,721,454

See Notes to Consolidated Financial Statements

INTERNATIONAL FLAVORS & FRAGRANCES INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(AMOUNT IN THOUSANDS EXCEPT PER SHARE AMOUNTS)
(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Net sales	$783,312	$774,907
Cost of goods sold	423,103	428,630
Gross profit	360,209	346,277
Research and development expenses	63,385	63,462
Selling and administrative expenses	123,543	118,995
Amortization of acquisition-related intangibles	6,061	1,840
Restructuring and other charges, net	—	187
Operating profit	167,220	161,793
Interest expense	12,478	11,095
Other income	(154)	(5,710)
Income before taxes	154,896	156,408
Taxes on income	36,293	28,150
Net income	118,603	128,258
Other comprehensive income (loss), after tax:		
Foreign currency translation adjustments	14,077	(50,515)
(Losses) gains on derivatives qualifying as hedges	(10,192)	12,083
Pension and postretirement net liability	2,555	5,547
Other comprehensive income (loss)	6,440	(32,885)
Total comprehensive income	$125,043	$95,373
Net income per share - basic	$1.48	$1.58
Net income per share - diluted	$1.47	$1.57
Average number of shares outstanding - basic	79,666	80,654
Average number of shares outstanding - diluted	80,055	81,195
Dividends declared per share	$0.56	$0.47

See Notes to Consolidated Financial Statements

INTERNATIONAL FLAVORS & FRAGRANCES INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(DOLLARS IN THOUSANDS)
(Unaudited)

	Three Months Ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net income	$118,603	$128,258
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization	26,697	19,985
Deferred income taxes	4,193	13,932
(Gain) loss on disposal of assets	(2,713)	34
Stock-based compensation	5,930	5,387
Pension contributions	(7,410)	(54,048)
Changes in assets and liabilities:		
Trade receivables	(60,655)	(62,891)
Inventories	3,256	13,172
Accounts payable	(29,375)	4,618
Accruals for incentive compensation	(11,598)	(27,675)
Other current payables and accrued expenses	10,456	12,585
Other assets/liabilities, net	(25,769)	(21,881)
Net cash provided by operating activities	31,615	31,476
Cash flows from investing activities:		
Additions to property, plant and equipment	(22,512)	(19,381)
Proceeds from disposal of assets	1,366	1,450
Net cash used in investing activities	(21,146)	(17,931)
Cash flows from financing activities:		
Cash dividends paid to shareholders	(44,826)	(37,971)
Net change in revolving credit facility borrowings and overdrafts	(124,602)	265
Deferred financing costs	(4,796)	—
Proceeds from issuance of long-term debt	555,559	—
Loss on pre-issuance hedges	(3,244)	—
Proceeds from issuance of stock under stock plans	163	227
Excess tax benefits on stock-based payments	1,032	8,597
Purchase of treasury stock	(40,007)	(10,660)
Net cash provided by (used in) financing activities	339,279	(39,542)
Effect of exchange rate changes on cash and cash equivalents	(2,859)	(8,887)
Net change in cash and cash equivalents	346,889	(34,884)
Cash and cash equivalents at beginning of year	181,988	478,573
Cash and cash equivalents at end of period	$528,877	$443,689
Interest paid, net of amounts capitalized	$20,729	$19,697
Income taxes paid	$23,884	$20,634

See Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

Note 1. Consolidated Financial Statements:

Basis of Presentation

These interim statements and related management's discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the related notes and management's discussion and analysis of results of operations, liquidity and capital resources included in our 2015 Annual Report on Form 10-K ("2015 Form 10-K"). These interim statements are unaudited. The year-end balance sheet data included in this Form 10-Q filing was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States of America. We have historically operated and continue to operate on a 52/53 week fiscal year ending on the Friday closest to the last day of the quarter. For ease of presentation, March 31 and December 31 are used consistently throughout this Form 10-Q and these interim financial statements and related notes to represent the period-end dates. For the 2016 and 2015 quarters, the actual closing dates were April 1, and April 3, respectively. The unaudited interim financial statements include all adjustments (consisting only of normal recurring adjustments) and accruals necessary in the judgment of management for a fair statement of the results for the periods presented. When used herein, the terms "IFF," the "Company," "we," "us" and "our" mean International Flavors & Fragrances Inc. and its consolidated subsidiaries.

Reclassifications and Revisions

Certain prior year amounts have been reclassified to conform with current year presentation. In addition, an adjustment has been made to two line items within net cash provided by operating activities for 2015 to reflect the previously recorded correction of a balance sheet classification associated with accounts payable and accruals. The adjustment was not material to the consolidated statement of cash flows.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued authoritative guidance which requires changes to several aspects of the accounting for share-based payment transactions, including the treatment of income tax consequences, classification of awards as either equity or liabilities, and classification of certain items on the statement of cash flows. This guidance will be effective for annual and interim periods beginning after December 15, 2016. Early adoption will be permitted for all entities. The Company is currently evaluating the impact that this new standard will have on its consolidated financial statements.

In February 2016, the FASB issued authoritative guidance which requires changes to the accounting for leases. The new guidance establishes a new lease accounting model, that, for all companies, requires entities to record assets and liabilities related to leases on the balance sheet for certain types of leases. The guidance will be effective for annual and interim periods beginning after December 31, 2018. Early adoption will be permitted for all entities. The Company expects the adoption of this guidance will result in significant increases to assets and liabilities on its consolidated Balance Sheet.

In May 2014, the FASB issued authoritative guidance to clarify the principles to be used to recognize revenue and made subsequent clarifications under the new requirements during March 2016. The guidance is applicable to all entities and is effective for annual and interim periods beginning after December 15, 2017. Adoption as of the original effective date is permitted. The Company is currently evaluating the impact that this new standard will have on its consolidated financial statements.

Accounts Receivable

The Company sells certain accounts receivable on a non-recourse basis to unrelated financial institutions under "factoring" agreements that are sponsored, solely and individually, by certain customers. The Company accounts for these transactions as sales of receivables, removes the receivables sold from its financial statements, and records cash proceeds when received by the Company. The beneficial impact on cash from operations from participating in these programs decreased approximately $4.7 million for the three months ended March 31, 2016 compared to a decrease of approximately $6.5 million for the three months ended March 31, 2015. The cost of participating in these programs was immaterial to our results in all periods.

Note 2. Net Income Per Share:

Net income per share is based on the weighted average number of shares outstanding. A reconciliation of the shares used in the computation of basic and diluted net income per share is as follows:

5

(SHARES IN THOUSANDS)	Three Months Ended March 31, 2016	2015
Basic	79,666	80,654
Assumed dilution under stock plans	389	541
Diluted	80,055	81,195

An immaterial amount of stock-settled appreciation rights (“SSARs”) were excluded from the computation of diluted net income per share for the three months ended March 31, 2016. There were no stock options or SSARs excluded from the 2015 period.

The Company has issued shares of purchased restricted common stock (“PRS”) which contain rights to nonforfeitable dividends while these shares are outstanding and thus are considered participating securities. Such securities are required to be included in the computation of basic and diluted earnings per share pursuant to the two-class method. The Company did not present the two-class method since the difference between basic and diluted net income per share for both unrestricted common shareholders and PRS shareholders was less than $0.01 per share for each period presented, and the number of PRS outstanding as of March 31, 2016 and 2015 was immaterial. Net income allocated to such PRS was $0.6 million during each of the three months ended March 31, 2016 and 2015.

Note 3. Acquisitions:

2015 Activity

Lucas Meyer

During the third quarter of 2015, the Company completed the acquisition of 100% of the outstanding shares of Lucas Meyer Cosmetics, a business of Unipex Group ("Lucas Meyer"). The total shares acquired include shares effectively acquired pursuant to put and call option agreements. The acquisition was accounted for under the purchase method. Total consideration was approximately Euro 284.0 million ($312.0 million), including approximately $4.8 million of cash acquired. The Company paid Euro 282.0 million (approximately $309.7 million, for this acquisition, which was funded from existing resources, and recorded a liability of approximately Euro 2.0 million (approximately $2.2 million). The purchase price exceeded the fair value of existing net assets by approximately $289.5 million. The excess was allocated principally to identifiable intangible assets (approximately $161.5 million), goodwill (approximately $186.8 million) and approximately $51.0 million to deferred taxes. Goodwill represents the excess of the purchase price over the fair value of net assets acquired. Separately identifiable intangible assets are principally related to customer relationships, proprietary technology and patents. The intangible assets are being amortized using lives ranging from 10-28 years. The purchase price allocation is preliminary pending final valuations of intangible assets, principally related to the valuation of customer relationships, allocation of asset values by legal entity and determination of useful lives.

No pro forma financial information for 2016 is presented as the impact of the acquisition was immaterial to the Consolidated Statement of Comprehensive Income. During the first quarter of 2016, the preliminary purchase price allocation was updated, however, none of the changes were material to the consolidated financial statements. The purchase price allocation is expected to be completed in the second quarter of 2016.

Ottens Flavors

During the second quarter of 2015, the Company completed the acquisition of 100% of the outstanding shares of Henry H. Ottens Manufacturing Co., Inc. ("Ottens Flavors"). The acquisition was accounted for under the purchase method. The Company paid $198.9 million (including $10.4 million of cash acquired) for this acquisition, which was funded from existing resources. The purchase price allocation was completed during the fourth quarter of 2015. The impact of the acquisition was not material to the consolidated financial statements.

Note 4. Restructuring and Other Charges, Net:

During the fourth quarter of 2015, the Company established a series of initiatives that are intended to streamline its management structure, simplify decision-making and accountability, better leverage and align its capabilities across the organization and improve efficiency of its global manufacturing and operations network. As a result, in the fourth quarter of 2015, the Company recorded a pre-tax charge of $7.6 million, included in restructuring and other charges, net, related to severance and related costs pertaining to approximately 150 positions that will be affected. During the first quarter of 2016, the Company made payments of $0.9 million and recorded accelerated depreciation expense of $0.1 million. The total cost of the plan is expected to be approximately $10 million with the remaining charges relating principally to accelerated depreciation. The Company expects the plan to be fully implemented in the second half of 2017.

Changes in employee-related restructuring liabilities during the three months ended March 31, 2016, were as follows:

(DOLLARS IN THOUSANDS)	Employee-Related Costs	Accelerated Depreciation	Total
Balance at December 31, 2015	$ 7,882	$ —	$7,882
Additional charges (reversals), net	—	101	101
Non-cash charges	—	(101)	(101)
Payments and other costs	(923)	—	(923)
Balance at March 31, 2016	$ 6,959	$ —	$6,959

Note 5. Goodwill and Other Intangible Assets, Net:

Goodwill

Movements in goodwill during 2016 were as follows:

(DOLLARS IN THOUSANDS)	Goodwill
Balance at December 31, 2015	$941,389
Foreign exchange	6,812
Other	2,976
Balance at March 31, 2016	$951,177

Other Intangible Assets

Other intangible assets, net consist of the following amounts:

(DOLLARS IN THOUSANDS)	March 31, 2016	December 31, 2015
Cost		
Customer relationships	$288,876	$293,799
Trade names & patents	38,871	34,182
Technological know-how	111,886	112,393
Other	25,792	22,711
Total carrying value	465,425	463,085
Accumulated Amortization		
Customer relationships	(70,214)	(66,324)
Trade names & patents	(10,918)	(10,282)
Technological know-how	(65,920)	(65,258)
Other	(16,285)	(15,217)
Total accumulated amortization	(163,337)	(157,081)