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IFF - Frutarom Industries Ltd., International Flavors & Fragrances Inc. - M&A Call

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OVERVIEW:

IFF announced that it has entered into an agreement to acquire Frutarom and the transaction has an implied enterprise value of approx. $7.1b. IFF also reported 1Q18 results.

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Sipke Moes

PRESENTATION

Operator

Welcome to today's conference call and webcast to discuss the merger between International Flavors & Fragrances and Frutarom, as well as IFF's First Quarter 2018 Earnings. (Operator Instructions) At this time, I would like to turn the call over to Michael DeVeau, Head of Investor Relations. Please go ahead.

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

Thank you. Good morning, good afternoon and good evening, everyone. Thank you for joining our call to discuss the combination of IFF and Frutarom, as well as IFF's First Quarter 2018 Earnings Results.

As a reminder, this call is being recorded and the press release and slide presentation regarding today's news are available on the IR section of IFF and Frutarom's respective websites. 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 today, and is on our website.

I would like to remind everyone that these statements being made -- that all statements being made during the call that relates to future results and events, including the proposed merger, are forward-looking statements that are based on current expectations. Actual results and events could differ materially from those discussed here. Please refer to the information on the disclaimer slides in the presentation as well as the additional information contained in the regulatory filings for both companies.

Presenting on the call today will be IFF's Chairman and CEO, Andreas Fibig; Frutarom President and CEO, Ori Yehudai; and IFF Executive Vice President and CFO, Rich O'Leary.

With that, I would now like to introduce Andreas.

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

Thank you, Mike. This is an exciting day for both IFF and Frutarom. I'm going to take you through why we are so excited about the news we have announced today, and then I will cover the transaction terms. Ori will take you through Frutarom's and its history at a high level for those that are not familiar. Finally, we will delve deeper into the compelling strategy and financial rationale for this transaction. Lastly, Rich will conclude with a brief discussion of our strong first quarter earnings. So let's get started.

We believe this combination will create a global leader in taste, scent and nutrition. This transaction is a win for both companies shareholders. Among the important benefits we expect to realize by combining with Frutarom, IFF will significantly increase its position in natural solutions. We will also strengthen our exposure to fast-growing small mid-sized customer accounts, gain new opportunities in attractive and fast-growing adjacencies such as natural colors, enzymes, antioxidants and health ingredients, and enhance our global reach. We will also be able to realize the benefit of strong talent comprising extraordinary employees globally. Overall, we have a tremendous opportunity to accelerate our growth, realize significant synergies and deliver attractive shareholder value.

Moving on to the terms of this transaction on Slides 7 and 8. Frutarom's shareholders will receive total considerations of $106.25 per share in a cash and stock transaction. The transaction has an implied enterprise value of approximately $7.1 billion. And the consideration is a mix of 67% cash and 33% stock, which provides shareholders both immediate value and the ability to participate in the compelling upside of the combination. Notably, the transaction has a significant synergy potential. We expect to realize approximately $145 million of run rate cost synergies by the third full year.

The transaction is expected to be neutral to adjusted cash earnings per share in the first full year and double-digit accretive to adjusted cash earnings per share in the second full year. The combined company is also expected to generate strong free cash flow. As such, we expect to maintain our quarterly dividend consistent with prior guidance following the close of the transaction.

We will also suspend our share repurchase program to prioritize debt reduction. In terms of financing, we have a solid foundation with a cash consideration expected to be financed with the combination of cash on hand, new debt raised and new equity of approximately $2.2 billion. We have bridge financing in place and the transaction is not subject to a financing condition. We are pleased that Ori has agreed to join us as strategic adviser following the close of the transaction to ensure a smooth transition.

We are expecting to close in the next 6 to 9 months, subject, of course, to the receipt of regulatory approvals, a Frutarom shareholder vote and other customary closing conditions. Affiliates of ICC Industries Incorporated, which owns 36% of Frutarom, has agreed to vote in favor of the transaction.

Before I hand over the call to Ori to tell you a bit more about Frutarom, I want to thank him and his team for the extraordinary effort they have put forth in this transaction. Over the last several months, as we worked on the details of bringing our 2 companies together, I have had an opportunity to get to know him and his team a lot. Everything I have learned during the process has confirmed my tremendous respect for Frutarom and its team. And I have shared with Ori on many occasions, Frutarom's expertise, reputation and record of performance is impressive. We have long admired Frutarom, and I'm excited to be combining forces. Ori?

Ori Yehudai - *Frutarom Industries Ltd. - President & CEO*

Thank you, Andreas, and it's a great pleasure for me to participate in this first call, while we are aiming to combine these excellent 2 companies, IFF and Frutarom. I admire IFF since I joined this industry more than 33 years ago, and I'm sure that we'll all, including with my excellent colleagues, will admire the combined company going forward in the right ways. In a way, if you allow me on a personal note, just shortly, I'm closing like 2 wheels or circles right now after this 33 years. I joined the company in '86 with sales at that time $3 million. We were able to grow fast, double our company every 4 years, build a global company with 70,000 products sold to 30,000 customers in more than 160 countries. This is a great power to -- that we will be able to use together in the cross-selling opportunity, while we combine the excellent product portfolio and technology of the 2 companies. Of course, great support from the high technology of IFF that, of course, we didn't have access before.

So we truly build a global company, combining fast internal growth above markets, 70 acquisitions added into the Frutarom portfolio and business over the years that enabled us to jump from $3 million in revenue to $1.6 billion to date, and hopefully more.

The second circle that I can see is value creation. Frutarom became a public company about 22 years ago. Market cap was $13 million, 1-3 million. We are closing this circle today, which is only the beginning of the circle for me with market valuation of over $7 billion. So we were able to give some value creation to our shareholders with a great belief that I already -- always mention. We must find a way how we combine 1 plus 1 that equal 3 or 4, because I'm very weak in mathematics.

I believe, and I'm sure that the combination of the 2 companies will allow Frutarom together with IFF to grow faster. Frutarom itself is a stand-alone company, had targets that were upgraded about 6 months ago, following excellent acquisitions that we did to $2.25 billion with EBITDA margin in our core business of above 23% before 2020. The 23% EBITDA margin I'm sure will be achieved much before, and I think the combination with IFF will enhance both the internal growth and the profitability following the synergies that were mentioned by my friend, Andreas, before and maybe he will come back to that later.

I believe that part of Frutarom's success was to see market trends before many of our competitors. In many cases, before the food industry; so the competitors. We built the company over the last 10 years on taste, on health, on naturals, on where -- on the areas where billions of consumers want to see in their foods and that's enabled us to grow at a double rate than the markets we are operating in with over 75% of our product today being natural products, much more than all our competitors. Another differentiation of Frutarom, definitely with IFF and with the other large companies, is that how we combine together to create higher value will be with our specific approach towards customers. 70% of them smaller, mid-sized local companies, out of them 1/3 of the company is private label. Private label sector in today's world is growing faster than many of the multinational. IFF's strength with the multinational. So we have now 2 strong legs, 1 with the multinational and 1 with the smaller customers and the private label primarily.

In the geography side, I think, again, we are dealing with complementary combination of 2 companies that are strong in different areas. And again, this will allow us to grow faster than the way we were going each company by itself up till now. The full solution of product that Frutarom can contribute with the cross-selling are getting now a very nice booster with the IFF technology. And I'm very, very optimistic that using these synergies in the best way will allow us to grow faster than any other company in our area.

In the last few years, Frutarom added some new technology into its portfolio through several acquisitions, natural color, natural antioxidant; infant nutrition, a fast-growing business that we acquired through a company called Enzymotec; natural cosmetics ingredient, and we have more acquisition to do in that area.

Starter culture, that's a very profitable growing business. I will not have the time to mention all of them. We'll have the time, me and Andreas, to talk to you and give -- maybe give you some training about the Frutarom product to those that are less familiar with the Frutarom portfolio and how the combination of the 2 companies create, I believe, the best company in the industry.

I take this opportunity to thank Dr. John Farber, our Chairman, for his vision, support and trust and to thank our excellent employees that brought us to where we are now. On a personal note, I really feel lucky to be part of such incredible group. And I'm excited and thankful for Andreas to invite me to be part of that. Thank you, Andreas, and the floor is yours, my boss.

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

Thank you, Ori. Let's go a bit deeper on the compelling strategy and financial rationale. As you can see on the Slide 11, this transaction solidifies IFF as a global leader in taste, scent and nutrition. We are uniting 2 industry-leading, innovative companies for its complementary customers and capabilities and a talented and committed workforce. Ori and the entire Frutarom team have done an incredible job innovating and building their natural platform. As a result, we will also become a global leader in this important arena and will be well positioned to meet the evolving needs of our customers and consumers.

We will offer our customers a stronger more differentiate portfolio of integrated solutions and capabilities. This will allow us to expand into attractive and fast-growing areas, such as enzymes, antioxidants, health ingredients and natural colors. Our customers will have access to a comprehensive portfolio with more value-added and integrated solutions. With Frutarom, we will significantly increase our exposure to fast-growing small- and mid-sized customers, which dovetails perfectly with our new Tastepoint platform.

Slides 12 to 14 outline what the combined company will look like at a very high level. We will be positioned as the leader in natural capabilities, which will extend across our entire platform. Our customers will have access to comprehensive and differentiated integrated solutions with increased focus on naturals and health and wellness. This is consistent with the consumer trends we are all seeing. As an example, through the ALDI partnership Frutarom has developed food supplements, but also cosmetic solutions that can be additive to our active ingredients platform. For flavor, paprika combines the benefit of natural flavor and clean label color. In addition, rosemary extracts are powerful antioxidants offering health benefits to food and beverage solutions.

On Slide 13, you can see that the combined company is expected to have approximately $5.3 billion of revenues in 2018, making it one of the largest players in the industry.

Turning to Slide 14. Once the transaction is closed -- closes, we will have a more diversified and more favorable revenue mix. This shift also supports a more favorable growth profile. We will have new exposure to attractive adjacencies, such as enzymes, antioxidants, health ingredients and natural colors allowing us to expand beyond flavors. Importantly, the adjacencies Frutarom brings us triggers competitive positions for the combined company in high value-added categories with increasing expected market growth rates.

Additionally, as outlined on Slide 15, by combining our R&D with the capabilities of Frutarom, we will be able to offer a full suite of value-enhancing integrated solutions to customers of all size. For example, we are excited about the potential to combine our technical expertise in savory modulation and delivery system with Frutarom's Savory Solutions to strengthen our product offering to our savory customers. On Beverages, combining our flavor and sweetness modulation expertise with Frutarom's citrus capabilities, natural antioxidants and natural colors, to build visually appealing, wholesome and nutritious beverage solutions. As a result, we will have products that are second to none.

As you can see on Slide 16, it is not just the market growth rate that makes us excited. The combination also increases IFF's access to faster-growing small- and mid-sized customers. This is a key demographic subset within the fast-growing markets just discussed that includes local and regional customers. We will also gain a presence with fast-growing private label customers.

Slide 17 provides more details on the significant synergies we expect to achieve from this transaction. We anticipate $145 million of run rate cost synergies by the third full year after closing with approximately 25% achieved in year 1. We expect the cost synergies to come from procurement, footprint optimization and streamlining overhead expenses. We have done our homework here and spent a lot of time looking at the business. We are confident that these are very -- these goals are very achievable. Cross-selling opportunities and integrated solutions are expected to drive revenue synergies, providing additional value to the shareholders over time.

As we have already discussed, we expect the transaction to drive strong earnings and cash flow accretion for the combined company; the anticipated double-digit cash EPS accretion in the second full year. Following the completion of the transaction, IFF is also expected to benefit from enhanced top line growth rates and a strong EBITDA margin. When you take all of this together, we expect tremendous value-creation opportunities. Importantly, we are committed to maintaining an investment-grade credit rating, and we'll prioritize deleveraging through our anticipated strong cash flow generation.

Wrapping up. Slide 19 underscores how this combination with Frutarom fits with our stated strategy and our refreshed Vision 2020 plan. Our Vision 2020 strategy focuses on building differentiation, accelerating profitable growth and increasing shareholder value. We look to win while we compete and strengthen our position through developing pioneering firsts. Our goal is to become our customers' partner of choice, and we will continue to look for ways to strengthen and expand our portfolio to fit into areas of expertise beyond the walls of IFF. This combination with Frutarom allows us to achieve all of these things.

With that, I turn the call over to Rich O'Leary to discuss our first quarter results before we open the call up for questions.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Thanks, Andreas. I'd like to now turn your attention to a review of our first quarter 2018 results. We have a few slides here to review. I'm pleased to report that we stared off the year very well with robust growth across all of our key financial metrics.

Our first quarter sales growth was strong as currency-neutral sales increased 7%, which was comprised of 8% growth in Fragrances and 6% growth in Flavors. Top line trends remain strong in both businesses with new wins, volume and pricing all contributing to growth. In Fragrances, we delivered broad-based growth from all categories and regions. And in Flavors, we achieved growth in all categories and nearly all regions.

In terms of currency-neutral adjusted operating profit, our focus on driving greater efficiency throughout our business by our cost and productivity initiatives continue to support overall profitability. When combined this with our strong top line performance, we had strong leverage in the P&L as operating profit and EPS both grew 12% on an adjusted currency-neutral basis.

Turning to Slides 22 and 23. Flavors' currency-neutral sales increased 6% with growth coming from all categories led by strong improvements in Savory and Dairy. It should be noted, on a 2-year average basis, growth continues to be strong at approximately 8%.

From a regional perspective, 3 of the 4 regions delivered growth led by double-digit increases in both EAME and North America. EAME increased 11% on a currency-neutral basis, led by strong double-digit growth in Africa and the Middle East as well as mid-single digit growth in Europe. Growth was achieved across all categories, led by strong performance in Dairy, Beverage and Savory. North America increased 10%, driven by strong new wins in Beverage and Dairy as well as double-digit growth in Tastepoint.

While the impact of the acquisition was not material on our overall results, PowderPure added a couple of percentage points to growth in North -- in Greater Asia, 2% growth on a currency-neutral basis as double-digit growth in India and China was muted by softness in Indonesia and the ASEAN region. And Latin America decreased 2% as mid-single-digit growth in the Southern Cone was more than offset by softness in Mexico and Colombia, which had strong year ago comparison. In terms of profitability, Flavors' currency-neutral segment profit grew approximately 15% led by volume growth, the benefit from productivity and favorable sales mix. Currency-neutral segment profit margin achieved year-over-year margin expansion of approximately 190 basis points to 24.8%.

Fragrances currency-neutral sales grew 8% in Q1, as growth was broad-based with contributions coming from all categories. Regionally, growth was led by double-digit increases in 3 of our 4 regions. From a category perspective, Fine Fragrances improved 4% on a currency-neutral basis. Growth was led by strong double-digit growth in Latin America and North America. In these markets, performance was driven by new wins as well as increases in volume.

Consumer Fragrances grew 6% on a currency-neutral basis. Growth was achieved in all categories led by high single-digit performance in Home Care, Toiletries and Hair Care, as well as mid-single digit performance in Fabric Care. The contribution of growth continues to be led by new wins, with modest improvement in volumes.

Fragrance ingredients sales were up 18% on a currency-neutral basis, driven by growth in nearly all regions led by double-digit growth in Latin America, North America and Greater Asia. Cosmetics active ingredients also continue to perform well as it grew strong double digits in the first quarter. Fragrances segment profit in Q1 grew approximately 12% on a currency-neutral basis, driven primarily by volume growth and the benefits from productivity initiatives. Currency-neutral segment profit margin increased 60 basis points year-over-year, finishing at 19.4% in the quarter.

As you see on the next slide, we are off to a strong start to the year and that gives us added confidence in achieving our financial objectives for 2018. And while it's still early in the year, we will -- we believe we'll be closer to the upper end of our previously communicated sales and operating profit guidance range. Those ranges are 3% to 5% currency-neutral sales growth, 5% to 7% currency-neutral adjusted operating profit and 4% to 6% currency-neutral adjusted EPS growth. In terms of foreign exchange, while there continues to be fluctuations, we expect currency-neutral translation to be favorable impact on sales of approximately 3 percentage points and add approximately 1.5 percentage points to adjusted operating profit and adjusted EPS, respectively.

With that, let me turn it back over to Andreas.

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

Thank you, Rich. Let's summarize. We are very pleased with our strong start to 2018. Sales growth was robust with growth across both business units, that when coupled with cost and productivity initiatives, translated into stronger currency-neutral adjusted operating profit and EPS growth. We are more confident in our outlook for year, as we expect to be towards the upper end of our previously communicated guidance range.

On this strong foundation, today's transaction comes from a position of strength. As we discussed, together with Frutarom, we anticipate delivering accelerated growth and offer our customers a stronger, more differentiated portfolio of integrated solution, allowing us to expand beyond our core taste and scent businesses into nutrition. We will drive differentiation via R&D, balance our customer base by emphasizing fast-growing small mid-sized customers and maximize our portfolio by expanding into fast-growing and diverse adjacencies. Our partnership will result in value creation for our shareholders and even more opportunities for the talented employees of both companies. We could not be more excited about what the future holds for both of us.

Operator, let's open for questions.

QUESTIONS AND ANSWERS

Operator

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

Mark Stiefel Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

I guess, just thoughts broadly, so the deal gets you bigger in Flavors, how do you think about the sustainability of Flavors' growth to remain ahead of Fragrances longer term? I guess, it has in recent years, so you're obviously expecting it to continue, but I guess I'd love to hear how you think about that. And then sort of related to it, thoughts on the strategic rationale for buying a business that had some overlap of competing within your core business, Flavors and Fragrances, I get they're not completely a competitor, with some smaller customer exposure. But how do you think about going into more traditional F&F versus going into an adjacent category at scale as Enzymotec, something like that? So I guess, thoughts on just overall growth rates would be helpful.

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

Okay. Yes, absolutely, Mark. So first of all, we would like to see that it's just an overlap on the classic and traditional flavors, but what we see is here a whole range of exciting adjacencies. And you well know, with our Vision 2020, we have started to expand beyond Flavors already and beyond Fragrances actually with the acquisition, for example, of LMC, where we went into active cosmetic ingredients. By the way, we will strengthen with the Frutarom acquisition the active cosmetics business as well, because we have parts of it in it. And if you look at all the different markets, and actually we have one of the slides showing it very well, the adjacencies. The market growth of these adjacencies is a bit higher than in our traditional F&F. And we have some of these areas which was really good profitability as well, so we are basically building beyond the traditional Flavor business.

That's the reason why we like to talk in the future about taste and nutrition as the 2 elements or segments where we are in. We actually believe that the deal with Frutarom is very complementary, actually in many regards; in terms of the portfolio and the technologies; in terms of the geographic exposure, because we are filling in some gaps we are having, for example, in Eastern Europe, where Frutarom is just very, very, very strong. So that's helping us a lot. So for me, it's a very natural prolongation of our Vision 2020 strategy and fits exactly into that. That's the reason why Ori and myself saw this combination as something which is just unbeatable, because it fits so well together. So we're a bit stronger on the taste and nutrition side, but we believe that's really good. Rich, do you want to step in?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Yes, I mean, Andreas, and more, I mean, for me I think it is very -- it's a great opportunity. It shifts the overall mix when you think about it. It's going to be favorable in terms of accelerating growth for the combined companies. From a business standpoint, the overall -- we know the overall markets on the Flavors side are higher than on the Fragrances side, but both businesses remain very attractive and very profitable. It helps from a category standpoint that Andreas talked about, that we're getting access to and a foundation to build upon some of the faster-growing adjacencies that we've targeted and saw real opportunities for our Vision 2020. And then the access to the faster-growing local and regional customers, all those things are going to be positive for the overall growth profile of the company.

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

And the good thing on the customer side there is, the overlap is not that big. So it actually helps us for the cross-selling quite tremendously, because we can sell our technology to Frutarom customers and vice versa. So we believe that we'll create a lot of value going forward just cross-selling.

Mark Stiefel Astrachan - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Great. And just following up on the last point. So how confident are you in retaining the customers? I guess, if you can give more of a specific percentage of customer overlap, that would be helpful. And just sort of another broader question related to customers. So your gross margins were a bit better in the quarter than I think most would have expected, certainly us. Have -- has the push back on the pricing which you talked about last fall subsided? And in doing a deal like this, do you think that helps get more scale? And just how do you think about the puts and takes in dealing with your customers on a go-forward basis? Obviously, you're offering them more solutions, but we're all still under pressure on their -- in their earnings algorithm.

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

So if you look at the customer base, Frutarom is covering around about 30,000 customers, we cover around about 3,000 customers. So there is actually, as I said, not a lot of overlap. We believe that the danger is that we are losing important customers is very, very little. We don't think that, that will happen. The good thing as well on the Frutarom side is because they are standing on so many legs with so many different customers, there is not this big customer, if we lose it, it will put the deal into jeopardy. I think it's actually a very good risk mitigation for all of us that they have such a wide customer base. And we will now go really into the targeting, how we do the cross-selling in the best possible way. On the pricing?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

It -- I mean, I think, my first comment I would say, when you look at the categories, I mean, there's not -- they are -- in a lot of ways, Frutarom, their business, where there is overlap from a customer standpoint, so a lot of that's coming in categories that we don't have today. So again, I feel like the risk of overlap is quite low from a pricing standpoint, but not -- I mean, it's a market environment and we have to manage through that the way we do day in, day out every day, okay?

Operator

Your next question comes from the line of Lauren Lieberman of Barclays.

Lauren Rae Lieberman - *Barclays Bank PLC, Research Division - MD and Senior Research Analyst*

First thing I want to ask about was just integration. So my understanding is Frutarom has been very, very active on the M&A front. And so as you're thinking about synergies and integration, I wanted to know, one; how much of the $145 million is sort of inclusive of integration plans that Frutarom was really in the middle of pursuing? And then secondly, if some of those plans kind of get reworked, because now integration may be meaning something different as you're integrating some of those deals into a bigger sort of infrastructure, vis-à-vis IFF. And just kind of visibility on timing of those pieces.

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

So Lauren, thank you for the question. And indeed, the integration is of utmost importance. First of all, we have started already with Ori and the Frutarom team to identifying what are the areas and that's how we came up with the $145 million. And we are actually very confident that we can achieve that. And we look during the DD, from our point of -- our vantage point on the integration, and we believe that we have already a good idea and a good plan in place. We will bring up an integration office, which is meant with people from both companies with one of our high-ranking IFF executives to lead this team for the next 1.5 or 2 years to really make it a priority for us. Actually we have even set up a board integration committee, which is led by -- as a Chairman, by Marcello Bottoli to make sure that we have the right focus on it. So I believe we are very well prepared. And then we should not underestimate that what Frutarom has done in the last couple of years is a lot of work on integration already. So we are counting here on a very experienced team, which can support us to bring this all on board.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Yes, I think from my standpoint, Lauren, I mean, we really did start with a very clean sheet of paper and said, "Look at the 2 organizations. Where are their opportunities? Whether it's from a technology standpoint, whether it's from a sourcing standpoint, manufacturing footprint, the overhead expenses, and I think we know we feel very good about and confident about our ability to deliver on that and leverage -- as Andreas said, leverage the talent and the expertise on both sides of the business.

Operator

Your next question comes from the line of Mike Sison of KeyBanc.

Michael Joseph Sison - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

In terms of the accretion potential in year 2, can you maybe talk through what type of growth you expect Frutarom to generate in that year? How much of the synergy would come in year 1 or in year 2? And then maybe frame up the -- I guess, your long-term goal, if you grow EPS organically, add double digits or 10% or something, that would be kind of a strong double-digit mid- to high-teens EPS growth in year 2, is that the way to kind of think about it?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Mike, there's a lot there. I'm not sure I can write that fast. Look, I think from a synergy standpoint, the cost side as we talked about in our previous materials, we think about 25% of the synergies will come in year 1. There will be probably between 70%, 75% in year 2. And then following in year 3, year 2, year 1, we believe would basically going to be neutral from a cash EPS standpoint and as we turn around here, double-digit increase and double-digit improvement in cash basis in year 2. From a top line standpoint, there is -- again, this is an attractive business. Frutarom has had a consistent growth for -- trajectory on an organic basis for the last 3 years, growing faster than we have been growing. On top of that there is benefits associated with their M&A program, which has been a crucial part of their business strategy. So I think on an absolute basis, combining organic growth and some of the carryover from that of their M&A program will have higher growth in year 1, and then the normal growth at the higher end of the range going forward.

Operator

Your next question comes from the line of Faiza Alwy of Deutsche Bank.

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

So I have 2 questions. One is just, can you talk about how much overlap there is in North America specifically? Because I know that's where you've made an effort to target some of the smaller and medium-sized customers? And to the extent there is sort of how do you plan to run the business together in North America, and then just globally post deal closure? And then my second question is just on, it seems like Frutarom's, like, gross margins and EBITDA margins are a bit lower than yours. Do you see that as an opportunity or do you think that's a function of the categories that they are in versus that you're in?

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

Faiza, thank you for the question. I'll take the first part and then Rich, the second one. So actually North America -- the overlap is very, very, very small how we see it. But it will fit actually very, very well into our business, in particular with the Tastepoint we have set up here. So we will make now this part of the business super, super strong, and it will help us in our home market actually a great deal. Rich?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Yes. On that same point, looking at the margins, I mean, first of all, Frutarom's had a tremendous impressive record of growing the business while expanding margins. It's a very strong business, and we're extremely pleased to have that opportunity combine the 2 companies. I think some of the opportunities and the differences reflected in the margin is reflected in the synergy opportunity that we already discussed earlier. And other piece of it can be mix related also.

Operator

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

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

I guess, my first question would be just around kind of what pro forma growth margins, capital intensity of the business. And as you think about what the pro forma organic revenue growth would look like for the combined business. I mean, acquisitions post close, I'd imagine would become less kind of eminent strategic priority. And then on the capital intensity portion, what the working capital -- do you see any opportunities in working capital post the deal? I think the cost synergies, which is the cost number and there wasn't any identified cash synergies. And then 1 quick follow-up on the quarter, you exceeded kind of your range on growth on all metrics, but the guidance range was left unchanged. Could you talk about drivers of implied deceleration over the balance of the year?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Okay. So I mean, from a growth perspective to give you some comments on the last one now, and we're -- actually we're not going to get into specifics. From a margin potential, I mean, when you look at the 2 businesses and on the synergies, we feel like we're going to be well positioned to be competitive at the high end of the market in terms of overall EBITDA margins. From a capital intensity standpoint, I think there's opportunities as we combine both organizations to drive improvements on an overall basis in terms of our working capital performance. It's going to help drive the cash flow over the next 5 years to help drive the leveraging. That's important for our overall strategy. From a CapEx standpoint, I think as we look to the overall position, over time it will come down. Again, we have to work through, some of the integration work will require some more CapEx. And then so there'll be some included in our estimates of the cash flow models over the next couple of years is some CapEx necessary to drive the synergies from a manufacturing standpoint. But overall, this is a very strong business. Both businesses are extremely profitable. Strong cash generation and that's going to get us where we need to be to grow the business and also deleverage on an accelerated basis. From a earnings standpoint and our guidance, there is an implied difference between first half or Q1 sort of first strong start Q1. As we've talked about on the last call; number 1, the second half comps in the last year it becomes much, much stronger compared to the first half last year. We feel confident about our ability to get to the higher end of the range from growth, from a sales and operating profit standpoint. As I've talked about on the prior call, there is still a lot movement in the industry in terms of demand, inventory impacts, and so I think we're being appropriately cautious at this point in terms of our guidance for the full year.

Operator

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

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

I just had 2. The first one is a simple one. I was just curious if Frut will continue its M&A strategy during the next few months? I know their pipeline is very full, so I just wanted a comment on that. And then secondly, Andreas, in our opinion, Frut grows the way that it does, because of its, what I'll call a satellite approach and heavy levels of decentralization, so their culture seems very different than yours. And honestly, when we speak to other companies in the industry, many times they say that they don't even know when they're going up against Frutarom in a bid or something like that just because of all their disparate acquisitions over time. So it does seem like you really have your work cut out for you in realizing your synergy target, which is a pretty high target to begin with. Do you feel like you're being aggressive with the time line of synergy realization? And can you just delve back into the confidence that you have in realizing that target and the work that you've done? Because again, I think some of us are just thinking, while Frut has all these different businesses then IFF may potentially have some real work ahead of it?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

So let me start with an easy one. From an M&A standpoint, I mean, as I made a comment earlier, I mean, the M&A part has been an important part of the growth strategy and the vision for Frutarom. It's a key core competency of the Frutarom organization. We want to continue to leverage that and help drive the growth as combined companies. We're confident and given the strong cash flow of both businesses and the industry as a whole that we can continue to execute on the M&A platform, while aggressively deleveraging the company.

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

On the second question, we believe that both companies have an entrepreneurial culture and that is a pretty, pretty good alignment. So we don't believe that we have an aggressive time line on the cost synergy realization. So we feel real good about this. And if you think, what we have started now, let's say, a year, 2 years ago with our Tastepoint experiment in the U.S., it basically shows how you can deal with these smaller companies. Remember, we brought David Michael and Ottens and we have combined them into the Tastepoint as an outreach or platform for the more regional, smaller and mid -- or mid-sized customers. I believe that we have already some expertise. And that we also know when you build this platform, for example, how do you basically separate the traditional IFF business with the big customers, but still make sure that companies like

Tastepoint and now in the future, the Frutarom subsidiaries will get access to IFF technology. And that's the part of cross-selling which will create a lot of value going forward. And I believe that's a tremendous opportunity.

Operator

Your next question comes from the line of John Roberts of UBS.

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

Could you comment on margins on the 25% of sales that aren't Flavors? I assume trading is below average in natural colors, enzymes and antioxidants are above average?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Yes, that -- I think that's the right way to think about it. I mean, the trading business is very much almost like a distribution type, so the margins are lower, but it's a key value-add service that the Frutarom business provides to its customers.

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

And then, how do you plan on reporting the non-Flavors part of Frutarom? I think sometimes The Wake Up in its report kind of tells us a little about how they'll manage the businesses well. Will you roll it into Flavors like you do at Lucas Meyer in Fragrances? Or will you put it over with the Fragrance Ingredients or how do you plan to handle that?

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

Yes, what we will do over the next couple of months until the closing is that, we will come up with the right structure for the business going forward, which is -- positions us to capture the value as best as we can. And then we will basically decide on the reporting structure here as well. And you are right, John, there are couple of ways to go and now we have much more businesses, we have to look how we do it in the best possible way to make sure also that we support the cross-selling.

Operator

Your next question comes from the line of Jon Feeney of Consumer Edge.

Jonathan Patrick Feeney - *Consumer Edge Research, LLC - Senior Analyst of Food & HPC and Managing Partner*

Andreas, we've talked for a while about -- so one of the first questions I ever came up with, I don't know if it was a good one, was why mergers between the largest flavor and fragrances houses in the world don't really make sense. And I was referring to Givaudan, Symrise and Firmenich, there is discrete capabilities, there is overlapping customers. So what are their aspects of this transaction that suffer from that? Like do you -- are there major overlaps where you have commented on the existing customer base, there's something special about Frutarom and IFF's capabilities that make that a lot less of a problem? And -- or if you wouldn't mind, if I could ask you, what makes IF -- certainly a great company, lot of growth for all the reasons you outlined and incredibly are going to -- would accelerate any flavor house's growth, why IFF as a partner, owner, colleagues going forward?

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

So let me start with it and then hand it over to Ori. So for us, the great thing about this and why we believe it's the best fit you can find in the industry is that we don't have these major overlaps, either in the customer base, which basically broadens the customer base of the new company and also makes us much, much stronger on the naturals, which is a very great strategic fit for us. So Ori, why IFF?

Ori Yehudai - *Frutarom Industries Ltd. - President & CEO*

Many reasons. First is the one is the guy that talked before me, Andreas, that I think in a way just in love with him and decided to go with him even though we had other bidders and other interested parties that were less attractive to Frutarom. But on a more, I would say, serious note, even though the previous one was the truth, I mean, look, there are not -- there aren't too many flavor or specialty farm ingredients that are relevant in this space. Financial investor is not interested -- interesting for Frutarom, because it's not money that we are looking for. I strongly believe, and Andreas correctly said, that here we're really talking about a combination of 2 companies that are operating in different fields in 80% of the cases. If you're talking about Savory Solutions for the processed meat, processed fish, ready meals, Frutarom built over the last 12 years a leadership position in that area and that's not the strength of IFF. So here, this will be completely complementary to IFF, but we will use the excellent capabilities of IFF in flavor creation of specialty savory ingredients. When you go to natural products, again, Frutarom built over the last 10 years an exciting product portfolio, i.e., natural color, natural antioxidant, natural cosmetics ingredients that, of course, will go together with IFF and give them a very nice boost with high-end technology of product coming from ALDI or coming from extracts and other application. The difference in customer portfolio, 75% of Frutarom customers mid to -- local midsized with a special emphasis on the private label, I believe that was not the focus of IFF, correctly so as a large company. And I'm sure that between Andreas and me and the management, we will know how to -- not to lose customers and really use both expertise to create the 1 plus 1 equal 4. So it's the combination of the differentiation in customers, differentiation in product. And then talk about geography. Frutarom is very strong in some geography, where I believe IFF historically were not very strong. I will give example. Central and East Europe, very strong growth for Frutarom, but not where IFF invested before. Frutarom is very, very weak in Asia, IFF is strong in Asia and now we have both Frutarom portfolio and IFF portfolio to go to the same customers. Frutarom acquired Enzymotec with the infant nutrition business, that's not a business that IFF has, but IFF has many large customers that are using or might use this type of technology, so we are going to a new area of basic nutrition ingredients that enhance our position. Frutarom acquired a company called Taura with unique amazing technology to dry fruits within less than 1 minute in an authentic way, no flavor, no sugar added. This is extremely interesting for many customers. For example, in the United States, nutritional bars, many other areas, the large customers that are IFF customers, not necessarily Frutarom customers. So the entrance into these customers will be much higher. I can continue talking about it for another year, but really this is about creating value and growth. And I strongly believe that this is what we are going to achieve together.

Operator

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

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

Look, you've spoken a lot about the synergy potential and the margins. Can I just ask at all the returns from the Frutarom acquisition for IFF? You've got this target to and your cost of capital within 3- to 5-year time horizon. I think all, except one acquisition were within that time frame. Where does Frutarom in your projections stands on return on invested capital basis? That's the first one. And the second one, on sales synergies, you've got $145 million in cost synergies by the third full year of acquiring Frutarom. You've spoken a lot of the sales synergies, but can you put some numbers on that? That would be very helpful.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Okay. Let me start with the first one from a return standpoint. Yes, this -- given the size and the transformative nature of this deal, I think we're looking at 2 different ways. One, on a cash basis, again focusing on how strong a business both companies are, we're probably going to -- we're going to -- we project that we're going to get the cost of capital returns between year 5 and year 6 on a cash basis. On a GAAP basis, probably another year later, 1 additional year, so we still feel very good about the return profiles of combining the 2 companies and certainly the long-term value creation that combining the 2 companies provide. From a synergy standpoint, again, we're focused on the cost synergies. We do believe that there's substantial opportunity out there from a cross selling standpoint, but don't -- we're not going to comment specifically on what that value is.

Operator

Your next question comes from the line of Fintan Ryan of Berenberg.

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

Next question, operator?

Operator

Your next question comes from the line of Patrick Lambert of Raymond James.

Patrick Gerard Jean Lambert - *Raymond James Euro Equities - Research Analyst*

Two questions for me. I think a bit financial related to the transaction. The cost of integration of the businesses, you haven't mentioned it. And questions around the IT systems, any -- anything that you think is going to be a bit challenging in terms of integrating Frutarom to IFF? Linked to that also, again for, I guess, which is the tax impact. What can you actually deduct, I know it could be a good driver for value if you can deduct a lot of the intangibles there. And finally, I think you answered the overlap of clients, but a very quick one on Q1 results in terms of the 8% Fragrance growth, in particular. How much was pricing versus volume overall for IFF and in Fragrance in particular? And are you a bit more in -- could you a bit more precise your view on the citral description and impact in Q2, Q3 and the remainder of the year? Have you got a bit more details on that, a bit more granularity on it?

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

Maybe I'll take the last question first. So on Q1, as you were saying very strong growth on the Fragrance side, there was not much pricing built in this -- in the first quarter. So it's volume, which is great. On the citral situation, you probably see that, that BSF is coming back to manufacturing, so we are basically for the second and third quarter on our plan. And we are actually in a very good position to deliver what our customers' need. And we're optimistic going forward. So that's where we are. And we are in a very good position. Now I hand over to Rich on the financials.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Okay. Thanks, Andreas. Yes, just one quick comment, I mean, on the Fragrance growth, it was predominantly volume and commercial performance, new wins, but there was pricing in there, so it was outflow. In terms of citral, I do think it's going to be heavily into the impact. As Andreas said, we're on target with our previous estimates. We still believe that's appropriate. I think, we'll see the biggest impact in Q2 and Q3, again, depending on what happens from their side. From a cost standpoint, the cost we executed and achieved the synergies, it's roughly 1.3x, it's at ballpark. It's a combination of cost. As I mentioned earlier, there are some capital in there that we believe is going to be necessary to the extent in order to achieve the synergies. From a financing standpoint, it's still pretty early in the process. I think there are opportunities and we'll structure the deal at -- within the company in order to optimize that from a standpoint and look at where the business operates, where the cash flows are generated. So we still have some opportunities there to work through, but I think we're confident in our ability to help -- to have that drive, the ability that returns that I talked about earlier in the year 2 on a cash basis.

No, I mean, as part we still have to go through the details and work with the Frutarom team in terms of how to optimize and structure that analysis to generate -- get the cash from where it's generated to where we need to do the -- pay down the debt, and that work with the specifics of the tax implications associated with that.

Operator

Your next question comes from the line of Fintan Ryan of Berenberg.

Fintan Ryan - *Berenberg, Research Division - Analyst*

I think most of my questions have been answered, but I would just like to get a sense that within the synergy plans or the integration going forward, do you plan on any asset disposals, particularly around some of the trading and marketing operations within Frutarom? And/or within the duration as well, I know Frutarom has acquired majority stakes in a number of entities. Is there any sort of change in control at provision in those deals so that you need to buy out some of the minorities as well taking on just the bulk of Frutarom equity?

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

No, actually, we are not planning to dispose any of the businesses, at least not big parts. And we go forward with the businesses where Frutarom has entered into agreements and has majority parts of the business. So I think that will be business as usually for Frutarom and for us going forward as well.

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Yes. I think, as I mentioned earlier, trading business is a value-added service. And Frutarom management team believes its central in terms of their relationship with the customers. Again, we'll look at potential asset sales, as we work through these integration process, but it's too early to say.

Operator

Your next question comes from the line of Patrick Rafaisz of UBS.

Patrick Rafaisz - *UBS Investment Bank, Research Division - Director and Chemical Research Analyst*

From a technical point of view, on the contracts you have, is there a break fee in case the transaction doesn't happen? And can you elaborate a bit on what happens to obviously other interested party that was mentioned to be involved? Why was that an inferior solution? And lastly, you talked a lot about the complementarity of the business and very little overlaps. And so does that mean that you do not foresee any antitrust-related issues in any of the key markets in this transaction?

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

So let me start with the last piece. We certainly have to work with the regulatory authorities on the antitrust, but in our initial assessment, we believe it will be positive and benign, so we don't expect any extra hurdles here. And then, I hand over to...

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Yes, from a -- there is included in the sales purchase agreement a break-up fee. It's standard and it's consistent with industry standards.

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

And on the other interested party, I think Ori gave the reason why he believes that IFF has the best partner in the industry.

Operator

Your next question comes from the line of Sipke Moes of Kempen Capital Management.

Sipke Moes

I have one question. I heard somebody referring to that he was not good at mathematics, but I'm now beginning to do doubt myself. I also wondering if you could give a pro forma leverage for the deal because I saw somewhere $3.7 billion, but I'm not exactly sure how you arrived at that specific number?

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

Thank you for the question. Rich?

Richard A. O'Leary - *International Flavors & Fragrances Inc. - Executive VP & CFO*

Yes, it's $3.7 billion on a simple basis in terms of just looking at the net debt of over the EBITDA on a run-rate basis. And then, we expect, as I said, to get deliver quickly over the next 18 to 24 months and probably get down to less than 2.5x over that period.

Operator

At this time, there are no further questions. I'll now return the call to Andreas for any additional or closing remarks.

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

Well, it's an exciting day for Frutarom and for IFF. We're making really good progress, and I would like to thank all of you as well for participating in the call. I think it worked out very well and the 2 of us believe it's a real strong combination, and it's more than 1 plus 1 is 3 or 4. I think going forward, it will be a great future for both companies. Thank you.

Operator

Thank you. That does conclude today's conference call. You may now disconnect your lines, and have a wonderful day.