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IFF - Q1 2014 International Flavors & Fragrances Inc. Earnings Conference Call

EVENT DATE/TIME: MAY 06, 2014 / 2:00PM GMT

THOMSON REUTERS

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PRESENTATION

Operator

At this time I would like to welcome everyone to the International Flavors & Fragrances first-quarter 2014 earnings conference call. (Operator Instructions)

I would now like to introduce Shelley Young, Director of Investor Relations. You may begin.

Shelley Young - *International Flavors & Fragrances Inc. - Director of IR*

Thank you. Good morning and good afternoon, everyone. Welcome to IFF's first-quarter 2014 conference call. Earlier today we distributed a press release announcing our first-quarter results. A copy of the release can be found on our IR website at www.iff.com. 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, which I will read out loud. During the call we will be making forward-looking statements about the Company's performance, particularly with regard to the second quarter and our outlook for the full year of 2014. These statements are based on how we see things today and contain elements of uncertainty. For additional information concerning the factors that could cause actual results to differ materially from forward-looking statements, please refer to our cautionary statements and risk factors contained in our 2013 10-K filed on February 25, 2014, and our press release that we filed this morning, all of which are available on our website.

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

With me on the call today is Doug Tough, our Chairman and Chief Executive Officer; Nicolas Mirzayantz, our President of Fragrances; Matthias Haeni, our President of Flavors; and Kevin Berryman, our Executive Vice President and Chief Financial Officer. Matthias joins us for the first time in his new role, so welcome, Matthias.

I would now like to turn the call over to Doug.

Doug Tough - *International Flavors & Fragrances Inc. - Chairman & CEO*

Thank you, Shelley, and good morning and good afternoon to everyone. Before I start my formal comments, I would like to extend a warm welcome to Matthias Haeni. As of April 1 Matthias assumed the role of Group President, Flavors, after serving as regional General Manager of Flavors for our EAME region for the past three years. Prior to that Matthias was the regional General Manager for Flavors of our greater Asia region.

Under his leadership IFF expanded our manufacturing network in Asia and Europe. We opened new plants in China and Singapore for Flavors, and more recently we have been expanding our strategically located facility in Gebze, Turkey, which will serve the fast-growing emerging markets in the region, including the Middle East and Africa.

We also achieved consistently strong sales and operating profit growth in both EAME and greater Asia in Flavors. Matthias is a 23-year veteran of the flavors and fragrance industry, and we are pleased and excited to have someone with his experience and insight in this role.

Turning to the agenda for today's call, I will provide an overview of the first quarter for consolidated IFF, followed by Nicolas Mirzayantz and Matthias Haeni, who will provide their perspective on the performance of our fragrances and flavors business segments, respectively. Then Kevin Berryman will provide you with a financial overview of our first quarter and turn the call back over to me for a balance end-of-year outlook and some concluding comments before we open the call to your questions.

Turning now to the first quarter of 2014, our local currency sales growth was 7%, which reflects balanced growth between flavors and fragrances and includes a percentage point of growth from our Aromor acquisition, which we acquired on January 15. This quarter fragrance delivered growth of 8%, which includes 2 percentage points of growth from Aromor, and flavors achieved growth of 5%. Growth this quarter was also more balanced between the emerging markets, which grew 7%, and the developed markets, which grew at 5%.

Our organic growth this quarter reflects a higher level of new wins, consistent with our performance in 2013. The level of new wins was strong across both business units due to our emphasis on innovation and technology, and the strength of our teams in leveraging our consumer insights, R&D, and creative capabilities to provide outstanding, high-performance products for our customers.

As you may recall, on our fourth-quarter call we said we expected to see more moderate top-line growth in the first quarter following a strong Q4. We were pleased that we were able to deliver 7% growth for the second consecutive quarter. Due to some seasonal order patterns, we had stronger-than-expected sales in the final few weeks of the quarter, which accounted for a large portion of the upside to our original forecasts.

On a regional basis our strongest local currency growth was achieved in greater Asia, where we are investing in new facilities and capacity and technology in order to support our customers. We saw continued strong double-digit growth in many of the countries where IFF has committed capital, such as Singapore, China, and Indonesia. We also delivered high single-digit growth in EAME and positive growth in Latin and North America. All of our regions are seeing positive growth, which added to our overall sales growth.

Turning to our profit margins, our gross profit margins improved 150 basis points versus the prior year. Our strong growth and favorable mix of business contributed to the margin expansion.

Our adjusted operating profit in the first quarter of 2014 increased 14%. This is primarily due to our strong growth, combined with margin expansion and disciplined cost control. The results of Aromor were not significant to our consolidated financial performance.

IFF's adjusted earnings per share increased 11% to $1.32, in line with our long-term growth targets. We did not benefit from the R&D tax credit this quarter, which resulted in a higher effective tax rate than our adjusted tax rate in the primary year.

In summary, we started the year with strong top-line momentum, which resulted in favorable gross and operating margin expansion and enabled us to grow our adjusted earnings per share by 11%. I would now like to turn the call over to Nicolas and Matthias, so they can provide more detail on their respective business units. Nicolas, it's over to you.

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

Thank you, Doug. Good morning and good afternoon, everyone.

Turning to our fragrance business, we had a very strong first quarter with many highlights. Fragrance net revenue of $404 million increased 9% this quarter on a reported basis. Excluding the impact of foreign currency, fragrance delivered local currency sales growth of 8%. This includes 2 percentage points of growth from our recent Aromor acquisition. The strong overall organic growth of 6% reflects a continued high level of new wins, resulting in continued momentum and broad-based growth.

The developed market had local currency growth of 9%, and the emerging markets had local currency growth of 2%, indicating the benefits of our geographic and customer diversity. Regionally, our strongest region this quarter was greater Asia, with local currency growth of 16%, and our EAME region had local currency growth of 12%.

North America had growth of 8%, reflecting continued strong momentum from new wins and increased coalesced participation. With our stronger move this quarter in our developed markets, a reversal of what we have seen in prior quarters, due to a higher volume of fine fragrance sales, in particular to customers in North America and Western Europe, we delivered double-digit growth in fine fragrance in both our North America and EAME regions.

Regarding our decline this quarter in Latin America, I would like to put our results into perspective. We are comparing two very strong growth of 15% in Latin America in the first quarter of 2013, including 37% growth in fine fragrance and 11% in consumer fragrances, both higher than the market growth. The overall fragrance business unit growth of 8%, even with the decline in Latin America, points to the strength and diversity of our portfolio.

In regard to our end-use category of commercial ingredients within fragrance compounds, we are recently realigned. Starting with our first-quarter results, we are reporting our top-line sales growth consistent with our new organizational structure. Fragrance compounds consists of two newly-defined market categories: fine fragrances and consumer fragrances. Fine fragrances needs no further explanation. Consumer fragrances consists of five end-use categories, including fabric care, home care, personal wash, toiletries, and hair care.

Fine fragrance achieved 10% local currency growth this quarter compared with growth of 1% in the first quarter of 2013. This growth reflects very strong performance with our customers in Western Europe and the United States. We are seeing continued momentum in some of our prior launches, such as Invictus for Men by Paco Rabanne from Puig and La Vie Est Belle by Lancome from L'Oreal.

Due to the ongoing longevity and popularity of our classic fragrance launches, which are still in high demand by global consumers, we continue to have strong (inaudible) volume in addition to our strong win rate.

Consumer fragrances had steady growth of 4%, led by double-digit growth in hair care and high single-digit growth in fabric care, offset in part by a slow decline in home care. Our hair care category was up double digits in North America, Europe, and Latin America; and single-digit in greater Asia, in large part due to our success in providing our customers with consumer-preferred fragrances.

Our performance was very strong in fabric care, particularly in greater Asia, which accounted for more than half of the upside due to a high level of new wins in both global and regional customers in the region.

Our fragrance ingredients business, which now includes the results of Aromor, had local currency growth of 22%. Aromor added 14 percentage points to the ingredients end growth. The business unit's growth of 8% benefited from sales of unit product families, including specialty ingredients.

We also saw the continued planned migration of some of our volume in fragrance compounds. Excluding the impact of both Aromor and the planned migration, which had a 4% negative impact on growth, fragrance ingredients had growth of 12%.

Next quarter will be the final quarter of the planned migration of volume from ingredients to compounds. In summary, we achieved very good top-line growth, thanks to the strength and diversity of our portfolio, customer base, end-use category, and consumer insight in our key markets.

Here you see both our top-line and operating profit growth. As you can see, we were able to leverage our 8% local currency sales growth into higher segment operating profit expansion of 28% due to gross profit improvements combined with improved cost control.

Our gross margin this quarter benefited from strong volume gains and improved end-use category mix, as well as a favorable impact of price to input costs and continued focus on cost reduction through multiyear programs, which have resulted in productivity enhancements.

The extreme margin growth combined with the higher growth units resulted in a $19 million improvement in segment profit to $87.2 million. Our segment profit margin improved 320 basis points to 21.6%.

For the second quarter we are expecting continued momentum in the business. We are anticipating a modest amount of inflationary pressure in the input cost environment in the second half of the year.

And we have been focused and continue to focus on driving efficiency into our portfolio through the use of overhead cost structure. To that end, over the past few years we restructured and streamlined our organization. We reduced our manufacturing footprint both in compound and ingredients and realigned our organization to increase go-to-market and offer improved alignment with customers.

By implementing these actions we were able to minimize price increase to our customers. Before I conclude, I would like to make a few comments about our recent acquisition of Aromor. We are very pleased they have joined IFF, and all of our teams -- R&D, creative, commercial, operations, and finance -- are working closely with our new colleagues to ensure a successful integration.

Our combined R&D pipeline is very strong, and we are working collaboratively to capture synergies between the two organizations.

I am also pleased that some of our new launch in the second half of the year will include fragrances formulated using our new molecules, which you may be call were only recently launched internally. This signifies not only our increased confidence in our new molecule pipeline, but also shows our faster speed to market, which is a testament to the collaboration of the entire team and improved processes.

Before I turn the call over to Matthias, our new President of Flavors, I would like to welcome him to the new role and wish him continued success.

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

Thank you very much, Nicolas. Good morning and good afternoon, everyone. I'm very pleased to be here on today's conference call. I joined the team in New York.

Turning to our sales performance, in the first quarter flavors achieved local currency sales growth of 5%, led by double-digit growth in the emerging markets, which continues to be a strong and important driver for our business. We achieved solid growth within our long-term targets despite weakness in North America, thanks to the diversity and breadth of our portfolio and customer base.

Notably, we achieved strong performance in many of the countries where committed or are committing capital to add capacity or technology. In particular, the growth we are seeing in emerging markets of greater Asia, Latin America, and central and southeastern Europe clearly supports our investment strategy. In total, flavors through 12% in the emerging markets, led by Latin America, where we had growth of over 20%; and greater Asia, which achieved high single-digit growth.

Turning to the regions, in Europe, Africa, and the Middle East, as you see on the slide, we had solid growth of 4%. This was supported by growth in all categories. In greater Asia there was widespread growth across all end-use categories, resulting in total local currency sales growth of 8%. There was double-digit growth in many countries, and we were extremely pleased to see the continuation of strong trends.

In North America this quarter we saw a decline reflecting overall market weakness, which resulted in lower volumes on existing business, and new wins were not sufficient to offset the volume losses. Our customers have been impacted equally to softer market environment we have seen in North America, and we are closely monitoring the situation.

Finally, turning to our strong performance in Latin America: I know Hernan talked about Latin America in the past and the improvements that IFF was making in this market. Our people in the region have been working hard to leverage our technology and creation capabilities to develop new growth opportunities. And we are seeing the results of their efforts in terms of strong new wins, especially in beverages, where our technologies are opening new avenues for growth.

Latin America increased 23% in the quarter and was up double digits for the second consecutive quarter. The accelerated positive momentum is based on the strength of our product offerings; based on our creative and application know-how; and customer intimacy, which is ultimately the hallmark of IFF.

We also looked at our performance through the lens of end-use categories. Flavors delivered double-digit growth in beverages and mid-single-digit gains in savory and dairy, all supported by our health and wellness platforms.

As you know, our flavors' creative and applications teams worked with customers across end-use categories to develop high-performing products that address the needs of health-conscious consumers who want great-tasting food and beverages that have less fat, less salt, and less sugar. In summary, flavors achieved solid and widespread growth, with emerging markets again a key growth driver.

Turning to our financial performance, local currency growth of 5% included high levels of technology-driven wins and double-digit growth in the emerging markets. Historic volume growth combined with mix gains, net favorable pricing inputs, costs, and manufacturing efficiencies resulted in enhanced gross margin again this quarter.

At the same time, we exerted tight control over our fixed expenses, resulting in increased growth leverage. The margin gains combined with disciplined spending resulted in a 6% or $5 million improvement in our segment profit performance this quarter. Put another way, our segment profit margins expanded by 70 basis points to 24% in the first quarter.

Turning to our outlook for the second quarter of 2014, we expect moderate growth as we compare to strong like-for-like growth of 8% in the second quarter of 2013. We expect continued growth in the emerging markets, where we have made significant positive investment in capacity and creation capabilities to better serve our customers.

In summary, our performance this quarter was solid on top and bottom lines. We continued to make focused investments to better serve our customers and to provide growth for the short, medium, and long term.

I will now turn the call over to Kevin, our CFO.

Kevin Berryman - *International Flavors & Fragrances Inc. - EVP and CFO*

Thank you, and good morning and good afternoon, everyone. As you can see on the slide, our performance was certainly strong in Q1. Our net sales of $770 million were up on a reported basis by 6%. Excluding the 100 basis point negative impact of foreign currency this quarter, our consolidated local currency sales growth was 7%.

As noted earlier, our consolidated sales included the results from our recent acquisition of Aromor, which added a percentage point to our consolidated growth. We are pleased with the initial results from this strategic acquisition and welcome our Aromor colleagues to our global organization.

This quarter fragrance represented 52% of our sales, and flavors comprised the remaining 38%. Our growth in the quarter was well balanced between flavors and fragrances. We had a strong mix of business between the emerging markets and developed markets, up 7% and 5%, respectively.

Our adjusted gross margins this quarter improved by 180 basis points to 44.7%, which reflects gross margin expansion in both business units due to very strong volume gains, certainly driven by growth from the wins, sales mix improvements, as well as some favorable impact of price to input costs and cost reduction initiatives.

Strong margin growth and disciplined cost control resulted in a 14% increase in our adjusted operating profit to $159 million. Our adjusted effective tax rate in the first quarter of 25.5% was above our effective rate of 24% in the first quarter of 2013, primarily reflecting loss of tax benefits relating to the US R&D tax credit this year. As a result, our adjusted EPS growth of 11% brought our first-quarter adjusted EPS to $1.32, resulting in an EPS growth in line with our long-term targets.

Turning to our research, selling, and administrative costs, RSA as a percent of sales increased 10 basis points this quarter, from 23.9% of sales to 24% of sales, for an increase of $11.5 million. The increase reflects the addition of Aromor to our operating results as well as slightly higher incentive compensation accruals for the quarter.

We remain focused on maintaining cost discipline while investing in research and development and other strategic growth opportunities. Importantly, our research and development spending was 8% of sales in the quarter, consistent with our continued focus on driving our innovation agenda.

Here you see our customary chart showing the change in the strength of the euro relative to the dollar. This quarter, despite the strengthening of the euro, foreign exchange had a 100 basis point negative impact on our top-line growth, as favorable foreign exchange rates were more than offset by a significant weakening of some currencies during the quarter, including the Indian rupee, the South African rand, the Japanese yen, and the Australian dollar.

As it relates to our bottom line, however, as a result of our hedging programs and proactive management, FX had a slight positive impact on our EPS, reflecting our continued focus on reducing volatility in our results through our cash flow hedging programs or other measures.

At this point in the year the full-year impact on our bottom-line growth is expected to be somewhat favorable versus year ago at current foreign exchange rates. As a reminder, for 2014 the majority of our euro exposure is hedged at a rate of $1.32, close to the average for 2013.

Turning to our cash flow, our operating cash flow in the first quarter of 2014 was $35 million compared with an operating cash flow of $19 million in the prior-year quarter. The prior-year cash flow included a $30 million incremental US pension contribution.

The year-over-year increase reflects the $16 million improvement in net income, partially offset by increased incentive compensation payments in the first quarter of 2014 versus the first quarter of 2013. As a percent of sales, the current-quarter operating cash flow is 4.5% of sales compared with 2.6% in the year-ago quarter. Core working capital improved in absolute dollars to support our business growth; however, it declined on a percentage of sales of the business.

Turning to our capital structure, capital spending for growth in infrastructure and newer technology continued to be our most important use of cash. Over the past few years we have been investing approximately 4.5% of sales on adding capacity where it's needed to optimize our geographic footprint and provide newer technologies to our customers in all markets.

As Matthias mentioned, we are in the midst of building out our manufacturing capacity and building a new creative center in Turkey. At the end of 2013 we also announced a $50 million investment in Indonesia to build a new manufacturing facility in the Jakarta area and install a new creative center on our existing site in Jakarta for our customers.

We are also committed to returning capital to our shareholders in the forms of dividends and cash. We currently carry a quarterly dividend of $0.39 a share. In addition, in the first quarter of 2014 we spent $20 million on share buybacks, representing 227 million shares at an average price of $88.70, which brings our total spending program to date to $71 million through the end of the first quarter.

Based on the current share price we continue to expect that we will spend more our share buyback in 2014 than we did in 2013. Consequent to quarter end, we also completed the extension of our $950 million credit facility to April 4, 2019, at more attractive rates than our previous revolver. This provides IFF with continued financial flexibility and a lower cost than the Company's previous facility.

Finally, we continue to evaluate business development opportunities such as Aromor and other entities, and we are targeting those opportunities that will provide us with access to new technology, geography, or business adjacency that will make strong strategic sense and leverage our expertise in science and technology.

Before turning the call back over to Doug, I would like to provide you with an update on the performance of our portfolio as it relates to economic profit. This slide highlights the progress we have made in improving the return profile of our overall portfolio.

I would like to highlight that while improving the return profile, we have been delivering against our sales growth objectives, consistent with our long-term financial targets. This demonstrates our ability to both grow the business while improving the profitability of our portfolio.

The pie chart on the right shows the breakdown of our portfolio at the end of 2013, while the pie chart on the left shows the breakdown of our portfolio at the end of 2009, the year immediately preceding the initial implementation of economic profit as a management tool. At the end of 2013, 80% of our invested capital was supporting EP-positive categories, up from 65% in 2009. Furthermore, a full 95% of our portfolio is now EP breakeven or positive, up from 85% in 2009, or an improvement of 10 percentage points.

As you may recall, as part of our objective to strengthen our overall portfolio, we identified in 2011 approximately $50 million of operating profit opportunity that we believed we could realize while applying the principles of economic profit and driving efficiencies into the underperforming parts of our portfolio. By exiting lower-margin sales activities, focusing on profitable growth, and driving operating efficiencies, by year-end 2013 we had exceeded our going-in target of $50 million -- two years ahead of our original estimated time. This has been reflected in our improved operating margins and results.

Today we still believe there are additional opportunities to improve certain parts of the portfolio further while delivering meaningful product innovation. While we expect that this will represent additional profit opportunities, we also expect that certain growth investments will be made that will offset this benefit over the next few years. These ongoing, continuous improvement efforts are a fundamental part of our three-pillar strategy.

I will now turn to call back over to Doug discuss our outlook and provide a wrap-up.

Doug Tough - *International Flavors & Fragrances Inc. - Chairman & CEO*

Thank you, Kevin, Matthias, and Nicolas. As you heard from the team, we had a strong start to the year based on our operating performance. Our local currency sales growth of 7% was higher than our original forecast.

Given the strong start to the year, we are reconfirming our expectation for local currency sales growth of 5% to 7%, which includes a percentage point of growth from the Aromor acquisition. Due to the volume growth and the improved mix of business, we delivered strong gross and operating margins.

Our adjusted operating margins achieved growth of 14%, while our adjusted earnings per share increased 11%. We also reconfirming our expectation to deliver double-digit operating profit and earnings per share growth for the full year.

For the second quarter we expect more moderate sales growth. However, given our emphasis on productivity savings and other margin improvements, we expect to see continued gross margin expansion, but at a rate of year-over-year improvement, especially as we compare the improved gross margin performance of the prior year in quarters two, three, and four.

In addition, we are also closely monitoring input costs and expect to see some inflationary cost pressure in the second half of the year. Certain input costs are expected to increase.

Our emphasis on our ten key research and development platforms has resulted in a stronger pipeline for the Company, and we continue to invest in our programs and subject them to a disciplined review process to make sure they are proceeding on track. For the second quarter of 2014 we are expecting to achieve sales, operating profit, and earnings per share growth within our long-term targets.

I would like to leave you with a few key takeaways from our first quarter. First, we achieved strong momentum in both business units, with more balanced growth between our emerging and developed markets. We also achieved growth in both our local global and regional accounts. This diversity provides us with greater stability and enabled us to achieve 7% growth, even when some areas of our business are facing a more challenging set of circumstances.

Second, we have made and continue to make strategic investments in the business to expand our footprint and make sure we have the necessary capacity to grow with our customers in the regions and to continue to work with new customers who have strong local positions. We are able to work with global, local, and regional customers and provide them with consumer insight, R&D expertise, and fragrance and flavors that they can sell to consumers anywhere in the world.

Third, we continue to grow our gross and operating margins by focusing on productivity, efficiency, and quality improvements. And we have seen the benefits in our strong profit growth.

Fourthly, our strong performance reflects the collaborative efforts of our people to leverage our consumer insights, R&D, and creative capabilities to provide outstanding results for our customers and our shareholders. We are making investments in our people to make sure they have the necessary training and development to better serve our customers and anticipate future trends.

And fifth, we continue to execute against our three strategic pillars to leverage our geographic reach, to strengthen our innovation platform, and to maximize our portfolio. We continue to believe execution of our three pillars will enable us to drive profitable growth for our shareholders.

Thank you for your participation today. We will now open the call to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Mark Astrachan, Stifel Nicolaus.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Good morning, everybody, and welcome, Matthias. I guess just couple -- few questions. One just sort of broader question on the developing markets.

So a bit of a slowdown relative to 2013 growth. I guess we have heard from some of your larger customers that they are starting to see a slowdown. I guess maybe sort of quantify what you've seen year to date in 2014, and how you are thinking about that growth going forward -- and maybe even talk about specific markets, countries where you may be seeing a bit of a slowdown.

And then Matthias, can you talk a bit about the North America business? I know you haven't been there that long, but maybe talk a bit about what you are thinking about expectation-wise in terms of potential improvements, since -- you know, it's not just this quarter; it's been a bit weak over the last year or so.

Doug Tough - *International Flavors & Fragrances Inc. - Chairman & CEO*

Okay, Mark, I will start off, and then I'll ask both Matthias and Nicolas to weigh in with their perspectives. I think the overarching comment is: we still have great confidence in overall emerging market opportunities -- the celebrated next billion consumers. We believe that trend is inexorable, and we remain committed to it.

I'd also say that -- and you will get more specifics in a minute -- but to the degree that some of our customers are sensing or mentioning some of the slowdown, it's been marginal for us. And the buoyancy continues pretty good across almost all of the major emerging markets. So we haven't seen the trend to the degree they have, and we remain bullish.

But you have asked specific questions. And I will ask Matthias to start, and then Nicolas can weigh in with thoughts from fragrances.

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

Thank you. Let me tell you that we are really pleased to see development which we see with the emerging markets. We have string seen very strong momentum in Latin America, but also in most of the strategic key markets in Asia Pacific as well as in central southeastern Europe, and strong, focused markets for our folks in Africa. As such, we don't see a slowdown.

I believe we have continued solid performance going forward in these markets. Coming back to your question on North America, indeed we are disappointed with our performance in the first quarter this year. We have experienced lower volumes on existing business; and new wins, which we had particularly in key categories like beverages could not offset the weakness we have experienced with our sales to many key accounts.

I tried to outline that we will be up against very strong comparables. Also, in the second quarter in North America we will expect a different order pattern and a change in our performance in the second half of this year.

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

Mark, good morning. This is Nicolas. Sentiments overall regarding our confidence in the emerging markets -- they have been a growth engine for many quarters in the past. You see we have continued momentum in greater Asia following last year's momentum, and coming from a very, very good -- increased new wins and increased penetration of the market, and also leveraging our encapsulation technology.

So maybe the additional comments will be about Latin America. The decline that we saw is coming after nine consecutive quarters of double-digit growth. I think that -- let me chart it through drivers. First of all, we are comparing to very strong growth of 15% in the first quarter last year, as I indicated: 37% including fine fragrance and 11% in consumer fragrances.

It would be sure to say that we are seeing in major countries, such as in Brazil, with the market slowing down a bit, and also some inventory correction from some of our customers.

Two important factors moving forward: first of all, the level of new wins is comparable to our historical average. So our momentum and our coalesced participation and success is continued. And also, we are early in the quarter. And we are seeing a reversing of the trend in Q2. So it's really one quarter which will be impacted by the factors I just shared with you.

Operator

Mike Sison, KeyBanc Capital Markets.

Mike Sison - *KeyBanc Capital Markets - Analyst*

Good morning, guys. Great start to the year. Nicolas, you talked about three to four areas that drove the improvement in operating margin this quarter. Pretty impressive there, in the low 20s.

Can you maybe give us a feel of which of those 3 to 4 areas were most pertinent and sustainable for the rest of the year? Is this sort of a new level of profitability we should expect going forward?

And then one for Matthias. Congratulations on the new spot there. Anything different that you are going to drive going forward? I think Hernan had a great run. Anything new that you expect to do to drive growth and keep that business on track? Thank you.

Kevin Berryman - *International Flavors & Fragrances Inc. - EVP and CFO*

Okay, Mike. This is Kevin. Thanks for the call, and let me make a couple of comments on some of the drivers on margin, and then I can turn it over to Nicolas to provide further clarity.

I think at the end of the day we have continued to be driving the maximization of the portfolio, which is about a lot of initiatives throughout the organization to help drive incremental profitability into the portfolio. That really was the primary driver to our improvements in margin on a total basis for the Company.

If you think about growth leverage, you think about the benefits of mix, you think about the cost reduction initiatives that are in place -- those were the majority of the driver for the gross margin improvement. Of course, that was really the big driver to our operating profit improvement as it relates to the combination of the two -- the volume -- you know, the growth at the top line as well as the gross margin improvement.

So the road from -- slight benefit as it relates to the net benefit of input costs and pricing options that had been taken are really the big drivers. And the material part of the improvement was relative to the growth leverage, the mix, and the cost reduction initiatives.

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

Mike, this is Nicolas. Just to add to Kevin's comment, you have already talked about the extreme focus on the productivity initiatives, and we've really reduced our footprint. We've been focusing on some of the most effective parts of our portfolio.

We invested. It's the result of innovation and really driving the innovation through our portfolio faster. And now you are on the level of execution. So all these productivity initiatives, along with the focus on really maximizing our portfolio and driving innovation have been some of the key drivers of the improvement.

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

Thank you very much, Mike. We have made significant (inaudible) in key strategic markets and added infrastructure to increase capacity, but also in our creative skill set. We have a very strong innovation pipeline in our health and wellness portfolio, where we are addressing the demands to reduce sugar, fat, and salt.

I am very confident we will capitalize on the many investments which we have made in the past (inaudible). I am very proud that I have a very strong management team which I can take over from Hernan.

Doug Tough - *International Flavors & Fragrances Inc. - Chairman & CEO*

And, Mike, it might be fair for me to weigh in, having worked with Hernan and now Matthias for a short while. Matthias is focused on technology, and technology being a driver of growth and innovation is probably something I have really noticed. And it fits and aligns really well with what we are trying to do. Matthias's knowledge of the industry and technology is going to be a real plus for us.

Operator

Faiza Alwy, Deutsche Bank.

Faiza Alwy - *Deutsche Bank - Analyst*

So I have a couple of questions. First of all, I wanted to get an update on the input costs. I know that you talked about a benefit this quarter, but then the back half is expected to be -- it's supposed to be more expensive on the input costs side. But then it looks like you took some pricing this quarter. So was that pricing related to the expected increase in input costs in the back half? Or -- and then more specifically, where exactly are you able to take the pricing this quarter?

And then my second question was on for selling and admin costs. It looks like those increased -- and I know you highlighted the incentive comp increase. Was that really the only thing that drove that increase? Or were there any costs associated with, for example, the Aromor acquisition that you may have considered as part of adjusted operating profit, but may really be extraordinary? If you could just comment on that? Thanks.

Kevin Berryman - *International Flavors & Fragrances Inc. - EVP and CFO*

Thanks for the question, Faiza. I think, first thing, on pricing, we really didn't take any pricing in the quarter. So if you look at our top-line performance, it's really related to volume and mix, which is driving the top line. So no real fundamental change in pricing levels for the quarter.

The second point as it relates to input costs, we feel pretty comfortable as we sit here today that our current inventory levels plus contractual arrangements won't result in their being a material change and any pressures on gross margins this year, per se. But we do know that current pockets of areas of input and material are in fact at elevated levels versus what we would be enjoying at this particular point in time in terms of our costs.

So once we get back into the market and are purchasing those new inventory levels, they will be at higher prices. And we expect that to be occurring over the back half of this year. I would call out a couple of areas: I would call out citrus, I would call out onion, I would call out patchouli as some areas where we know that there are some increases in costs coming.

So as we realize those costs, we will be having targeted discussions with certain customers to understand those pressures that will be developing. And certainly, as we enter into 2015 we will start to see some of that flowing through the P&L.

Operator

(Operator Instructions) Edward Yang, Oppenheimer & Co.

Edward Yang - *Oppenheimer & Co. - Analyst*

Good morning and congratulations a nice quarter. Just following up on the question about pricing. How often do you go back and talk to customers now on pricing?

Back in the day in the industry, I think generally you kept prices pretty stable and tried to get higher prices on new products. But I think that changed during some of the raw material inflation we saw in the last five years or so. So how often do you have these conversations at this point in terms of pricing?

Kevin Berryman - *International Flavors & Fragrances Inc. - EVP and CFO*

Let me take a stab at this -- Kevin -- at the question, because I think it really is depending on the specificity of the issues that are involved and the magnitude of the increases. And we could have targeted discussions with one group of customers because of the mix of the materials that they use, and no discussions with other customers, because they are not faced with the same dynamic.

Look, if in fact there is a general minor cost increase, I think generally speaking, we don't look for pricing relative to that, because we look to drive efficiencies into our portfolio on an ongoing basis. So we try and limit our asks for price increases for our customers.

But when we look at the increases that we are expecting in the areas I called out, they are high enough where we are going to need to have a discussion with certain customers, and that will be occurring probably over the back half of the year, as we see those costs developing.

Edward Yang - *Oppenheimer & Co. - Analyst*

And do the customers, Kevin, come back and initiate pricing discussions on their own? For example, if you are getting raw materials relief, do they ask for -- have they been asking for concessions?

Kevin Berryman - *International Flavors & Fragrances Inc. - EVP and CFO*

I think as in any buy/sell relationships, our customers always ask for lower prices. I think that's a continuous kind of process. But certainly, it becomes a little bit more elevated if, in fact, they believe there are input cost reductions that we are able to realize.

But I would remind you, though, at the end of the day, the input costs where we are today are still at very extraordinary levels versus historical. So at the end of the day, we are still underwater in terms of gross margins, just from the input cost increases we saw over the course of 2011 and 2012.

We have recovered the gross profit, but not the gross margin impact of that. So as we look at these input costs going forward, we will be having those targeted discussions with customers.

Edward Yang - *Oppenheimer & Co. - Analyst*

Okay. And just some final cash flow questions. The buyback activity -- you said that would be up year over year. Could you give a sense of the range there? Is it still going to be targeted towards primarily offsetting options creep? And the CapEx was up 13% year over year. What's your expected spending for 2014?

Kevin Berryman - *International Flavors & Fragrances Inc. - EVP and CFO*

Sure. Our expected spend is consistent with the message that we have been delivering over the last actual few years. We will be in the neighborhood of 4.5% -- so between 4% and 5% of sales. And I would say probably closer to 4.5% -- kind of in the middle of that range in terms of CapEx.

In terms of the share buyback, certainly at current share price levels, I would say it will be slightly above the amount of the share buyback that we had last year. But certainly, that's dependent upon what's happened on the share price going forward. If we see significant increases, we will probably be buying a little bit less. And if we see significant decreases, we will be buying more.

Edward Yang - *Oppenheimer & Co. - Analyst*

All right. Thank you.

Operator

And there are no further questions at this time.

Doug Tough - *International Flavors & Fragrances Inc. - Chairman & CEO*

Thank you very much for everyone's participation on today's call, and we look forward to talking to you again in early August, when we have our Q2 results. Thank you.

Operator

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