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IFF - Q4 2014 International Flavors & Fragrances Inc Earnings Call

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PRESENTATION

Operator

At this time, I would like to welcome everyone to the International Flavors and Fragrances fourth-quarter and full-year 2014 earnings conference call. (Operator Instructions)

I would now like to introduce Michael DeVeau, Vice President, Corporate Communications and Investor Relations. You may begin.

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

Thank you and good morning and good afternoon, everyone. Welcome to IFF's fourth-quarter and full-year 2014 conference call. Earlier today, we distributed a press release announcing our financial results. A copy of the release can be found on our IR website at www.iff.com.

This call is being recorded and will be available for replay on our website. Please take a moment to review our forward-looking statements.

During the call, we will be making forward-looking statements about the Company's performance, particularly with regard to our outlook for the first quarter and full year of 2015. These statements are based on what we see today and contain elements of uncertainty.

For additional information concerning factors that can cause actual results to differ materially from forward-looking statements, please refer to our cautionary statement and risk factors contained in our 2013 Form 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 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 this morning.

With me on the call today is our Chairman and CEO, Andreas Fibig; our Group President of Flavors, Matthias Haeni; our Group President of Fragrances, Nicolas Mirzayantz; and our Interim CFO, Rich O'Leary.

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

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

Thank you, Michael, and good morning. Good afternoon to everyone. I would like to start by providing some introductory remarks and then pass the call to Matthias and Nicholas, who will provide their perspectives on performance for the individual business units.

Then Rich will review our consolidated financial performance in greater detail and finally turn the call back over to me for our 2015 outlook and some concluding comments before opening the call to your questions.

To begin, I want to share some of my onboarding experience over the past five months. During that time, I focused my attention on getting to know many constituents inside and outside of IFF. As part of this process, I was fortunate to tour 19 IFF sites around the world.

While at each location, I took the opportunity to meet with many of our global and strategic customers. It was an invaluable opportunity to learn about our relationship with our customers and more importantly, understand where we are successful and where we have opportunities to improve.

The tour also provided an excellent opportunity to meet with approximately 80% of our employees via 24 local town hall meetings, which engaged with all of these people on a personal level to get their feedback on our business, strategy, and future opportunities.

Coming away from these visits, one thing is extremely clear. Without the passionate dedication of all of our employees, we would not have achieved as much success as we did over the history of IFF. I deeply value all of that feedback and I'm glad to have met and spoken with so many of them.

Finally, I also had the great fortune in meeting much of the investment community. It was terrific to hear their insights and perspectives on our performance, strategy, capital structure, and M&A.

So for those of you whom I have spoken with, I thank you for taking the time to share your opinion and it's helpful to gain insight into what matters most for our shareholders.

For those of you who are new to the IFF story, our organization has had a lot of success over the past five years. Through our three-pillar strategy, we are now much stronger strategically, innovatively, and financially.

We will continue to drive performance through sustainable profitable growth, which in turn will lead to incremental shareholder value.

To that end, we have embarked on a strategic refresh, where we are pressure testing our current three-pillar strategy to ensure we are maximizing our performance. Incorporated into this process is much of the insight I mentioned earlier, but also includes guidance from an external consulting firm to ensure a deep and broad range of perspectives.

This refresh is currently underway and will continue for the next couple of months. We expect to communicate our 20/20 vision at our June 2 investor day in New York City.

Turning now to the full-year 2014 results, we are pleased to report that for the fourth time in five years, IFF achieved its long-term financial targets. We met or exceeded our sales, operating profit, and EPS goals. And at the same time, continue to invest in R&D, manufacturing, and commercial resources to strengthen our business. Local currency sales grew 5% on a consolidated basis, driven by new win performance and the acquisition of Aromor.

The emerging markets, which grew three times faster than the developed markets on a local currency basis in 2014, now represents approximately 50% of total sales, which we believe is best in class within our industry. Excluding our item impact and comparability, adjusted operating profit increased 11%, led by a 60 basis point improvement in gross margin, disciplined cost control, and lower incentive compensation expense. The net impact was positive, as adjusted operating profit margin expanded 120 basis points to 19.5%.

From a EPS perspective, we benefited from a lower tax rate and gained incremental leverage via our share repurchase program. As a result, adjusted diluted EPS improved 14% to $5.08 per share, which is a Company record.

Beyond financial results, 2014 was a year of achievement and progress. For example, we are very proud of our accomplishments in the area of sustainability. In 2014, we were included in the CDP Climate Disclosure Leadership Index and opened the largest solar field in our industry. And just recently, LMR, our in-house naturals facility, and its partner in Turkey were awarded the For Life Social Responsibility Certification for IMO.

2014 also saw some key investments into the business. We opened our new creative facility in Jakarta and a new sales office lab in Chile. And just last week, we opened our new flavors facility in Chicago, expanding our coverage in the Midwest of the United States.

On the R&D front, we have made advancements in our external collaborations and continue to work with our scientific advisory board. And with the successful integration of Aromor into our fragrance business, we are already seeing positive results and expect this positive momentum to continue in the coming year.

Finally, 2014 was also a year of celebration. Globally, it was IFF's 125th anniversary, an event celebrated in IFF sites around the world. It was our fifth anniversary of our membership at the New York Stock Exchange.

And what a perfect year it was formally to launch our core corporate values of passion, creativity, expertise, and empowerment, which was a grassroots campaign directed from our employees themselves. Overall, I am very pleased with our accomplishments in 2014 and look forward to continue this success.

With that, I would like now to pass on to Matthias.

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

Thank you, Andreas, and good morning and good afternoon, everyone. I'm happy to report that flavors' local currency sales grew 6% in the fourth quarter, which was our strongest performance in 2014.

Our overall growth was driven by 7% increase in the emerging markets, including double-digit performance in India, the South Cone of Latin America, Africa, and selected markets in Southeast Asia as well as a 6% improvement in the developed market.

On a category basis, beverages grew double digit, with broad-based growth across all regions. This strong performance was a result of our creative team's ability to provide innovative solutions that are differentiating and satisfy consumer desires for healthier and better-for-you products.

Growth in savory was also solid, improving mid-single digits globally, led by strong new wins. In EAME, local currency sales growth was strong, increasing 7% as our performance continues to improve sequentially versus Q2 and Q3 over 2014. Results were driven by strong double-digit growth in beverages and mid-single-digit increases in savory and sweets, all a result of new win performance.

I would like to highlight also that we think EAME, the mature markets of Western Europe, are up mid-single digits. Greater Asia was solid, posting a 3% local currency sales growth led by mid-single-digit improvements in savory and in beverages.

Southeast Asia and Japan continued to post solid growth, yet was offset by softness in China, where overall consumer sentiment and weaker economic conditions impacted results.

In North America, conditions continued to improve as [we sat stabled] earlier this year, growing 7% year over year in Q4. This improvement can preliminarily be attributed to strong growth in dairy and in beverages, which were both a result of strong innovation geared to support our customers' needs for healthier, better-for-you product that maintain consumer preference.

Latin America continues to be our strongest performing region, up 13% on a local currency basis as a result of our successful delivery systems. This marks the fifth consecutive quarter of double-digit growth, which is a clear indication of the value innovation has on our business.

From our -- from a profitability perspective, segment profit increased 5% and segment margin improved 10 basis points to 20.4%. On a full-year basis, local currency sales grew 4%, led by Latin America and EAME. Full-year segment profits totaled $331 million versus $323 million in the prior year and our segment profit margins remained constant at 22.7%.

In addition to our solid financial results, it has been a great year for flavors in terms of geographic expansion, as we opened our improved facilities in all four regions over the last 12 months. Last week, I joined the North American flavors team for the opening of a brand-new facility in Chicago, where we now have applications and flavors labs as well as a culinary center.

In November, we announced the opening of a new site in Chile in Latin America and a new creative center in Indonesia, Greater Asia. And in EAME, we invested in a new regional dairy center in Hilversum, the Netherlands. These new facilities enhance collaboration and allow us to partner more closely with our customers, building differentiating taste solutions.

As we also launched our Always Vanilla campaign, which many of you, you will see at the CAGNY next week, showcasing our expertise with these key ingredients. In addition, our consumer insight team developed new tools, such as [trend ovation], powerful programs to help our customers win in the marketplace by identifying key consumer trends at the very early stage. I am proud of all our 2014 achievements as we build a strong foundation for the years to come.

In 2015, we expect growth to continue to be driven by new win performance. Looking at Q1 specifically, while it is still early, we are seeing indications of strong growth.

I will now turn the call over to Nicholas.

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

Thank you, Matthias. Good morning and good afternoon, everyone. I am pleased to report that fragrance local currency sales grew 7% this quarter, including 2 percentage points of growth related to Aromor, acquired earlier in the year.

Our overall performance reflect mid- to high single-digit growth across all regions. The developed market for our fragrance compound business, which includes consumer fragrances and fine fragrance, was strong, growing 7%. This was led by high single-digit performance in North America, where we continue to benefit from being added to a new core list.

On a category basis, consumer fragrance performance was strong, growing 8%, as fabric care, home care, and hair care all grew double digits. North America and Latin America both grew high single digits, followed by mid-single digits in EAME and Greater Asia. It should be noted that this marks the 13th consecutive quarter of consumer fragrance growth.

Fine fragrance local currency sales declined by 1% against a very strong 13% growth reported in the year-ago period and 24% growth in Q4 2012. Our double-digit performance in Greater Asia was more than offset by weakness in EAME, which compared to a 32% growth rate reported in the fourth quarter of 2013 as well as softness in Latin America.

Turning now to our ingredients business. Local currency sales increased 13%, including incremental sales from Aromor. This performance reflects strong growth of specialty ingredients, including Aromor, as well as key product families from IFF, including naturals.

From a profitability perspective, fragrance segment profit increased 23% or $14 million to $76 million. This strong improvement in segment profit and segment margin reflects top-line growth, lower incentive compensation expenses versus a strong year-ago period, and productivity initiatives, including savings from the closure of our Augusta, Georgia, ingredients plant, which all combined to offset rising input costs.

The net result was robust, as segment profit margin expanded 290 basis points to 19.1%. On a full-year basis, local currency sales growth was strong, growing 7%, led by a double-digit growth in Greater Asia and high single-digit growth in EAME, along with the addition of Aromor earlier this year. Every region and every category in our fragrance compound business had positive growth.

On a category perspective, fine fragrance sales increased 2% on top of the 8% we reported for the full year of 2013. In consumer fragrance, sales grew 5% against an 8% comparison, supported by advancements in our market-leading encapsulation technology. Fragrance ingredients, which benefited from the addition of Aromor, was up 18% in 2014.

Looking at profitability for the full year, segment profit grew 18% and segment profit margin expanded 210 basis points year over year.

2014 was a very strong year for fragrances outside of our financial results. We launched two new captives fragrance molecule, received the For Life designation for our LMR naturals portfolio, we successfully integrated Aromor, we strengthened our leading encapsulation technology, we established a new strategic insight group, and we were acknowledged for climate leadership by the Carbon Disclosure Project.

From a customer perspective, we successfully gained access to three new core lists; secured meaningful wins with key customers, leveraging our leading encapsulation technology; and created the number one men's fragrance in the US, Invictus by Paco Rabanne, which was previously launched with great success in Europe in 2013. All in, 2014 was a year of accomplishment and I would like to thank the entire IFF team for their many contributions.

In 2015, we expect continued growth, driven by strong new win performance. With respect to Q1, we believe we can deliver modest growth, as we are facing our most challenging year-ago comparison.

With that, I will now turn the call over to Rich.

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

Thank you, Nicolaus, and good morning and good afternoon to everyone. Looking at our Q4 results, net sales in the fourth quarter were up 7% on a local currency basis, led by high single-digit growth in Latin America, North America, and EAME.

This quarter also benefited by approximately 2 percentage points associated with an additional week of sales, or the 53rd week, which generally occurs every 6 years. The emerging markets grew 6%, while developed markets increased 5%. While local currency sales grew 7%, net sales increased 4%, reflecting a stronger US dollar versus most currencies.

The slight decline in gross margins year over year, which was driven by higher input costs, was more than offset by ongoing control of our research, selling, and administrative expenses and lower incentive compensation costs versus the strong prior-year results. As a result, our adjusted operating profit increased 18% to $133 million and our adjusted operating profit margin improved 210 basis points to 17.5% this quarter. Finally, adjusted EPS grew 17% to $1.07, as the year-over-year gains in adjusted operating profit were partially offset by a slightly higher adjusted tax rate and interest expense.

To factor in year-over-year comparisons in looking at our top-line growth, I thought it will be helpful to include a two-year average local currency sales growth chart by quarter to highlight the underlying trends. As you can see, in Q4, local currency sales growth accelerated sequentially, growing 7% on a two-year average basis.

If we exclude the impact of the additional week of sales in the fourth quarter, the two-year average growth rate is 6%, which is in line with the trends we've seen in the first half of 2014. The improvement versus Q3 is primarily attributable to flavors, which was more in line with historical norms.

Quickly putting our full-year results into perspective, I want to highlight that our 2014 performance was within our long-term targets and continue the strong trends we've seen over the past three and five years. RSA as a percent of sales decreased 220 basis points from 28.3% of sales to 26.1% of sales. The year-over-year decline was driven primarily by lower incentive compensation expense.

Our continued focus to control costs and drive process improvements remains a priority, and by doing so, allows us to reinvest in R&D and commercial resources to build competitive advantage for our business long term. In Q4, R&D as a percent of sales remained within our 8% to 9% target range, at 8.2% of sales.

Now taking a look at currency. Here you see our usual chart showing the change of the euro relative to the US dollar, as the movement in the euro represents our largest exposure relative to the impact in our overall results.

Foreign exchange movements in Q4 had approximately a 3% negative impact on our top-line performance, while on a full-year basis, it was negligible. As a reminder, the US dollar strengthening versus the world's currencies does not necessarily impact IFF in many emerging markets, as two-thirds of our sales are tied directly or indirectly to hard currencies, primarily the US dollar.

Looking to 2015, approximately two-thirds of our euro exposure from an operating profit perspective is now hedged at a $1.32 rate, a little bit below the full-year average for 2014. And while this significantly reduces our exposure for 2015, at current rates, around $1.13, we believe it will have a little more than a 3 percentage point negative impact on operating profit in 2015, based on an almost 15% strengthening of the US dollar versus the euro.

In addition, at a current rate of $1.13, we would expect to see approximately a 5 percentage point negative impact on our 2015 reported sales, as we do not hedge the translation impact on our top line, but rather protect our overall operating profit by hedging our raw material purchases. This impact is included in our full-year 2015 guidance that Andreas will speak to more about momentarily.

Now turning to a cash flow perspective. Our operating cash flows in 2014 was $518 million, or 16.8% of sales, compared to $408 million, or 13.8% of sales, in the prior-year period. The increase in cash flow from operations was driven primarily by an increase in net income, lower amounts associated with Spanish tax payments, and lower year-over-year pension contributions.

Our core working capital levels continue to show improvement year over year as a percent of sales, as our five-quarter rolling average figures through the end of the quarter are down 60 basis points to just above 29% of our trailing 12-month sales.

From a capital structure standpoint, capital spending focused on growth and infrastructure was a significant use of cash. Over the past three years, we have been investing approximately 4.5% of sales on adding capacity and new technology where it's needed to optimize our geographic footprint and deliver winning solution to our customers around the globe.

In 2014, we were in line with our target, as CapEx as a percent of sales was 4.6%. For 2015, we expect a similar level, between 4% to 5%, and then we believe it will revert back to a more normalized level of between 3% and 3.5% going forward.

Finally, regarding our share buyback program in 2014, we have spent approximately $88 million on share buybacks. This, combined with our dividend payments, resulted in total cash return to our shareholders of $221 million or 53% of net income.

I will now turn the call back over to Andreas.

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

Thank you, Rich. As we look ahead to 2015, we believe our business is well positioned for continued performance that generates returns for our shareholders, despite macroeconomic uncertainty and increasing currency pressure. We have well-balanced geographic profile, a diverse product portfolio, and a very strong innovation pipeline that sets us apart from the competition.

We believe this breadth and diversity provides our investors with an attractive combination of sustainable growth and strong cash flow generation. As such, our local currency sales are expected to grow in line with our 4% to 6% long-term target, with balanced growth across both businesses.

We also expect to see operating profit in 2015 grow in line with our long-term target of 7% to 9%, albeit at the low end of the range, given the impact of our unhedged portion of our euro exposure. We set up our expected incentive-based comp and expense to 100% target level at modest inflation in our raw material costs.

Given that we are at the low end of our operating profit range, we expect to see EPS gross high single digits on a reported basis or double digits on a constant currency basis.

In summary, 2014 was a successful year. We achieved our long-term financial targets for the fourth time in five years, continue to invest in R&D to drive innovation and differentiation, made great strides in sustainability, benefited from the integration of Aromor, and advanced external collaboration, all critical for future success.

On a full-year 2015 basis, we are confident that we should be able to deliver top-line and operating profit growth in line with our long-term targets, despite some headwinds, such as the macroeconomic uncertainty, currency pressure, and modest raw material inflation.

Before I close, I want to remind everyone that we will be presenting at CAGNY next Thursday, February 19. I hope to see many of you at the presentation, but also at our correspondent dinner, where we will showcase some of the art and science aspects of our business.

With that, we are happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Mark Astrachan, Stifel Nicolaus.

Mark Astrachan - *Stifel Nicolaus - Analyst*

I guess one housekeeping question first. What was the benefit to EBIT and EPS in the quarter from the extra week, Rich?

And then secondly, just sort of broadly, I'm trying to understand the sales growth expectations for 2015, given the volume weakness that many of your customers are seeing. What gives you confidence -- obviously, you had a good fourth quarter on tough comparisons, but what gives you the confidence that that is going to continue?

And then related to that, how are you thinking about pricing as a contributor absolutely and relative to the benefit in 2014 that it's embedded in that number?

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

Mark, I will start with the first one and then let Andreas talk to the top line. As we noted earlier, the impact from a top-line perspective was about 2% -- 2 percentage points of additional growth.

But when translating that into operating profit impact, you need to remember that the fourth quarter is our weakest quarter in terms of overall gross margin profile. And in December -- within the quarter, December's generally weaker within the quarter. This, combined with some RSA expense -- the higher RSA expenses in December, I'd say that the overall impact from an operating profit standpoint was marginally positive.

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

Okay. And I'll take it, Rich, on the sales growth. Mark, I would answer the following as first of all, we have a very good and balanced portfolio across our two business units; we have good innovation right now, which we can offer our customers; we have a good balance between the emerging markets and the established markets.

And actually, if you look at our customer base, it's not just the big global customers. We have almost 50% of our sales with local and regional customers, and here we see growth as well. So all in all, we believe it would be a good perspective, 4% to 6% growth in local currency for 2015.

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

And Mark, let me go back to the third question around the pricing impact. Since the middle of 2014, we've been talking about pricing pressure and input cost pressure, particularly in the naturals. Key items such as orange, lemon lime, vanilla, and patchouli are all up significantly.

These increases are started to flow through our cost of sales. And as I mentioned earlier, we actually saw that [throat] hit impact our fourth-quarter gross margins pretty significantly. We've been continuing to proactively work with our customers and address these pricing pressures.

On the other side, from an oil perspective and how that impacts our results going forward, it's important to remember that we are two or three or four steps down the chain from a derivative standpoint off of oil. And so I think overall, based on we what see today, that impact coming in later in 2015, we still expect to see overall input costs up on the order -- I'm going to call it about 1% for 2015.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Great. Thank you.

Operator

Lauren Lieberman, Barclays.

Lauren Lieberman - *Barclays Capital - Analyst*

I was hoping you could give a little bit of color to the fragrance margin expansion? Because it was really significant and just whether or not that -- sources of it and whether or not that should be sustainable going forward?

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

Lauren, a couple things -- it's Rich. First, good top-line growth and leverage throughout the P&L was certainly a key driver of that. As we mentioned in the commentary, that more than offset the impact of higher input costs, which were up significantly -- or noticeably in the fourth quarter.

And then another big driver was incentive compensation expense. Last year, results in both businesses were quite strong. On the fragrance side this year, I would say they were closer to or more closer to normal levels. So we also have a benefit of incentive comp. So top-line growth, incentive comp benefit, more than offset input costs.

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

And Lauren -- good morning, it's Nicholas. Also to add to this we also continue to see the benefit of the multi-year productivity initiatives that we had put in place, number one.

Number two, also, we're getting the benefit of the closure of our Augusta facility. So all the restructuring of our manufacturing footprint that we have shared with all of you for our fragrance business is also paying dividend.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay, great. And then also Nicholas, you mentioned -- I know there were three new core lists this year, but then I think the commentary for Q4, you specifically talked about one of them.

So when do -- is it the right way to think about it that you kind of lapped that benefit? Because it sounds like the access to core list, there were wins that came with it. Or is it more just -- it's ongoing because of access to more business?

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

I think it's ongoing. As you start to -- you are building up your portfolio of initiatives and you are increasing your ability, so you are increasing your market access and you are increasing your growth opportunities. But we are very pleased with the initial start with the engagement with these three new core lists.

Lauren Lieberman - *Barclays Capital - Analyst*

Okay, great. Thanks so much.

Operator

Jeff Zekauskas, JP Morgan.

Silke Kueck - *JPMorgan - Analyst*

Good morning. It's Silke Kueck for Jeff. How are you?

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

Good. Good morning. Thank you.

Silke Kueck - *JPMorgan - Analyst*

I was wondering whether you can talk about the product launches on the flavor side in Latin America? I noticed that the volume growth was up 16% in local currencies this year and I think that's on top of maybe 11% last year. So what are the new proprietary delivery systems and is that something specific to the region? Maybe you can give us a slight clarity?

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

Yes, thank you. This is Matthias speaking. Well, as we communicated on our Q2 and Q3 calls, we saw higher than normal volume in [Roche] due to select few customers cycling product launches last year.

As we cycle those few products, performance in Q4 significantly improved in North America, led by strong new wins, particularly in the flavor taste solutions for healthier products, which really made a significant difference to the new win performance for us in North America.

Silke Kueck - *JPMorgan - Analyst*

How about the growth in Latin America?

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

In Latin America, our growth was very strong. A lot driven by a new proprietary IFF technology solutions. We mentioned to you in earlier calls that we very successfully launched new delivery systems, but it's not only the delivery systems which gives a more authentic performance of the flavor. We were also very successful with very strong inroads in many new product launches, which are reducing categories, which are profiting, again, better-for-you performance products.

Silke Kueck - *JPMorgan - Analyst*

Okay. And I had a follow-up question on share repurchase. My memory is that there was sort of like a $250 million share repurchase program that was launched in -- maybe it was shared during early 2012.

Is it sort of completed? Is there anything left? Do you continue to repurchase shares in 2015 with that part of your earnings guidance?

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

Silke, it's Rich. There is -- as you said, the original authorization was $250 million. We have approximately $100 million, maybe a little bit less remaining on that authorization, so we will expect that -- to continue that into 2015.

As we've talked about prior calls, we have a very structured approach in terms of how those -- how the share repurchases are implemented based on the price of the stock price in the marketplace. If the stock price is higher, we will buy back less; if it slower, we buy back more. But our guidance does reflect the expected share purchases in 2015.

Silke Kueck - *JPMorgan - Analyst*

Okay, thanks very much. I'll get back into queue.

Operator

Faiza Alwy, Deutsche Bank.

Faiza Alwy - *Deutsche Bank - Analyst*

So I just wanted to follow up on two things. One was the new wins in fragrances. One, I just wanted to clarify, is that mostly in developed markets? And then what is driving those new wins? Is your encapsulation technology or is it -- I just want to think about what your competitive advantages are versus your other large competitors.

And then just on the flavor side, if you could talk about maybe is there a way to think about what percentage of your flavors portfolio now is geared towards better-for-you or health and wellness products?

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

Yes, good morning, Faiza. It's Nicholas. So regarding the new wins, actually we have a very well-balanced portfolio of new wins in both developed and emerging markets. And we spoke about it last quarter as we're getting into 2015, that the newly gained access to core lists, which are giving us a benefit also in Europe and North America.

As you have correctly identified, our leading encapsulation technology has given an access to new wins and will continue to give us growth with a technology in both 2015 and 2016. So that a pipe is stronger, we are expanding it to new categories, and we are supporting very interesting and attractive growth opportunities with our customers.

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

Coming back to your question on the portfolio or the innovation program on what we can capitalize on the many investments we are starting for health and wellness, I cannot share with you exactly on what is the mix on -- how much really of new products which we have in the portfolio that are geared towards health and wellness.

But I can confirm to you that more than half of all the new wins are geared towards health and wellness, not only in the developed market, but also in developing markets. And I am referring to health and wellness, I am referring to reduced -- sugar, less (inaudible), less fats. I'm referring to mouth feel. I'm referring to many other very innovative taste solutions as the industry moves more and more from flavors into taste.

Faiza Alwy - *Deutsche Bank - Analyst*

Okay, great. And then if I could just follow up on guidance for next year. What's going to drive some of the margin growth? Because this year, it seems like it was -- there was some pricing that was better commodities and then incentive comp rolling over and some of the productivity savings. So is that going to go through next year or is it really just better sales leverage?

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

No, there is -- embedded in our model in the guidance is leveraged through the P&L. That 4% to 6% growth translates into 7% to 9% operating profit growth. We've talked about some of the pressures at the EPS level that make that the last leg on the lower end of our guidance.

The leverage will be a little bit less this year, as we've talked about earlier, given currency pressures and incentive comp reset, but we build into our expectations leverage at -- throughout the P&L and then we would expect that to continue next year.

Faiza Alwy - *Deutsche Bank - Analyst*

Okay, great. Thank you.

Operator

Jon Feeney, Athlos Research.

Jon Feeney - *Athlos Research - Analyst*

A couple questions. Is there anyway, first of all, of giving us a sense how much of the sales here -- in the places where you are really growing, that's across the board in fragrances and in the emerging markets within flavors -- how much of that is share gain versus your big global competitors versus you coming up with new products in the pipeline, if you will, for customers that we just haven't seen yet, maybe?

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

This is Rich. I'll start with some general comments and then I can turn it over to Nicolaus and Matthias to fill in where they feel appropriate.

I think overall, as we mentioned earlier, the growth of -- in Q4, we saw an improvement in terms of -- our commercial performance to win/loss [preferralments] compared to particularly the third quarter, so that's a component of the driver. Volume erosion on existing business was again a little bit more favorable in Q4 compared to Q3.

So I think it's -- those are some of the drivers. Ultimately, longer term, as we've said in our commentary, our growth going forward is going to be largely driven by commercial performance and our wins in the marketplace.

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

Thank you, Rich. I can outline on this as well. Over the last few years, as you may know, we have made significant investments in our geographical footprint. We invested in many new locations and creative sense to be closer to our customers.

We also expanded significantly our account base in many of the markets. And not only into the emerging markets, but also in more the developed markets and including US. [Since we still] opening of Chicago, you may understand that we want to have a different proximity to our accounts. We want to engage at the material stage.

And as a result of the many investments in our geographical footprint, in the expansion of it, we are engaging with more customers at the earlier stage. I cannot tell you to which extent we will be gaining market share, but I can share with you when we measure our performance, as expressed by Rich, in the commercial performance, that we are eliminating the volume erosion or volume increase. We are very satisfied with the performance in Q4 and overall in 2014.

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

Jon, good morning. It's Nicholas. I think it's a combination of different factors. Number one, we are able to leverage our long-standing presence and leadership in emerging markets. Also the newly gained access to core lists, which are really impacting our performance in developed markets.

And then it's really the results of the consumer insights, excellence, and investment that was done over the last decade, and combined with technology, especially the leading encapsulation technology, providing superior performance, but also superior consumer acceptance for the brands we engage with. So it was a lot of investment in fundamentals than are now all combined and are fully providing that momentum.

Jon Feeney - *Athlos Research - Analyst*

Okay, great. Thank you for your perspective on that. And rich, I'm relatively new -- I've only covered the stock for a couple years. I wasn't around for the last extra week. I'm trying to understand why a business -- most of the food and beverage companies I've covered, if they have a 14th week, that it's something more like a 7% or 8% affect on sales in a quarter as opposed to 2%.

What is it about the sales cycle or the linearity to the weeks in the fourth quarter, particularly, that makes it only a 2% impact? And how did you handle -- when was the last extra week, because I couldn't find it looking through, and how did you handle it last time?

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

Okay, couple things. It happens generally every six years, depending upon the cutoffs, but it's generally I would say every six years. Within our industry, as we are more B2B than consumer-oriented, the second half of December by itself is quite light as it is.

In the case of this week -- you think about this week, it ended on January 2. You've got maybe 2 1/2 days at most of true shipping days available, because customers are also looking at their supply chains. That's -- those are probably the key drivers on why it's not going to have a comparable impact than you might see in a consumer products company.

Jon Feeney - *Athlos Research - Analyst*

And is it -- I guess there's a second half of December that you are lapping as well. Is it do people change their order cycles or something like that in the quarter? Do I just have to go back and look? Do you know off the top of your head when the last extra week was last time? Last time you did a [50 there]?

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

Again -- I will go back and look. But I would say it's six years ago. When you think about it and you -- why you probably don't see it is when you translate that into a full-year impact, we're talking about plus or minus 50 basis points on a full-year basis. So that's probably why we haven't -- that's why it's not going to be highlighted.

Jon Feeney - *Athlos Research - Analyst*

Got you. Okay. Thank you very much, Rich.

Operator

John Roberts, UBS.

John Roberts - *UBS - Analyst*

Andreas, this is maybe an industry question or you can answer it as IFF, but ADM bought WILD recently. And at their investor day, it sounded like they are targeting several billion dollars more of specialty food ingredient acquisitions, higher than the legacy ADM.

Do you think the flavors business is going to have to have ancillary products or bolt-ons to broaden the portfolio? Just a few minutes ago, you mentioned this move from flavors towards taste and I don't know if you go even broader than that in the food ingredients area.

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

John, thank you for that question. It's certainly a good industry question. And we see that the acquisition of WILD by ADM, that they moved, so to say, into a new player on the lower end of the flavors market. And we will see how the integration of WILD and ADM will work out and what they do next, so that -- actually, we don't see any impact at the moment on our business.

In particular, if we look at our business, it's more in terms of specialization, it's more based on our innovation and technology. So at the moment, we don't see too much overlap with our business. But nevertheless, we will monitor the situation. We will see how that comes out.

John Roberts - *UBS - Analyst*

And then for Rich, since you hedged, the potential eventual impact of the current foreign exchange rates is pushed out. How far out are you hedged? And at that time, if you go out beyond the hedges, what would be the run rate headwind of foreign exchange versus 2014?

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

Well, as I said in the early commentary, we're about two-thirds hedged for 2015. We've got -- we layer in the hedging month by month in a very programmed, disciplined approach. We are hedged -- we impartially hedged, certainly not to the two-thirds extent that we are in 2015 for 2016. Then the impacts of the hedges roll through and as we are hedging raw material purchases.

The impact of when it affects our P&L -- there's a time lag difference between when the contracts are closed out and then we offset the impacts on a P&L perspective. So I think the best I can tell you is what I talked about earlier in the commentary, which, given the current euro exposure rates and assuming $1.13, we think it's about a 3% headwind on the operating profit level versus a 5% headwind on top line.

John Roberts - *UBS - Analyst*

Okay. That was a 2015 comment, right?

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

2015. Beyond --

John Roberts - *UBS - Analyst*

On a run rate, what kind of number would be further out?

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

I think we want to focus our commentary and feedback on 2015. That's too far out beyond that.

John Roberts - *UBS - Analyst*

Okay. Thank you.

Operator

Mark Astrachan, Stifel Nicolaus.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Two questions -- a follow-up. So one, Rich, just on RSA expenses X R&D, X incentive comp, is there an opportunity for leveraging the remaining piece of that, since it is still fairly large as a percentage of sales?

And then Andreas, I was intrigued by your -- how much about this health and wellness driving growth in the quarter or the new business wins. Any idea where the adoption of health and wellness by geography is? It seems like Europe might be a little bit further along in the adoption curve. Any idea where North America is versus Latin America, Asia, or if you can separate it between developed and developing markets, that would be sort of helpful.

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

Hi, Mark. Let me just start with your first question. And again, from a leverage standpoint, we expect to have leverage throughout the P&L. And I think in addition to that, we are constantly looking for ways to drive process efficiency and savings in the organization.

That allows us to then reinvest in R&D, commercial, business development, and related expenses to grow the business. So I would expect to continue to see leverage in 2015.

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

Matthias?

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

Coming to your question on the activity levels on health and wellness -- launches of our health and wellness program, I would say that Western Europe and North America is significantly more advanced versus many other geographies.

Yet when it comes to sugar, we also see a lot of this in Latin America, a few countries that introduced stock hold sugar tax introduction. So you are paying additional taxes if you have a high sugar containing or a high calorie containing product. And it simply forces a lot of manufacturers to take calories out. And the overall [advantage] also of the consumer is changing dramatically.

I don't think that in many parts of Asia, health and wellness in form of reduced sugar is much advanced. We see, though, first signs, particularly in India and some of the markets. I think it will take probably a few more years there until we see the same engagement and activity level as we would -- as we right now see in Latin America, in Western Europe, or in North America. I hope this answers your question.

Mark Astrachan - *Stifel Nicolaus - Analyst*

It does. Is there any impact on the fragrances side as you sort of shift in the same fields?

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

Nicholas?

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

Hi, Mark. A few things. I think that you see in terms of wellness, a lot of promoting better hygiene overall. So it's one of the different habits that the brains can be promoting, but we are obviously looking at what is a solution following the flavor trend in that respect that can be supporting the needs for consumers. So within our system ability initiatives, we're also strengthening our portfolio in R&D and to meet future consumer demand.

Mark Astrachan - *Stifel Nicolaus - Analyst*

Thank you.

Operator

Curt Siegmeyer, KeyBanc.

Curt Siegmeyer - *KeyBanc Capital Markets - Analyst*

Just a couple quick ones. You guys had some costs associated with the new plant in third quarter in the flavor segment. That doesn't seem to have repeated here in the fourth quarter. Is it safe to say that is behind us now?

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

Yes. I think the other thing that you start to see in the fourth quarter is some of the productivity savings that Nicolaus talked about on the fragrance side of the business. So I think the impacts of that as we exit 2014 were then going to be on a apples-to-apples basis.

Curt Siegmeyer - *KeyBanc Capital Markets - Analyst*

Okay. And then just one other one on North American flavors market, which you guys sort of touched on. Some new product introductions that sort of helped in the quarter.

What is kind of the health of the underlying market? I know you said it seems to have gotten a little less bad, but is it -- is the right way to look at the underlying market is down and you guys are growing maybe low to mid single digits all from new product introductions or what's the delta there?

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

We are mainly growing thanks to new product introductions. I cannot tell you that our volumes will be increasing a lot. I think the conditions in the North American market as such, they are not really that encouraging overall from a -- in the food and beverage industry, as reported by many of our customers.

We are, however, really satisfied with the traction which we have with the inroads we made, thanks to differentiating flavor technology.

Curt Siegmeyer - *KeyBanc Capital Markets - Analyst*

Great. Thanks, guys.

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

So then I would like to close the call here. Thank you very much for your questions and I hope I see many of you during the CAGNY conference next week in Boca. Thank you. Have a good day.

Operator

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