Sensient Technologies Corporation

Moderator: Lori Hauser
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Operator: This is conference # 51676891.

Operator: Good morning, everyone, and welcome to the Sensient Technologies Corporation 2017 Second Quarter Conference Call. Today's call is being recorded.

At this time, for opening remarks, I would like to turn the call over to Mr. Steve Rolfs. Please go ahead, sir.

Stephen Rolfs: Thanks. Good morning. I'm Steve Rolfs, Senior Vice President and Chief Financial Officer of Sensient Technologies Corporation. I would like to welcome all of you to Sensient's conference call to discuss 2017 second quarter financial results. I'm joined this morning by Paul Manning, Sensient's Chairman, President and Chief Executive Officer.

Yesterday, we released our 2017 second quarter financial results. A copy of the release is now available on our website at sensient.com.

During our call today, we will reference certain non-GAAP financial measures, which we believe provide investors with additional information to evaluate the company's performance and improve the comparability of results between reporting periods. These non-GAAP financial measures remove the impact of restructuring costs, currency movements and other costs, as noted in the company's filings. Non-GAAP financial results should not be considered in isolation from, or as a substitute for, financial information calculated in accordance with GAAP.

A reconciliation of non-GAAP financial measures to the most directly comparable GAAP financial measures is available on the Investor Information section of our website at sensient.com and in our press release. We encourage investors to review these reconciliations in connection with the comments we make this morning.

I would also like to remind everyone that comments made this morning, including responses to your questions, may include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Our statements may be affected by certain factors, including risks and uncertainties, which are discussed in detail in the company's filings with the Securities and Exchange Commission. We urge you to read Sensient's filings for a description of these factors. Please bear these factors in mind when you analyze our comments today.

Now we'll hear from Paul Manning.

Paul Manning: Thanks, Steve. Good morning. Sensient reported adjusted earnings per share of $0.87 in the quarter compared to last year's second quarter result of $0.84. Foreign currency translation reduced adjusted EPS by $0.01 in the quarter.

As I noted in prior calls, last year's results included a $0.04 benefit to the Flavors & Fragrances group from a one-time sale of import rights. And in this year's second quarter, we realized a tax benefit of $0.07. Removing the impact of these items in both years, this year's second quarter adjusted EPS is essentially even with the prior year result. Obviously, this performance does not meet my expectations.

Color had a good quarter, but we had a number of operational issues in Flavors & Fragrances and soft results in Asia Pacific.

Flavors & Fragrances had a disappointing quarter, much of which related to the winding down of restructuring activities. Operating income was down by 19 percent. Recall that last year's second quarter included a $2.7 million benefit from the sale of an import right, but the most significant issue this quarter was the impact of restructuring.

While we completed our restructuring-related production moves in June, the impact of this transition had a substantial effect on the group's performance this quarter. We experienced production and shipping backlogs, which shifted a significant amount of orders into the third quarter. We have been reducing the value of the order backlog, and we expect to be caught up this quarter.

As a result of the restructuring delays, we also had higher production and logistics costs, including overtime, temporary labor, expedited shipping and additional warehousing costs. We will continue to see higher production costs in the short term, but we expect that plant costs will normalize by the end of the year.

In addition to the significant restructuring-related issues, Flavors & Fragrances has been -- also been impacted by other unusual items in the quarter, including higher production costs at an additional site, lower pricing and lower volumes in aroma chemicals, a working capital adjustment and lower volumes from one of our customers in Asia. I'll add more detail on the Asia customer issue in a few minutes.

It was a very challenging quarter for Flavors & Fragrances, but we still have high expectations for the group. We have completed the restructuring program, which has been a significant distraction for the last 3-plus years.

In addition to the restructuring changes, we completed the sale of two businesses earlier this year. The divestitures removed operations that did not align with our strategy, were dilutive to the group's operating margin and increased working capital balances.

These actions have already improved the group's mix, which is reflected in a 120-basis-point improvement in the second quarter gross profit margin. And furthermore, these changes allow the group to focus on new product development and other initiatives that will drive growth, improve the group's product mix and generate higher operating margins.

Asia Pacific also had a challenging quarter. In local currency, revenue was off 3.7 percent and operating income was down significantly. On the last call, I mentioned that the group's first quarter performance was impacted by order timing and product mix, and those issues have continued longer than we originally expected. One of our larger customers in the region is implementing a change in its distribution network, which has affected their sales and consequently, their requirements for our products. These lower volumes represent a significant portion of the income variance compared to last year's second quarter. We expect volumes to normalize once our customer resolves this issue.

We still see good long-term opportunities for our businesses in Asia Pacific. We have made significant investments in both personnel and facilities in the region to increase our technical capabilities, allowing us to work more closely with customers and to sell products that are aligned with the strategies in Color and Flavors.

We recently opened a new production facility and expanded manufacturing capabilities at another site in the region to reduce cost and to shorten lead times. Expanding our presence in Asia Pacific is a significant part of our growth strategy, and we remain very optimistic about the opportunities in this region.

Color had a good quarter, driven by strong results from the Cosmetics and North American Food Color businesses. For the group, revenue was up just over 1 percent and operating income increased 4 percent in local currency. The group's operating profit margin increased 50 basis points to 21.9 percent in the quarter.

The Cosmetics business continues to perform well with strong growth for both revenue and operating income.

The Food Color business in North America reported solid profit growth driven by natural colors.

Our results in Latin America were down, but we think this is an anomaly because there is a strong interest in natural colors and clean label ingredients.

Our Cosmetics business continues to see strong demand for makeup, lipstick and other personal care products. The end markets for cosmetics have been very strong, and we have a robust innovation program, which allows us to develop solutions for a wide range of applications, including makeup, skin and hair care. Our success in Cosmetics remains broad-based with growth in every region.

In the food and beverage markets, we expect to see the strong interest in natural colors continue for some time. In the second quarter, approximately 80 percent of all new product launches in the U.S. featured natural colors, and this figure is about 75 percent globally. Many of the world's largest food companies, including some of the largest food retailers, have announced their intentions to use natural colors in their products. We expect these conversions to take place over the next few years. But for the near term, conversion activity has been driven by local and regional manufacturers or private label brands.

Sensient is the market leader for food and beverage colors, and we have developed proprietary technologies that allow our customers to offer natural products without compromising on the appearance or affecting the taste. We are uniquely positioned to lead the conversion to natural colors because of our investments in new technologies and our applications expertise.

Earlier, in my comments about Flavors & Fragrances, I noted that we had completed our restructuring activities. We stopped production at the last facility in June, and we have closed or sold 9 major production sites in the last 3-plus years. Those facilities were not core to our ongoing strategy. By rationalizing our facilities, we have lowered our cost structure and reduced our ongoing capital expenditure requirements.

This very necessary restructuring has been a serious distraction for several years. As Flavors & Fragrances moves on from restructuring, we will be able

to apply more resources to initiatives that will drive growth, including new product development. We will have some residual restructuring costs for the remainder of the year, but they will not be significant.

We had many challenges in the second quarter. And while I'm not satisfied with our results, I remain confident in our expectations for the businesses for this year and beyond. Color had another strong quarter, and we continue to see strong demand for cosmetic products and natural food colors. My expectations for Color has not changed, and I still expect Color to deliver mid-to high single-digit revenue growth and high single-digit profit growth for the year. Flavors & Fragrances has been improving its product mix and will move on from restructuring. I expect them to deliver low single-digit profit growth with more than 100 basis points of margin improvement.

I have revised my earlier expectations for Flavors & Fragrances because of the restructuring-related issues and the other unusual one-time items that happened this quarter. We are having a temporary setback in Asia, largely driven by issues at one of our larger customers, but we are optimistic about our ability to grow in this region.

We are revising our adjusted EPS guidance to be between $3.40 and $3.45 for the year, which represents mid-to high-single-digit growth in local currency terms. Our previous guidance was $3.35 to $3.45. I remain very optimistic about the company's future.

Steve will now provide you with additional details on the second quarter results.

Stephen Rolfs: Thank you, Paul. Sensient's operating income was $44.4 million in the quarter compared to $43.7 million in last year's second quarter. The operating income results include restructuring and other costs of $7.9 million in the quarter and $13.6 million in the comparable period last year. Excluding the restructuring and other costs, adjusted operating income was $52.3 million and $57.2 million in the second quarters of 2017 and 2016, respectively.

Foreign currency translation reduced both revenue and adjusted operating income by approximately 1 percent in the quarter.

Diluted earnings per share from continuing operations were $0.69 in the quarter compared to $0.55 in the comparable period last year. Restructuring and other costs reduced earnings per share by $0.17 in this year's second quarter and by $0.29 in last year's second quarter.

Adjusted earnings per share were $0.87 in the quarter and $0.84 in the comparable period last year. Foreign currency translation reduced adjusted EPS by $0.01 per share in the quarter.

The second quarter results included a $0.07 tax benefit, which was primarily due to a planning opportunity that was available to us this year. We expect the full year tax rate to be consistent with last year's tax rate.

Corporate costs were down $3.1 million in the quarter, primarily due to lower performance-based compensation and lower professional fees. Operating income was $68.4 million in the first 6 months of this year and $91.2 million in the first 6 months of 2016. The operating income results include $39.2 million and $16.9 million of restructuring and other costs in the first halves of 2017 and 2016, respectively.

Removing the impact to restructuring and other costs, adjusted operating income was $107.6 million in the first half of this year and $108.1 million in the first 6 months of 2016. Adjusted diluted earnings per share from continuing operations was $1.69 in the first 6 months of 2017 compared to $1.59 in the comparable period last year.

Foreign currency translation reduced revenue, adjusted operating income and adjusted diluted earnings per share by approximately 1 percent in the first half of this year.

Cash flow from operations was $25.2 million in the quarter compared to $54.7 million in last year's comparable period. The second quarter cash flow was

reduced by higher working capital balances and higher income tax payments compared to last year's result.

Capital expenditures were approximately $10 million in the quarter, and we still expect capital expenditures to be between $60 million and $70 million for the year. We repurchased approximately 180,000 shares during the second quarter.

Our balance sheet remains strong. Adjusted debt to adjusted EBITDA was 2.5 at the end of the quarter. We plan to keep debt levels in line with an investment-grade profile to maintain the flexibility for capital expenditures, dividend payments, share repurchases and acquisitions. We will continue to take a balanced, prudent and long-term approach to our capital allocation strategy, which includes evaluating share repurchases and acquisitions on an opportunistic basis.

Thank you very much for your time this morning. We will now open the call for questions.

Operator: (Operator Instructions) And our first question comes from Brett Hundley from The Vertical Group.

Brett Hundley: Paul, you kind of -- you threw a lot at us on the Flavors & Fragrances side as an explanation for why results didn't come in as you had expected. And maybe you can go into a little bit more detail on some of those issues. I guess at its core, what I'm ultimately going to be trying to get at is where do you think Flavors & Fragrance growth could have been ex some of these items? Where do you think that segment margins could have been ex some of these items?

Because without the individual details on the things that you brought up, I look at your segment performance and I kind of back out what I think is a culling effect. I back out what I think is a ForEx impact or what you gave us as a ForEx impact, and that kind of implies flat organic growth at best for your Flavors & Fragrances division. And then when I look at your margin for the division, clearly it was about flat sequentially, flat year-on-year when you

make some adjustments. And you've been talking about this kind of 100-basis-point-plus improvement in segment margins for the course of this year, and it sounds like you're moderating that somewhat because of the issues that you brought up. So that's at its heart what I'm trying to get at, and I'm just wondering if you could just go into more detail on the issues that you brought up and when we might be able to see some of them clear up.

Paul Manning: Okay, sure. Let me go through those items for you, Brett. So getting right to it, I would tell you that if we were to, to get at the heart of your question, what were the results without these items, I would tell you that if I were to add up the profit impact of these one-time items that I featured in the opening monologue there, we would have been up about mid-single-digit profit growth, essentially consistent with where I thought we were going to be each quarter of this year.

Revenue was obviously also impacted by the backorder situation as well as the FX piece, which was only about a percentage this quarter, and then you got a couple of percentages related to the divestiture of those other businesses. So net-net, assuming none of these factors that I addressed in the opening monologue had been in play, we would expect that the operating profit to be up certainly mid-single-digit and perhaps, say, in the range of, say, 5 percent to 6 percent. Revenue would have been a lot closer to flat, and then the operating profit margin would have also been up, obviously, in excess of that 100 basis point that I had guided to in the beginning of the year.

So if you'd kind of separate what are we doing externally versus what is happening internally, when I gave the guidance for Flavors and Color in Asia for 2017, it was based on what we felt we could win in the market, what costs we were going to take out. And so that was why we certainly formulated the original guidance to you.

And as we talk specifically now about Flavors, it was mid-single digit and perhaps even high single digit on profit. It was flat on revenue owing to the culling and some of the FX, but that was where we were guiding. As you look at the second half, that guidance still applies. That is ultimately what we believe we're still able to achieve externally. Now I think you would anticipate

Q3 or Q4, and we'll just say the back half, as being sequentially much better than Q2 for Flavors and much more consistent with the results that you saw in Q1. So I think we would get back on track with the OP margin growth being 100 better, 100-plus basis points for the back half. I think you'll see revenue closer to that flat that we had suggested -- or I suggested was the forecast for the year. And then I think we would be back in that ballpark of mid-, certainly mid-single-digit growth on OP for the back half for Flavors.

So the -- kind of underlining all of this is I think the nature of these things. I emphasized that there's a difference between what's happening internally and what's happening externally. I think externally, this restructuring issue aside, we are making -- we continue to make very good progress on our program, on our strategy throughout much of the Flavors & Fragrances group. I think putting this restructuring behind us is going to be a tremendous benefit.

As you can imagine, after 3-plus years of this, this gets a little bit tiring to everybody. But obviously, you know what? We didn't execute in Q2 and I'm very disappointed with that, but I would tell you that the nature of it, it was very much internal rather than external factors, which would suggest that either we couldn't compete or we couldn't overcome obstacles in the market, and that's not the case.

Brett Hundley: I appreciate that. I mean, this question may be a little late or it may not even have much relevance at this point, but looking back, do you think that you guys would have benefited from maybe more outside help as it relates to going through the restructuring and even the aftermath of the restructuring? I mean, I know this isn't your first rodeo as it relates to these things, but was this one more complex than you thought? And even as you look forward, are there lingering issues potentially, where having some outside help to manage your way through and allowing the senior managers of the company to focus on areas of growth strategy, et cetera, makes more sense?

Paul Manning: Well, I would say at this point it's somewhat academic, inasmuch as restructuring is done from the standpoint of consolidating plants and moving products. These are not easy things and fortunately, I haven't really had to talk much about the inner workings of restructuring. We've been able to overcome

many of these things, but it came at the very end. Why this one? Because I think you said it very well. This is a far more complex move, to some degree, that's why it was held towards the end. But I think in general, as we move forward, I don't really need to use the word restructuring, because from an operational standpoint, we have now closed that last plant and it's just a matter of when we sell that facility, it's gone forever.

But we've effectively sold every other facility at this point, we're out of them, and we're really talking about growing beyond this. Some of our other regions where we also restructured, and again, it's never easy. It's not like consolidating two widget plants into one widget plant and you just continue to build. It's certainly been far more complex than that. But we've shown and demonstrated in these other regions that have sort of moved past restructuring that once we get to that phase, it's a very different game.

And we can compete very effectively in the marketplace and we're regenerating wins where we believe we can, and I think you will expect and you should expect to see much of the same coming out of this -- these two U.S. businesses that were affected by the restructuring here.

Brett Hundley: Okay. So just two others for me. On Color, the margin was very solid again and exceeded my expectations. The top line performance was a little bit disappointing to me, when I just think about the backdrop for a number of different business lines that you have there. And even one of your competitors has continued to put up pretty good results on tough comparisons, and so the growth that you guys saw in that business was a little bit disappointing to me.

You mentioned LatAm as a potential effect there, but I was wondering if you could just talk about that business a little bit more and the expectations you have internally. Do you believe that you're seeing any share degradation in certain areas? Just a little more help there would be helpful.

Paul Manning: Sure. So our guidance for Color at the start of the year was mid-single-digit top line, high-single-digit OP. That is still the guidance for the Color group for the year. Part of that guidance is also could there be some uplift in operating

profit margin? Yes, but I didn't commit to some significant movement in that because as you already noted, it's quite good.

If I were to break down those businesses in general, I think Cosmetics had an outstanding quarter. Again, this is continuing in their program over the last couple of years of very strong results, top line and bottom line. Our Pharma business had very good top line growth as well. I think what you're ultimately getting to was natural colors.

Natural colors has been a significant uplift in this business for the last several years, and our results continue to be good. Now something that was somewhat relevant for the second quarter was essentially the pace of new product launches in the U.S., in North America in particular, but even on a global basis. If you look at kind of year-to-date 2017, new product development launches are down 22 percent in the North American market. Globally, it's down 7 percent to 8 percent.

So that certainly can have an impact. But certainly, that affects us and a lot of other people in this market. I think when you look at some of our core business, where we have a lot of synthetic color business, that's one picture. But when you look at the natural color business, that's a very different picture. Clearly, synthetic colors, by design, are going to be flat and perhaps even on the decline as we convert customers to natural colors.

But to get at your real point, are we winning in this market? I would tell you that indeed we are. When you consider the various spectrums of products in the market, from the innovative and the very sophisticated products to the more mundane building blocks, we certainly win and have an outsized advantage, I would argue, on the more innovative products that provide much more closer to synthetic color matches than you're seeing right now in the market on some of these building blocks.

And an important thing to think about with natural colors, companies that are going to convert to natural colors, there's two ways to do this, in my opinion: Correctly or incorrectly. The correct way would be to find the closest match to a synthetic color. And for those companies that have done so, we have very

detailed IRI data that tell you that those brands are growing, those categories are growing. For those who would elect to take the building block, kind of the more muted, not good matches to synthetic colors, those brands are being negatively impacted from that. So not only do they have the negative impact of the economics by converting to synthetic -- to natural, but they also have the negatives because they didn't do it on a like-for-like basis, and consumers are rejecting these products that don't offer a comparable visual appearance to the synthetic alternative.

So we continue to focus on that part of the market. We continue to focus on those opportunities, and I feel very good about that natural color business. And Color in general, right now, we're up about mid-single, a little bit lower end of that for top line for the year, but I feel very good about maintaining that guidance and that expectation for the year. Certainly to get to that, natural colors would have to be above that expectation, because we have a big synthetic business that is essentially below that expectation. So I don't know if all that makes sense, but I just wanted to give you that kind of color to the whole thing.

Brett Hundley: It does. I appreciate the thoughts. And I'll stop there and yield the floor. Thank you.

Paul Manning: Okay. Thanks Brett.

Operator: And our next question comes from the line of Curt Siegmeyer from KeyBanc Capital Markets.

Curtis Siegmeyer: Just a follow-up on Flavors. You mentioned low single-digit op income expectations for the full year. And given where we are sort of year-to-date, kind of down high single-digit range, it seems to imply, obviously, up high single digit in the second half. And I know there'd be a point or two of FX in there, but I guess the question is just how confident are you that, that's sort of how the second half will unfold? And do you expect any lingering effects in the third quarter now that the restructuring is behind you? Or do you anticipate a pretty rapid improvement in terms of sort of volumes and some of the inefficiencies kind of going away that you've been dealing with?

Paul Manning: So to begin, your math is about right and I would tell you that number two, I'm very confident. And I'm very confident because I'm already seeing what we're selling in July and I'm seeing what our orders in August look like, and it's a picture that allows us to achieve those financial results that I just alluded to. I think with respect to these residual costs, I don't want to get into accounting romance here, but obviously, some of these things bleed over into a quarter, which is obviously dependent on your inventory levels. But needless to say, some of those costs will bleed into Q3, but we -- I believe we can rapidly remove and continue to remove those costs post -- in this post-restructuring phase that we're in. So in short, I feel very comfortable about this.

The reason that I felt comfortable with our guidance is, again, because I see the path we are on and I see the results and I see the Q2 event effectively being an internal issue, and an internal issue that we now address and have overcome, and in some cases, because they were one-time, they're not repeating. I feel very good about the prospects in Q3 and Q4.

Curtis Siegmeyer: Okay, great. And then just one on the guidance. Given that you kept your Color outlook roughly the same and maybe tweaked down Flavors a little bit, given what you've already seen over the first 6 months, the low end of EPS guidance, raised $0.05, is it all due to less FX headwind? Is there a little bit of a benefit from maybe a lower tax rate for the full year? Or maybe if you can just sort of talk about that.

Paul Manning: Well, so I'll answer the first part -- the second part of your question first. We expect tax to be about the same as it was in '16 as it will be in '17. So think about tax in essence as a timing issue. With respect to your FX comment, yes, I think at the beginning of the year, we anticipated and we had projected FX to be about a $0.10 impact. We're looking more like it's about half that and depending, as my crystal ball here tells me, that may be about right for the year. But we will continue and potentially revise again if rates would move and provide more of a tailwind for us. But yes, I think FX had a big part of raising the lower end of that guidance.

Curtis Siegmeyer: Great. Thanks a lot Paul.

Paul Manning: Okay. Thanks Curt.

Operator: And our next question comes from the line of Francesco Pellegrino from Sidoti Capital.

Francesco Pellegrino: So I just wanted to stay on the Flavors & Fragrances topic. And to be honest with you, I think it all sort of like boils down to how big of a back -- how big are these backorders that are sort of going to be in the third quarter? Because you talked a lot about higher cost sort of persisting into the third quarter, but I would think you would've gotten a little bit more operating leverage in the second half of the year if these backorders are of any significant size. I was just wondering if you could give a little bit of, no pun intended, a little bit of color in the Flavors & Fragrances segment on that end.

Paul Manning: Sure, I'll say this, so number one, when we closed the other facility, a whole bunch of costs come out as a result of that. So I think that's already, as we've declared in my opening monologue, that happened in June. I think a lot of the other costs associated with expediting orders and making sure that production levels are correct and that things are working more seamlessly, this is something that, again, much of this happens and will continue to happen right now. And as we continue into 3 and in the fourth quarter as well.

So I think these costs are very much in our control, to take them out, because, again, they were precipitated at the onset of restructuring. Prior to that, this was actually a very well-run, efficient, lower-cost plant in the whole company. So I've got a lot of confidence that with the new products that we've introduced and the new volumes that we've introduced that, that's going to be something very much in our control to take those costs out and continue to commit to the savings that we had pledged with respect to the restructuring savings.

We haven't necessarily talked about those on this call, but we have certainly more nominal savings for '17. But the savings we expect to generate are still there, and they will be something that we work towards internally and

communicate externally. As we get into the tail end of '17 and into -- more like into '18, those savings are still available to us to be generating from this -- the closure of this site.

Backlog, again, I think with the -- as I look at our progress there, certainly we see the end is very much in sight and it's in Q3, and I just want to certainly be very clear about that. But I think the more -- the longer you operate in this facility, the more efficient you become, the more successful you become and this is essentially what I've been seeing. It gives me a lot of confidence that we addressed these issues, get through this backlog and move on.

Francesco Pellegrino: Okay. Let me ask you maybe the same question in a different way, just to help us with some -- how the sell side should really be thinking about maybe next year as well? And I know you're a couple of quarters away from giving 2018 guidance, so I'll approach this very carefully.

When we think about just the strong margin profile that we're probably going to be seeing in the Flavors & Fragrances in the second half, I'm a little bit concerned about how I should sort of take the second half and view what should be happening in 2018. How sustainable is a lot of the margin growth that's going to be happening in the second half of '17 and then sort of like rolling that into '18, given just all the different moving pieces that we've been seeing so far from the first half?

Paul Manning: Well, I -- listen, I pledged to our shareholders that we're on the road to 20 percent operating profit margin in Flavors, and so that is very much still within our sights. We still have a significant number of our businesses that have demonstrated tremendous improvement in operating profit margin. Prior to this quarter, we've been talking about that for about the last year and a half, the very strong progress we have made on operating profit margin, so I think that continues to be a very realistic goal for us. Again, you throw out the rest of these costs post restructuring.

We continue to emphasize selling the products, consistent with our strategy, continuing to focus on moving away from the lower-margin, less competitive products. And so I think these still provide us with a path to the eventual 20

percent OP margin that I would anticipate communicating here and our progress towards that throughout 2018 and 2019. So the upside is there. And ultimately, once we get past cost, then really, the uplift will come principally from product mix. And I think those are very consistent with where we have suggested from the very beginning, with the 3 or 4 pillars as to how we get to that 20 percent OP margin.

Francesco Pellegrino: Okay, individual segments. I know for Flavors & Fragrances in Asia Pacific, you cited the decline in volume. Is there a way to sort of quantify the volume declines in each of the segments, just so we can sort of better understand what's happening with pricing in the segments, while also obviously being cognizant of shifts in the product mix? I don't know if you have those numbers handy.

Stephen Rolfs: So Francesco, generally, I would say since we are -- we have been moving price up in the Flavor business, so pricing would be a moderate favorable and volume would account for a little bit more than the reported revenue change then. In Asia, most of the decline that you see will be volume-related, I would say.

Francesco Pellegrino: Okay. And let me push back a little bit. If Color group was basically flat year-over-year and price points for Color on a per unit basis are higher, are volume sales in the Color group lower? Were they lower in the second quarter?

Stephen Rolfs: So my -- the comments I just gave were on Flavor in Asia.

Francesco Pellegrino: Right. So I guess just digging a little bit into the Color group then.

Stephen Rolfs: So in terms of Color, we would have seen favorable volume growth on food and beverage colors, primarily on natural colors, offset slightly by synthetic colors. Cosmetic was very strong on volume, and those would be the key drivers in the quarter.

Francesco Pellegrino: Okay, okay. That makes sense. And so I guess maybe just looking at it a different way, and this is my last question, in regards to your EPS growth guidance, is there maybe a way to sort of quantify what you guys might be

looking for on a consolidated basis for operating income growth? So we just sort of like back out some of the moving pieces, like share buybacks, the tax rate?

Paul Manning: Are you talking for 2017 or 2018, Francesco?

Francesco Pellegrino: 2017.

Paul Manning: 2017?

Francesco Pellegrino: What does your guidance imply for operating income growth guidance?

Paul Manning: So it would imply mid-to mid-single-digit growth.

Francesco Pellegrino: Okay. Mid-single-digit. Okay, perfect. That's it for me. Thanks again.

Paul Manning: Okay. Thanks.

Operator: And our next question comes from the line of Andrew Lane from Morningstar.

Andrew Lane: So with the restructuring program now completed, I wanted to ask you to take a step back and comment on some key takeaways from a bigger picture perspective. So when reorganizing and combining your operational footprint, were there any aspects that you didn't anticipate, that perhaps by surprise ended up being highly valuable or maybe led to improved efficiency for your ongoing facilities?

Paul Manning: Well, I suppose one day, I would -- well, no. I guess with restructuring, it's the very nature of the program. You anticipate a lot of things. You plan for a lot of things, but they're very challenging. And like I said, I can't tell you how excited I am about restructuring being over, but I think you can't underestimate -- despite the fact that you make a product in one production facility, when you move it, it doesn't necessarily do the same things that it did in the last facility. Why? Any number of factors might have changed. The operating environment, the utility support, all these factors could come into play.

I think that when you're talking about a specialty chemical versus a fine chemical, there can often be a lot of variability in raw materials and variability in operating conditions that, again, lend itself to a very complex transition of a product. You're talking about transferring individuals or training new individuals as well, can certainly add to the complexity. And then as you're doing this, you're also, in some cases, trying to rationalize and to improve formulations, to take out costs. Formulations just to simplify the supply chain requirements for any given product.

So there's a whole host of things that can go right and things that can go wrong. A lot obviously did not go right in this last one, but a lot has gone right in the earlier ones, because, again, I haven't really been talking about this kind of stuff until now.

So yes, if I can get into my time machine and go back, sure, there are some things that I would do differently here to affect the outcome and to improve the outcome. But I think for this point, it's really a matter of how do we expedite the removal of these costs in these plants and work on improving throughput and other efficiencies in these, so that we can get to where we really wanted to go.

Restructuring was an absolutely essential and necessary step that the Flavor group needed to take to not only take out costs, but to take out complexity. Operating a lot of plants becomes a very complex game, particularly when you're trying to staff all those plants. The capital expenditure requirements grow considerably when you have more plants. And so these things are all very essential. And I think long term, we're going to be very, very pleased that we went through this painful process of restructuring.

Andrew Lane: All right, fantastic. Thanks. Changing gears to your R&D spend, I wanted to touch base on that quickly here. It was up a bit to about 3 percent as a percent of sales in 2016 after kind of being in that 2 percent to 2.5 percent range over the last decade. Some of your larger competitors have high-single-digit R&D spend as a percent of sales. Particularly now with restructuring in the rearview

mirror, do you have a specific target for Sensient into the future on this line item?

Paul Manning: Yes, my target is about measuring outcome, not measuring effort. And so from that standpoint, each of the businesses is evaluated on their ability or their top line growth that's generated from new product development. So that would be comment number one. Certainly for some of our businesses, we assign a 7 percent, 8 percent, 10 percent top line growth expectation out of new product development, with the assumption that you have some products out in the market that go away or the customer cancels them, and you have some that you're also adding that are not considered new products, that are more standard products. So I would say that's comment number one. Number two, a lot of this depends on how you define R&D.

We don't necessarily say anybody wearing a white lab coat constitutes R&D spend. We're fairly purist when it comes to who is actually doing real R&D, rather than who is just in a lab. So it's not necessarily -- I'm not -- I can't speak to my competitors, because I'm not necessarily intimately familiar with their process for measuring this. But I can tell you, from our process, we're very strict and very rigid with how we measure the actual spend.

But ultimately, your question is driving at are we spending enough in this area? I think in the majority of our businesses, we are, but there is certainly more opportunities, particularly in Asia Pacific, to continue to enhance our investments there so that we can drive a better outcome from new products. But there's always opportunity in every business, and so a lot of this is about picking the right products, too.

There's a lot of blue sky stuff that a company could do, but sometimes you got to focus on what customers actually want and they're going to buy and they will talk to you about being committed to buying. So those are some of the metrics that we look at very closely on that one.

Andrew Lane: I appreciate the insight. Thanks. I'll turn it back over.

Paul Manning: Sure.

Operator: And our next question comes from Garo Norian from Palisade Capital Management.

Garo Norian: The first question I had, just on the Asia situation, the customer there. I guess you went through the Flavors & Fragrances side and kind of got a lot more confidence that, that was internal and more shorter-term lived. I mean, what's the right way of thinking about how Asia is likely to play out over the next couple of quarters?

Paul Manning: Well, I think that Asia has had, I'll be a little bit deductive on my answer here. Well, actually, let me be inductive first. Asia is going to have a very good 2018. So there's the longer-term answer. I think right now, it's just a matter of timing on some of what we mentioned or what I mentioned in the monologue. I think as you look at those Asia Pacific region by region, I think we feel very good about a number of our regions. Like the Oceania region, we feel very good. We feel very good about parts of North Asia. We feel very good about parts of Southeast Asia.

But I think each one of these areas has different challenges associated with them, and some of our challenges right now are what I had mentioned there. But a lot of this, too, is how do you continue to identify the opportunities. I mean, Asia is a far more, in general, is a far more fragmented market than you're going to see in the U.S. or Europe. So there's a lot more players, there's a lot more opportunities for a company like Sensient to be successful.

There's not as much of the stranglehold on the markets that you see in some of the other parts of the world that we're dealing in. So the opportunities are there and certainly the focus is there. And I have very strong expectations for Asia Pacific, certainly in '18. '17 is harder for BRIC. I got to be completely frank with you on that one, because it's not necessarily within my control.

Nevertheless, I think that it's a good market. It's a good market for our products and there's a growing interest in our products, whether they're cosmetics or inks, or flavors, or food colors, a lot of the same trends we're seeing in the Americas and Europe. Whether it's natural colors or extracts, or

digital inks, or very sophisticated cosmetic products, that entire market is a prime opportunity for Sensient.

Garo Norian: Got it, great. And then related to something you had mentioned earlier on the Color side, with some of these customers that might have switched to natural with maybe, let's call it, a lower-quality path. Have any of them already started to come around and talk about going to the higher quality way of doing things?

Paul Manning: Yes, is the short answer there. I think it's a -- there's a little bit of a different model at play. In general, you'd see products in Europe tend to not have the same level of vividness as a U.S.-based product. But in the U.S. market, it has never been demonstrated that, that type of, what I call whitewashed color on some products, works with the consumer, particularly a consumer who's been acclimated to products that are very bright and vivid, and in that person's mind, connect very strongly with the flavor of that product. And what tends to happen, interestingly enough, and what would oftentimes will drive customers to make these changes in their colors is the end consumer has decided that the product no longer tastes the same. It used to be really red, now it's like light red. "Well, it tastes different. I don't like the taste anymore."

And on one level you can say, "Well, of course, it tastes the same." But there is such a strong connection between the visual color and the flavor outcome, that this is what has driven many of these customers who are experimenting with the non-matching solution, it's driven them to rethink that solution. But I can't speak for every customer out there.

Garo Norian: Got it. Got it. Thanks. And then some more technical questions. The working capital through the second half of the year, I mean, obviously, there's a big use in the first half. What's the expectation for the second half?

Stephen Rolfs: Sure. So in the first half, there are really two themes on working capital. The Cosmetic business, which has been very strong, performing very well, we see higher inventories and receivables there and that's as expected. Then on the Flavor side, some of this -- some of the impacts of restructuring have

impacted working capital and so we saw a negative usage there. And we would expect that to work its way out in the second half of the year.

The only other thing would be in our Natural Ingredients business. We've seen some higher inventories there, but that's somewhat by design. Every few years, you wind up with a crop issue, and so we'd rather be long and have the product to sell there. So I think the restructuring items should begin to work their way out in the second half.

Garo Norian: Yes, okay. So if I -- just as I'm thinking about things for the full year, I mean, we shouldn't be going higher than what we've used up already through the first half? Is that kind of a logical way of thinking?

Stephen Rolfs: Yes, I think that's right.

Garo Norian: Okay. And then just lastly, my model for the tax rate last year was about 25.5 percent. Is that what we're ball-parking?

Stephen Rolfs: For the second half of the year? Yes, that's about right.

Paul Manning: No, for the full year.

Garo Norian: For the full year.

Stephen Rolfs: Yes, well, so both those statements are right. So it will be about 25.5 percent for the second half and that will bring us to that rate for the year.

Garo Norian: Got it. Perfect. Thanks so much.

Paul Manning: Thanks Garo.

Operator: Our next question comes from the line of Mike Sison from KeyBanc.

Michael Sison: Paul, when you think about Flavors, you spent a couple of years now trying to transition the portfolio into more solution-type of applications versus ingredients. Could you maybe just update us on the progress by sub-segment, meaning is savory there? Is dairy? If you think about each of the segments, are

you almost where you want to be in terms of what you're offering to your clients as you head into '18, '19, '20?

Paul Manning: As you look at a spectrum by segment, you could say that where we are closest to that and where we are furthest from that. Closest I would tell you is beverage and fragrances. Furthest from that would be savory flavors and in the middle would be sweet flavors. And I think some of that is the size of the legacy business. So in other words, savory had a lot of ingredient sales. Sweet flavors had a lot of ingredient sales and by that, I mean, fruit preps. Beverage had fewer of those.

So it was a little bit more of a historical model that kind of, I think, set the trajectory moving forward. But I would tell you that in each case, that they are -- we are making very good progress on this, just a little bit of a further putt on some of them. And then again, when you have core business, that makes it a little bit longer term in terms of actually moving the OP margin in those individual business units. But I think certainly overall, we see the opportunities to sell these products. They're far more defensible.

And I think again, it goes back to the types of customers we're focusing on in the market. Nobody has asked this question, but certainly there are some big companies out there that have had some not particularly good Q2 results that they've mentioned publicly already.

But you'll notice that in a business like Color, where we have really set out for several years now to diversify our customer base, we can handle those types of declines and still grow the business. I think Flavors, because it wasn't necessarily strongly aligned with those really big customers on Flavors at the outset of all this, is going to be in a very good position as we continue the pursuit of these B&C customers because fundamentally, those are the folks who are growing.

Those are the folks who are launching products, and they're not necessarily holding back on that front. So I think we're aligned with more and more of the right customers, and that's going to certainly be a key part of this as well.

Michael Sison: Right. And then in terms of the areas that you're not as advanced as the others, are there opportunities, even if you have to pay a little bit more of a premium in acquisitions to sort of jump start that move to more solutions type of offerings?

Paul Manning: Yes. Yes, I'll leave it with a one-word answer, Mike, yes.

Michael Sison: Okay. Great. Thank you.

Paul Manning: Okay. Thanks.

Operator: And our next question is from Christopher Perrella from Bloomberg Intelligence.

Christopher Perrella: A quick question on the cadence of earnings in the second half of the year. With the hangover of costs into the third quarter, should earnings EPS be more balanced across the two quarters in the back half of the year than you've seen in the past?

Paul Manning: There's -- to some degree, there's obviously seasonality in the business. Our stronger quarters tend to be Q2 and Q3, which as you see last year, were pretty consistent with one another. And of course, Q4 and Q1 sometimes -- in fact, typically, Q4 is a little bit bigger than Q1, but that has historically not always been the case. So I would tell you that in general, as you look at the business historically, Q2 and Q3 tend to mirror each other or be very close to each other. Now I mentioned a lot of these one-time items in Q2, so make sure you're taking that into account. But Q4 would be certainly not as strong as a Q2 or Q3 and a lot closer to, say, a Q1 outcome.

Christopher Perrella: Okay. And then the gross margin, how should I think about raw material cost pressure and your ability to offset that with new products or with some pricing?

Stephen Rolfs: So we've generally been very successful at offsetting that with pricing. The other thing to keep in mind is that we have so many different raw materials that there are always things moving in different directions. So you might hear

about pressure on one particular ingredient, but then we're going to have others that are going in the other way. So there aren't necessarily any trends out there right now that I think are going to be a problem for us. It should be a fairly stable environment in terms of our ability to offset anything that happens.

Christopher Perrella: Okay. That was it for me. Thanks very much.

Stephen Rolfs: Thank you Chris.

Operator: And we have reached the end of the question-and-answer session. Please contact the company with any additional questions. At this time, I will turn the conference call back to the company for closing remarks.

Stephen Rolfs: Okay. Thank you very much this morning for attending the call. That will conclude our remarks. And as the moderator said, if anybody has any follow-up questions, please feel free to call us. Thank you.

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