Sensient Technologies Corporation

2019 Q4 and Year-end Conference Call

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CORPORATE PARTICIPANTS

Steve Rolfs – *Senior Vice President and Chief Financial Officer*

Paul Manning – *Chairman, President, and Chief Executive Officer*

PRESENTATION

Operator
Good morning, and welcome to the Sensient Technologies Corporation 2019 Fourth Quarter and Year-end Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question you may press star, then one on your touchtone phone. To withdraw your question, please press star, then two. Please note, this event is being recorded.

I would now like to turn the conference over to Mr. Steve Rolfs. Please go ahead, sir.

Steve Rolfs
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 2019 fourth quarter financial results.

I'm joined this morning by Paul Manning, Sensient's Chairman, President and Chief Executive Officer. This morning, we released our 2019 fourth 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 currency movements, depreciation, and amortization, non-cash stock-based compensation, divestiture, and other related costs, the impact of the 2017 U.S. tax legislation and other items 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, including our forthcoming 10-K, 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. This morning we released our fourth quarter results. During 2019 we had strong results in natural colors, finished flavors and extracts, and our pharmaceutical business. These results were offset by several market dynamics and by the impact of a number of underperforming businesses that we are in the process of divesting. In 2019, Sensient's business was impacted by a number of adverse market factors. We saw uncertainty in higher costs tied to raw material availability, tariffs, and trade disputes. We also saw changing consumer trends for cosmetic

products, particularly makeup, that had an adverse effect on our sales for the second half of 2018 and for all of 2019.
Food-related markets were impacted by changing consumer tastes that have challenged many of our larger customers as well as certain product lines in which we participate. We have implemented a number of actions in response to these challenges. I expect a much better year in 2020, as our actions deliver improved results and as we focus on the strengths within our product portfolio.

As we enter 2020, I am pleased to report that our raw material costs and availability challenges have been substantially addressed. Raw material inflation and availability were headwinds during 2019 in our food color, cosmetic, natural ingredients, and fragrance businesses. With respect to changing consumer trends, you will recall that consumer spending on cosmetic makeup products began to decline in 2018 in most of our geographic locations. Our historical strength in cosmetics has been in cosmetic makeup and as a result of this change in consumer buying, we saw lower sales throughout 2019.

Our business began to stabilize in the fourth quarter of 2019 and we have increased our efforts to sell skin and hair care products. We expect our cosmetic business to rebound in 2020. The pace of the rebound will be driven by a resumption in the market demand in the cosmetic makeup category, plus continued growth in hair and skincare products. Additionally, the coronavirus will impact our cosmetic Asia Pacific business and it could present significant headwinds there. The situation continues to evolve.

Furthermore, the fixed cost takes out actions we implemented in cosmetics throughout 2019 will help us to deliver improved profits as the year progresses and as sales continue to grow. Our sales win rates across the company are high. We are winning new projects across all three groups, however, 2019 was a challenging year, owing to a higher than normal level of product churn in the marketplace and declines in several legacy flavor ingredient businesses. Many of our customers have had to adapt to changing competitive dynamics, changing channel and product preferences and oftentimes intense end-consumer price pressure. These dynamics created pricing headwinds and higher than normal attrition rates for many of our businesses. This product churn remains high, as our customers continue to pursue evolving end-consumer preferences.

You will also recall that some of our flavor ingredient sales were impacted by the decline in demand for yogurt and several prepared food categories. We have reacted to these trends by reducing our fixed cost structure and by focusing on retaining and winning business where our portfolio is strong.

We have made strategic decisions to exit certain product lines, including our inks, fragrances, and yogurt fruit prep businesses. I'm confident that by divesting these product lines, we will be able to focus in our key strategic markets--namely food colors, finished flavors and extracts, cosmetics, pharmaceuticals, and natural ingredients. We can maximize our investments and efforts in these markets where we have better scale, better technology, and a much better competitive position.

The businesses we are divesting generated approximately $140 million in revenue and approximately $2 million in profit in 2019. Our fourth quarter results included charges, almost entirely non-cash, related to these divestitures. Going forward, we expect this more focused business to deliver growth in 2020.

The outlook for the Color Group remains strong. Food colors, cosmetics, and pharmaceuticals will be our key strategic focus areas for the group. For food colors, we expect natural colors growth from continued wins and new product launches and as existing products convert to natural color solutions. In 2019, local currency sales in our natural colors business grew by approximately 4% in the fourth

quarter and by approximately 8% for the full year.

Sales of our pharmaceutical business grew at high-double digit rates in 2019. We anticipate that our cosmetic business will return to top line growth in 2020, as the cosmetic makeup market continues to normalize and as we continue to emphasize our cosmetic sales efforts in the skin and hair care segments. However, we are monitoring the development of the coronavirus and its potential impact to our cosmetic Asia Pacific business.

We expect continued wins in each of these Color Group businesses, and with an ongoing focus on our fixed cost structure and the divesting of the inks business, I expect improved results for the Color Group in 2020. I expect the first half of the year to generate low-to-mid single-digit revenue growth, with mid-single-digit revenue growth in the second half of the year. I expect profit to be lower in the first part of the year due to lower production volumes and mix effects, with improving profit in the second half of the year. Both revenue and profit, excluding the inks business, should improve as the year progresses.

Turning to the Flavor Group, our finished flavors and extracts business has performed well, delivering approximately 8% local currency sales growth in the fourth quarter of 2019 and approximately 6% for the year. But this performance has been overshadowed by challenges in our flavor ingredient portfolio. We're seeing improving trends in the Flavor Group, as we focus on winning new business and retaining existing business. We have positive growth in our savory product lines in North America and Latin America, and we expect our sweet flavors business to rebound in 2020.

We continue to focus on our commercial efforts across our portfolio. Our win rate for flavors and extracts continues to accelerate, and our attrition in flavor ingredients is finally getting back to a more normal level. I expect you will see our sales improve as 2020 progresses. Divesting our fragrance and fruit prep business will be a real positive. As I said during our last call, these product lines require substantial scale and capital investment.

In 2020, I expect the group to grow sales at a low-to-mid single-digit rate excluding the divested businesses. With a continued reduction of our fixed costs and improving production volumes, our profits should also return to growth as the year progresses.

Within our Asia Pacific group, we are beginning to realize benefits from the investments we have made in this group over the last two years. We're seeing new wins in both flavors and natural colors, and I expect the group will be up mid-single digits in revenue and profit in 2020. As we refocused our businesses in 2019 and reduced our fixed cost base, we also focused on free cash flow. Overall, our adjusted free cash flow increased by 11% in 2019.

We continue to remain focused on improving our working capital, specifically inventory, which benefited our cash flow by approximately $25 million in 2019. We expect to maintain a disciplined approach to our capital spending and inventory management in 2020 and continue to grow our free cash flow at a rate in excess of our EBITDA growth.

In 2019, we experienced a number of challenging market dynamics that have impacted our results. Despite these market headwinds, I'm confident that the actions we are taking, the focus we have on our key strategic markets, and our customer-centric discipline will lead to improved results in 2020.

Excluding the businesses we are divesting, we expect consolidated revenue to grow at a low- to mid-single-digit rate, with growth in all three groups and our consolidated adjusted EBITDA to grow at a low- to mid-single-digit rate. I expect our cosmetic business will return to growth in 2020, based on a normalization of demand in the consumer makeup market. I also expect our natural colors and flavor

and extract product lines to continue to achieve favorable growth throughout 2020.

We expect sales growth in the first quarter, in all three of our groups we will have some hangover in our profit performance during the first quarter as a result of the impacts from the inventory reduction in 2019, product mix in cosmetics, and the time necessary for our fixed cost takeout actions to realize their full run rate. Based on these impacts, we expect profit in the first quarter to be down on a year-over-year basis in both colors and flavors. Profit will improve after the first quarter.

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

Steve Rolfs
Thank you, Paul. In my comments this morning, I will be explaining the differences between our GAAP results and our adjusted results. The adjusted results for 2019 removed the impact of the divestiture related costs that were incurred during the fourth quarter. When we discuss 2018, the adjusted results removed the impact of the 2017 tax legislation accounting that took place in 2018.

Sensient's operating income was a loss of $14.5 million in the fourth quarter of 2019 compared to $45.3 million of income in the comparable period last year. Operating income in the fourth quarter of 2019 includes $45.9 million of divestiture-related costs. These costs are almost entirely non-cash expenses. In accounting terms, these costs primarily include non-cash impairment charges, inventory charges, and other divestiture-related costs. Excluding these costs, adjusted operating income in the fourth quarter of 2019 was $31.4 million compared to $45.3 million in the fourth quarter of 2018. Foreign currency translation had a minimal impact on both revenue and operating income in the fourth quarter of 2019.

Revenue for the Flavors and Fragrances Group was $169.1 million in the fourth quarter of 2019 compared to $175.5 million in the fourth quarter of 2018. The lower revenue was a result of lower flavor ingredient volumes, which included the yogurt, fruit prep, and fragrances product lines.

Operating profit was $14.2 million in the fourth quarter of 2019 compared to $22.3 million in the fourth quarter of 2018. The lower operating income was a result of lower production volume consistent with our efforts to reduce inventory, lower sales volume, costs associated with certain customer bankruptcy charges, and higher raw material costs, primarily in our natural ingredients business. Foreign currency translation had a minimal impact on both revenue and operating income in the quarter.

Revenue for the Color Group was $125.4 million in the fourth quarter of 2019 compared to $127.4 million in the fourth quarter of 2018. The lower revenue was primarily a result of lower volumes in inks and in some other industrial product lines and to a lesser degree in cosmetics. Operating profit was $19.7 million in the fourth quarter of 2019 compared to $21.9 million in the fourth quarter of 2018. The lower operating income was a result of the lower sales and production volumes as well as some negative mix effects. Foreign currency translation decreased revenue by approximately 1% and operating income by approximately 2% in the quarter.

GAAP diluted earnings per share were a loss of $0.40 in the quarter compared to $0.78 in last year's fourth quarter. The diluted earnings per share in the fourth quarter of 2019 includes $1.02 per share of divestiture-related costs. The diluted earnings per share in the fourth quarter of 2018 include $0.01 of tax expense related to finalizing our estimate of the U.S. tax law change. Adjusted diluted earnings per share were $0.62 in the fourth quarter of 2019 compared to $0.79 in the fourth quarter of 2018. Foreign currency had a minimal impact on EPS this quarter.

Turning to the income tax line, this year's fourth quarter rate includes approximately $0.16 of a net

benefit related to a tax planning strategy and regulation changes. The company's full year 2019 adjusted consolidated tax rate is 14.7% compared to 2018's full year adjusted rate of 17%. Consolidated operating income was $121.1 million this year, which includes $45.9 million of divestiture-related costs and excluding these costs, adjusted operating income was $167 million.

GAAP diluted earnings per share were $1.94 in 2019 compared to $3.70 in 2018. GAAP earnings per share in 2019 include the $1.02 per share related to divestiture-related costs. Two thousand eighteen's earnings per share includes $0.16 of benefit related to the finalization of the U.S. tax law changes. Removing the divestiture related costs in 2019 and the impact of the U.S. tax law changes in 2018, adjusted earnings per share in 2019 was $2.96 compared to $3.55 in 2018.

Cash flow from operations was $177.2 million in 2019 compared to adjusted cash flow from operations of $174.7 million in 2018. Capital expenditures were $39.1 million in 2019 compared to $50.7 million in 2018. Our adjusted free cash flow increased 11% in 2019 to $138.1 million. Total debt was $619.1 million as of December 31, 2019, compared to $709.6 million as of December 31, 2018, a decrease of $90 million. We will continue to be diligent in allocating capital in 2020. At this time, we expect 2020 capital expenditures to be between $40 million and $50 million.

Excluding the charges related to the divestitures and the operational results of these businesses, we expect positive revenue and profit growth from our Flavor, Color, and Asia segments in 2020. On an adjusted basis, our consolidated operating income and earnings may be flat-to-lower in 2020 however, because of the level of non-cash performance-based equity that may be deducted in 2020 based on our results.

In a normal year, we would expect non-cash performance-based equity to be about $6 million, or about $0.12 of EPS. Earnings comparisons between 2020 and 2019 will also be impacted by our tax rate, which was low in 2019 as a result of planning opportunities. Our adjusted tax rate in 2019 was 14.7% and a more normal rate of 22% in 2020 would create a headwind of about $0.26 per share. In considering our reported GAAP earnings per share in 2020, the comparison items previously mentioned must be factored into any estimates.

Based on the non-cash performance-based equity and tax headwinds discussed, we believe our reported EPS will be within a range of $1.85 to $2.15 per share in comparison to Sensient's reported EPS in 2019 of $1.94. These figures include the results of operations of the divested businesses and a current estimate for additional divestiture-related expense of approximately $0.65 to $0.75 in 2020, which is primarily non-cash.

On an adjusted basis, excluding these divestiture costs and the results of the businesses we are seeking to divest, our EPS is expected to be within a range of $2.60 to $2.80 as compared to our adjusted 2019 EPS of $2.96 per share.

Currently, we do not expect exchange rates to have a material impact on results. As a result of these complex factors affecting our comparison, we believe an important measure of our success in 2020 will be the growth in our revenue, excluding our divested businesses and the growth in our adjusted EBITDA, excluding our non-cash performance-based equity awards. We expect each of these metrics to grow at a low- to mid-single digit rate in 2020.

These expectations apply to full year results in 2020. Growth in our results should improve as the year progresses, as volumes are increasing across the company and our overall cost structure is improving. We expect the first quarter to be challenging, but we expect improvement throughout the year.

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

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press star, then one on your touchtone phone. To withdraw your question, please press star, then two. At this time we will pause momentarily to assemble our roster.

The first question will come from Brett Hundley with Seaport Global. Please go ahead.

Brett Hundley
Hi, thank you, and good morning, guys.

Paul Manning
Good morning, Brett.

Steve Rolfs
Good morning, Brett.

Brett Hundley
Steve or Paul, so are you guys booking the full $6 million performance equity in your guidance for 2020? I'm calculating that's about a 3% headwind to EBIT growth. And if so, were these performance hurdles amended or changed in any way heading into 2020?

Steve Rolfs
So first off, within the range, there is the full amount. Obviously, it flexes. If our EBITDA growth is not at the mid-single-digit rate we talked about, there would be less, which would buffer or mitigate the results. But within that range, there is the full amount. And then, could you just repeat your question on the—were they amended?

Brett Hundley
Yes, sure. So you just mentioned EBITDA, which I think for at least two years now a lot of that performance has been tied to EBITDA. I could be wrong, but I thought it had changed a couple of years ago, and I was wondering if heading into 2020, did you change how that performance comp is paid out, based on certain metrics?

Steve Rolfs
So heading into 2020, the structure is very similar to what it was last year. What you might be thinking of is a few years ago we were incentivized on EPS. So for instance, changes in the tax rate could have an effect. We are not incentivized on EPS going forward, so it's EBITDA, it's revenue, cash flow, and then return on invested capital, but from last year no significant changes, I would say.

Paul Manning
And part of this, Brett, has to do with the performance-based metrics around it, right? So, all of our equity awards are 100% performance based. There is no participation trophy of any kind. When we don't deliver, like what happened in 2019, there is essentially no equity payout. So it certainly is fully 100% aligned to shareholder interests, but what you have, though, can be a more dramatic swing, like what we're experiencing now.

So we had an underperforming 2019, we expect to perform in 2020. And given the nature that it's

100% performance-based, you can have a large swing, which would then represent a headwind, a non-cash headwind, but a swing no less. You have a good year in 2020, and then, as you get into 2021, these are significantly moderated. But it is, in fact, the very nature and our philosophy around pay for performance that essentially creates this financial dynamic that we have here.

Brett Hundley
Okay. Thanks for those comments. To the extent that you guys can comment on the divestitures, can we just get an update on the divestiture activity? You guys, obviously, recognized a number of costs during the quarter, but I haven't seen any notable headlines yet. So I just wanted to talk about potential interest in timing, given that we are talking about a lot of these businesses coming out for full 2020, or at least that's how I'm modeling it.

Paul Manning
So I think this, we certainly have interested buyers for each of the three businesses. I think that we're actively engaged with those individuals, so I can't necessarily get into details, as those discussions are certainly governed by a non-disclosure. But I would tell you that it's certainly our intention to sell these businesses. The buyers in these cases each have much greater scale and effectively capital footprint in the market, so I think it makes very good sense with them.

But we're going to do them right. We're going to get a fair price for them. And we're going to do that on a time frame that's consistent with that philosophy. Certainly, we'd like to sell them as soon as we can reasonably sell them, but we're not going to do anything stupid. And so to that end, sure, I would be very optimistic to have these things done as soon as possible, but we want to get them done right. We want to make sure we have the right buyer and that we get a fair outcome for our shareholders.

Brett Hundley
Okay.

Paul Manning
Yes, as we—yes, I mean, certainly, as we effect a signing and at closing, we would make that publicly, consistent with expectations on that front. But I would tell you that there is, at this stage, interest in the three, and I expect that we can get this done.

Brett Hundley
Okay. And if this is a situation where maybe this stretches into summer or beyond, and I'm sorry if I missed this in your prepared remarks, Steve, but would these be reported as discontinued ops during 2020?

Steve Rolfs
They do not meet the requirements for discontinued operations, but we will provide adjusted numbers with and without them. Actually, they're not in the accounting classification of discontinued operations.

Brett Hundley
Got it. And I have a couple more, but I'll jump back in the queue.

The other one I wanted to ask you about was just on capital allocation. You guys touched on it a couple of times in your prepared remarks, but CapEx is starting to work down. You've raised your dividend already. And just given some continued challenges, at least early on here in 2020 on the top and the bottom line, might we see you guys take a more aggressive approach to share repo ahead? Or are you thinking differently about strategic combinations at this juncture? I appreciate it.

Paul Manning
Sure. So, I think the prioritization that we've historically had for capital allocation-–I'm sorry, I'll take you on a little bit of a journey here, but I think it's good to share our philosophy on this. Number one, we're very committed to internally investing in the company, CapEx as we like to call it. That is the purest form of investment and typically earns the highest returns of other alternatives. The $40 million to $50 million is certainly consistent with that philosophy, but it's also the outcome of a lot of restructuring that we've done, shrinking our footprint, taking a much more strategic approach to capital—to CapEx throughout the businesses.

I think that you compare the $40 million to $50 million with where we had been previously, $80 million, $90 million, and even $100 million in some years, that is representative of, I think, some good work that was done in the course of restructuring. So I think that is a good and sustainable level for the time being, and that will continue to be a priority for us. The dividend will continue to be a priority for us. That is a source of value for many of our shareholders. We have a historical precedent of doing that, and that is one that we continue to be very committed to. And then, as you saw in 2019, we spend a lot of our free cash flow on paying back debt. We paid up approximately $90 million down of debt, which we thought was a good and prudent thing for us to do.

At this point, we want to continue to pay down debt. We like the debt-to-EBITDA to be somewhere in that 2.5 times to 3 times. That seems to work pretty well for us, enabling us to either do, as you suggest, buybacks or certain M&A activity. And so, as we look at 2020, those are the three moving parts: buyback, is there an M&A opportunity, or would we pay more debt. And I think as we see it right now, here on February the 14th, our focus is to take down some more debt. But we're always looking for M&A opportunities, and should there be an unusual event in the stock that creates a rather obvious buying opportunity, we would not be opposed to doing something along those lines.

So I won't give you a more precise answer, because things do change and we want to be very, very flexible there, but you've got the guide rails in terms of our thinking on each of those pieces.

Brett Hundley
That's great. Thanks, Paul.

Paul Manning
Okay. Thanks, Brett.

Operator
The next question comes from Mitra Ramgopal with Sidoti. Please go ahead.

Mitra Ramgopal
Yes. Good morning. Thanks for taking the questions. Just want to start first with the guidance. I know you had mentioned the coronavirus, you think, obviously, could have an impact, and it's just too early to sort of determine the extent of that. So I'm assuming that's not factored into the initial guidance. But I'm just wondering if it's already having an impact in terms of your manufacturing operations in Asia.

Paul Manning
So, it is for those businesses that produce in China, most specifically our cosmetics business in the Color Group and our food colors business in the Color Group. In general, in this company, we manufacture where we sell, so there's very little that we manufacture in China that is subsequently sent outside of China. Certainly, I can't think of anything off the top of my head that is destined for the Americas or Europe. There are some items made in China that we would send to another Asian

country, but that tends to be a very small part of what they do. In one sense that should tell you that the impact from China from a manufacturing standpoint is substantially isolated to China, because we do manufacture in other countries.

Where we are seeing an impact now is, initially, the coronavirus happened right during Chinese New Year, so during Chinese New Year sales dropped, very little activity going on in China and throughout many Asian countries. So the fact that the coronavirus happened essentially right in the midst of Chinese New Year, it's very, very difficult to see right now what the potential economic and financial impact would be. I can tell you this right now, from raw materials that we would source in China, at this point, we've not had significant disruptions. There has been, in my estimation, no significant concern around product safety. In other words, raw materials that are made in China as sent to the U.S. or Europe would not present a food safety challenge to food producers or cosmetic producers. In other words, the food would not be tainted with the virus.

So we don't see a raw material problem, but where we are seeing the problem is really in terms of accessing customers. On the sales side of the transaction for a business like our cosmetic business, this becomes a little bit of a problem, because we have technical people based in China who may travel throughout the region and we have technical people in Singapore who may travel throughout the region.

Just the other day, here's a little anecdote which you might find very interesting, we had a technical individual in Singapore who was destined for a customer in Korea, and the Korean customer would not see him, because he was coming from outside of Korea. So it's these types of dynamics that are at play. We have salespeople who are still confined to their homes in China.

So there's very little movement on the commercial side of the business in cosmetics, and so that could have—and that was the point in my prepared comments, that would be the headwind. At this point, it's really, really difficult for us to estimate what that headwind would be and what that impact could be. Information on this virus is coming out by the hour. Countries are restricting access in and out on a daily basis as this dynamic changes.

So, I can tell you there will be an impact on our cosmetics Asia business. That is indisputable, we're seeing that. But where it goes from there, I can't predict that right now. What my crystal ball is telling me is that this is going to be here for the next several months at least, until any sort of resolution or clear guidance is made very publicly available in China. Now that's my opinion, and you may get a different perspective from others. But I think the biggest impact for us, you'll feel it in the Color Group with our cosmetics Asia business.

Mitra Ramgopal
Okay. Yes. No, I really appreciate the color and the insight on that. And actually, just staying on the international front for a while, I don't know if you can give us a sense what the tariff impact was for you in 2019. It seems like that should be less of a headwind for you in 2020. And I was just wondering if you had anything factored there into the guidance also?

Steve Rolfs
Sure. So actually, on the raw material front, we believe we have that under control. And as of right now, that looks pretty good. So, going back to 2019, you had not only the tariffs, but you also had some regulatory actions that happened earlier in China they made it difficult to get certain raw materials. We've been pretty successful at moving our sourcing outside of China for those items that were impacted. At the end of the day, the tariff impact and the trade uncertainty impact appears to have

stabilized, ex- this virus issue that Paul talked about.

Mitra Ramgopal
Okay, okay. I know Brexit also had an impact for you in 2019, and I was just wondering now that that's sort of official, again, that should, if anything, be a plus for you this year, I would imagine.

Paul Manning
Yes. I think clarity creates stability in the market and creates stability in our business and for our customers, and I think now that there's much greater clarity around Brexit, I would say that, yes, we should not see any sort of incremental up or down versus prior year impacts as a result of Brexit and that being implemented.

Mitra Ramgopal
Okay. And then on the Flavors and Fragrances segment, I know one of the areas of opportunities for you was the BioNutrients, biotech markets, and I'm just wondering if you're seeing any additional traction there. And if you can maybe address potential new products that you might be looking to bring to the market that could be a nice catalyst for you.

Paul Manning
Sure. Yes. So for the folks on the line who may be kind of curious about the nature of BioNutrients, this is a portion of our flavor group that is essentially based on modifying protein sources, some of which we sell into the food industry, modifying those for different types of applications, in this case, mostly live cultures. So what that means in English is that essentially we make protein that feeds bacteria, for example, things you'd see in probiotics or prebiotics, animal nutrition, things of this nature.

And so, certainly the live culture, fermentation probiotics markets slowed in 2019. I think that's been pretty well publicized. Now they didn't go into decline, those markets, they went from, say, a 7% or 8% to maybe like a 3% or 4% growth rate. A lot of new entrants into that field, a lot of capacity for fermentation in that area. We think it's a very, very good market. What we like about it is it's a very technically driven market. It's all about improving the efficacy and yield of bacteria and these types of applications.
And so that fits very well into our wheelhouse of innovative-driven products, applications-driven customer service and then being able to deliver products consistently and on time and at a high quality.

So it's a very, very good market. Sure, it slowed down in 2019, but I think the prospects continue to be quite good. And it's also rather expansive in terms of the areas that you can get into. Sure, there's quite a bit of talk about probiotics declining, or moderating its growth, but the areas of animal nutrition are still quite large, the areas of fermented ingredients are still quite large and quite fragmented, at least from a supplier standpoint. So still a very good market and we would expect them to have a good year here in 2020.

Mitra Ramgopal
Okay, thanks. And on the Color Group, I know you touched on the customers transitioning from the synthetic to more natural formulations. And I'm just trying to get a sense as to how early or how far along are we in terms of that transition that you're seeing?

Paul Manning
In Europe, we're in the eighth inning. It's probably, I don't know, where they just finished the top of the eighth on that one. In the Americas and in Asia Pacific we're in about the third inning, so nobody's quite gone to get a hot dog yet, but, they're thinking about it. So we're maybe about a third of the way through this thing, which is to say about 30% to 35% of the products on the market right now contain a

natural color solution, or I could say even more broadly, a non-synthetic colored solution.

We do not expect any sort of legislative mandate from any jurisdictions outside of Europe, which is to say, this will continue to be a long burn. It will continue to be a consumer-driven trend rather than a government-mandated law, as we saw in Europe. So I think the prospects are quite good. We had an outstanding year in natural colors. We were up 8%. We won many of the key market conversions. But with our very, very strong number one presence in food colors we have access to a great many customers, not only those big multinationals, but also a lot of these B and C customers who are very, very aggressive about utilizing natural colors in their solutions. And so that's going to continue to be a real nice growth engine for us. Even in the fourth quarter, where there was a lot of slowdown in a number of markets, we were still up 4%.

So, we have a very, very good business platform there, very technically driven. There's still a lot of activity around replacing titanium dioxide. The good folks of California are trying to outlaw caramel in many applications. In fact, they actually have in Proposition 65. So, there's lots of opportunities for us to replace caramel. So, very, very good trends there for our business, and we think, as I said, that's going to be a real hit for us—it's been a real hit for us and it's going to continue to be that way.

One other trend I would note in Europe, you'll hear this term coloring food stuffs, just think of that as kind of a more natural version of natural colors. Some other time, we can get into the regulatory nuances of what I mean by that, but that would be the next wave that we see in Europe, and that's really been underway for several years, but that continues to pick up speed. So that means that there's still very good growth prospects for Europe, even though Europe is in the eighth and a half inning on natural colors, they're probably like—they just sort of sang the national anthem and they're sitting down for the first inning on coloring food stuffs, I would say.

Mitra Ramgopal
Okay. Thanks for the color on that, I appreciate it. And finally, Steve, I know the DSOs came in quite a bit at the end of the year, I'm just wondering how we should think about that going forward.

Steve Rolfs
So, a couple of things to point out on the balance sheet. So for a couple of the businesses that we're seeking to divest from an accounting standpoint, they've moved into a classification known as assets held for sale. So when you look at our balance sheet dollars, some of the receivables, inventory, some of the other lines, there's an amount that was reclassified onto this assets held for sale. What I would point out, however, particularly on the inventory line, if you normalize that, as Paul mentioned, I think, in his comments, we did a good job of bringing inventory down in the year. And so, I think on a normalized basis we took out about 12 or 14 days of inventory.

But just looking at the balance sheet, it's difficult, because some of those items are being reclassed. But if you adjust for that, we did make that improvement in inventory.

Mitra Ramgopal
Okay, sounds good. Thanks again for taking the questions.

Steve Rolfs
Thank you.

Paul Manning
Sure. Thanks, Mitra.

Operator
Again, as a reminder, if you'd like to ask a question, please press star, then one.
The next question will come from Heidi Vesterinen with Exane BNP Paribas. Please go ahead.

Heidi Vesterinen
Hi, good morning.

Paul Manning
Hi, Heidi.

Heidi Vesterinen
My first question, is it possible for you to tell us what the growth rate of the group was excluding the businesses that are being sold? You said natural colors, I think, was up 8%, right, for the full year. Perhaps you could even go business-by-business, could you share that with us? Thank you. That's the first question.

Steve Rolfs
Sure. So Heidi, on the businesses to be divested, first off, I think Paul did a good job of talking about the strategic rationale for that. It will just bring more focus to parts of the business where we have more differentiation. We lack scale there, and in most cases those businesses had limited synergy with the other parts of our business. But if you look back to this past year 2019, the $140 million of revenue that we're divesting, depending on the quarter, it was probably down high single digits to low double digits. So, for instance, if you were to take the fourth quarter, where our consolidated revenue was down 1.5%, we would have been flat if we had not factored in these divested businesses. So it did have between a 1% and 2% negative impact on the overall revenue.

Paul Manning
And so, then pairing that with the rest of the businesses, I mentioned the natural colors was up 8%. Our flavors and extracts were up 6% for the year and 8% for the fourth quarter. So, we're very pleased with that one. Our pharmaceutical business, where we're selling flavors and natural colors and extracts, that was up almost 20%. It's a small business, but it's a very strong growth engine for us.

The SNI business, the natural Ingredients business, was up about a percentage point. We think that will be up much more than that in 2020. When you look at cosmetics, cosmetics was down about 7% for the year, owing to all these factors we've talked about, not only the tariffs but really this moderating of demand in the makeup market that's really kind of been playing out over the last 18 months. So those are some of the highlights from the other parts of the business.

The flavor ingredients business, this is the one to sort of piggyback on some of what Steve said, that's the part of the portfolio that was down, down more than 10%. Now part of what gives me confidence that we will grow revenue in flavors this year is not only the quality of our wins, we're winning in flavors, we're winning in extracts, those products that rely much more on technology, application support, good customer service, good technical salespeople, but we're finding ways to moderate the loss of some of these flavor ingredients. And I think that's going to be really, really important as we move forward.

But that's kind of some of the highlights of the businesses, which when you kind of put them all together in that pot, comes out to where we came out in the quarter, down about 1.5%.

Heidi Vesterinen
Thank you. And then the next question, so you said that you're quite optimistic on the SNI business. We saw that Indian onion prices are spiking. Does that impact you in any way?

Paul Manning
These products always should be considered market products. However, India has traditionally been more of a domestic market. You recall from a couple of years ago, their move to introduce product into the US at the scale that they did was somewhat unprecedented. Nevertheless, onion raw material costs are up. I think that's been pretty well publicized in the U.S. and even in China, and certainly to your point about India, and so I think that is one of the factors that kind of hit us a little bit in Q4 because there is a lag between when you get cost and when you can take price at times.

And so, I think our products continue to be very, very competitive there, and I think that you would see us in a position to grow revenue, not only in the onion category but in garlic, based on new wins, based on pricing for sure. There's also some opportunities in garlic as well. But I think, yes, as a general statement, I would say, sure, you could say that bodes well for us.

Heidi Vesterinen
So that's in terms of top line. And your profits, I guess, will improve in that segment, because the prices will catch up with the inputs. Is that what you meant?

Paul Manning
Q4 to Q1, yes. I think as you think about SNI for the year, we would expect them to be, certainly at the average and perhaps even a little bit above the average for the Flavor Group in general on revenue. But there are higher costs that we're seeing in the raw material side of things, so we don't necessarily get into all the profit levers there within SNI, but we should expect to see low- to mid-, maybe even mid-single-digit top line growth in the SNI, which, as you know, is about 30% of the Flavor Group.

Heidi Vesterinen
Thank you. And then the last question. I think in your earlier remarks, so actually, it was in response to another question, you talked about new entrants in probiotics. Is this a relatively new trend, as I thought your customer base there was quite consolidated? And in which regions are you seeing these new entrants emerge? Thank you.

Paul Manning
So you're right, it is a very consolidated industry, there's kind of three names that you know pretty well that constitute the majority of this market. Nevertheless, there are many, many start-ups. Many of them are ex from some of those top brands that I've just referenced, vying for a position in the market. There's a lot of bacterial strains that have been developed or that are being used in the marketplace, so you may see a fairly steady group of bacteria in many probiotic products. But given the end consumer interest in these and in live cultures in general, there are literally hundreds of bacterial strains that can be developed for probiotics. And so, I think it is on that concept that you see many start-ups, many a little bit more established brands vying for positions in the market. In the U.S. market for sure, and the European market, for sure, those are really kind of our key focus areas that we pay attention to and really is where our business is today.

Heidi Vesterinen
Thank you.

Operator
The next question is a follow-up from Brett Hundley with Seaport Global. Please go ahead.

Brett Hundley
Thank you for taking these. I just had two quick ones. You guys have given us a lot of good detail on

the near-term in 2020 and thinking about the model, but I wanted to maybe have a quick higher-level discussion on flavor margins real quick. Just given the commentary that we've had over the last five years, I think it'd be helpful to revisit that. If I exclude divestitures, can you just maybe address utilizations across your footprint and talk about what type of OI margins might be possible for this flavors business over the next two years or five years as investors reset what's possible for this business?

Paul Manning
Yes. So today, flavors and extracts is about 40% of the Flavor Group, and about another 30% is SNI, about another 30% are these flavor ingredients. That's kind of a broad breakdown of them. Flavors are certainly the most technically driven, the ones that require the most innovation, application support, customer support in general and very, very high service levels. Now certainly, the high service levels and other features are clear in the SNI business, perhaps less so in the flavor ingredients business.
Given that, you should expect, and we do experience higher price points and higher gross margins in that flavor category.

So, those have been on a nice upward swing, the revenue growth, and that's what we're going to continue to push for is that mid, and maybe even as you saw in the fourth quarter, high single digit in flavor and extract growth. We think the extract market is much more fragmented than the flavors market, and this is an area that's not encumbered by core listings and other, in my estimation, factors that limit competition in a particular field of specialty ingredients.

So that said, that's going to continue to be the focus area. SNI continues to be a very, very profitable business as well on the operating profit margin line. I think the growth there, we should expect to see a fair amount within the Americas. Much of that growth is being driven in the Americas right now. We still see good opportunities within Europe, and we see very good opportunities within Asia for flavors and for extracts. Now what has been diluting that effort, and I've mentioned this in the prepared comments, is these flavor ingredients. So if you can imagine a production plant that makes flavors by the kilo and makes flavor ingredients by the ton, therein lies a little bit of the challenge of managing those two parts of the portfolio, which is why, in part, we made the decision to divest some of those flavor ingredient products.

So, as we do that and as demand reduces in for some of those flavor ingredient products, we've been reducing our fixed costs substantially to accommodate for lower demand in the market and lower portion of our portfolio dedicated to flavor ingredients. Those will, as you utilize your plant better, lend itself to enhancing not only the flavor ingredient gross margin but, by virtue of a better-utilized plant, the flavor and extract gross margin as well. So, that has been substantially clouded, inasmuch as we were losing flavor ingredient business, and we're taking out fixed costs on the heels of that. This is why we have a little bit of this overhang here in Q1, right? Despite the fact that we believe we're going to be up on revenue in flavors in Q1, we would still have a little bit of that overhang from the lower plant utilization on account principally of these flavor ingredients.

So the name of the game is to continue to shrink that flavor ingredient production footprint so that we have better utilized plants lending itself to much more per unit gross margin improvements across flavors and flavor ingredients.

So getting to the real crux of your question, can we still get to a 20% operating profit margin in the Flavor Group? Well, certainly, we can. And certainly, when you look at the flavor part of that portfolio, that is near or about where we are actually able to achieve. And so, as we continue to moderate the effect of these flavor ingredients, I think that's going to be quite helpful to getting us there.
First things first, let's be up on revenue, profit will follow, so we expect profit to follow as we get later

into the year. And then because we've taken out these fixed costs, because we've moderated our SG&A, we would expect that the operating profit leverage that we get from any incremental dollar of revenue would be very, very strong. So we expect a very good back half of the year for that reason. And I think that you would begin to see a significant improvement in the EBIT margin of the Flavor Group. A long answer, but I think I got what you were going after there.

Brett Hundley
You definitely did, and it was very good color, at least for me, so I appreciate it. And then just in the interest of time, just one quick follow-up. IFF mentioned yesterday that they saw an inflection point mid-Q4 with regards to flavor sales to large MNC customers. Are you guys noticing any of this, either in food and beverage colors or any other parts of your portfolio?

Paul Manning
Well, I think, perhaps, one of the things that—so I guess maybe not really. We don't necessarily sell flavors to a lot of multinationals to begin with. We really focus more on those Bs and Cs. And as you can see, it was really the driving factor in our flavors growth. I think on the color side, I would tell you that there's certainly been some activity amongst the big multinationals. There were a couple of key conversions from synthetic to natural last year in 2019. But I would still say the drivers are these B and C, these local and regionals, for sure.

As we look at Nielsen data for a lot of these markets, I look at yogurt, still down by 4%, still a market that's kind of dominated by larger players, ice cream is down, gum is down, cereal is down, and these are all volume declines. I think in some cases the multinationals may be up on sales, but they're down on volume. So I don't know, as I think about our business, I didn't see anything that was significant in which case, I could call it an inflection point. So maybe it's a matter of perspective, but I hope he's right.

Brett Hundley
No, for sure. And you guys do operate a different business. I was just curious if you had seen some of that elsewhere, but I think there are other drivers on the color side for you. So I appreciate the comments. And thanks for the follow-up.

Paul Manning
And one other thing on that, Brett, and this could be inferred from what many companies are saying, but product churn was quite significant in 2019. And the definition that I have for product churn would be products get launched and they get killed or discontinued in three months, or it's a limited time offering. It was only intended to be out there six months or a year. The rate of attrition was significant last year, the highest I've seen in many, many years, perhaps even ever.

Now some of this is the—when you get B and C customers, they are quicker to launch in general, and they are launching more and even more unusual products, in my opinion, in many of these markets. So the failure rates can tend to be very, very high. So in order to cover that significant attrition rate, you've got to have big wins. Our win rate was quite strong in the company last year, but what was happening was there was a lot of market churn. So that would be a key factor I think you want to be looking for in 2020, has market churn of products subsided or is it still remaining rather elevated? And I could give you more color on that as the year goes on.

One other thing, just to clarify an earlier comment I made, lest I create any sort of consternation, the Proposition 65 in California with respect to the use of caramel colors, principally in colas and other products, technically, the Proposition 65 is just a warning on the product. It does not outlaw caramel for those products. So I just wanted to clarify that one. But nevertheless, a warning may drive many

customers to want to replace caramel in their products, and that is something, from an innovation standpoint, we've spent many years refining and developing. So, I just wanted to make that clarification.

CONCLUSION

Operator
Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to the company for any closing remarks.

Steve Rolfs
Okay, that will conclude our call. I thank everybody for participating today. And if you have any follow-up questions, we can handle those after the call. So thank you.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.