

INTERNATIONAL FLAVORS & FRAGRANCES INC

Form 10-Q

August 05, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the quarterly period ended June 30, 2014

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-4858

INTERNATIONAL FLAVORS &  
FRAGRANCES INC.

(Exact name of registrant as specified in its charter)

New York

(State or other jurisdiction of  
incorporation or organization)

521 West 57th Street, New York, N.Y. 10019-2960

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (212) 765-5500

13-1432060

(I.R.S. Employer  
Identification No.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

Number of shares outstanding as of July 22, 2014: 81,161,082

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## INTERNATIONAL FLAVORS &amp; FRAGRANCES INC.

## CONSOLIDATED BALANCE SHEET

(DOLLARS IN THOUSANDS)

(Unaudited)

|                                                                                                                                                                                                                                                | June 30, 2014 | December 31,<br>2013 |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|----------------------|
| <b>ASSETS</b>                                                                                                                                                                                                                                  |               |                      |
| Current Assets:                                                                                                                                                                                                                                |               |                      |
| Cash and cash equivalents                                                                                                                                                                                                                      | \$326,853     | \$405,505            |
| Trade receivables (net of allowances of \$10,443 and \$10,493, respectively)                                                                                                                                                                   | 583,220       | 524,493              |
| Inventories: Raw materials                                                                                                                                                                                                                     | 257,328       | 252,457              |
| Work in process                                                                                                                                                                                                                                | 17,818        | 6,658                |
| Finished goods                                                                                                                                                                                                                                 | 279,725       | 274,691              |
| Total Inventories                                                                                                                                                                                                                              | 554,871       | 533,806              |
| Deferred income taxes                                                                                                                                                                                                                          | 30,475        | 40,189               |
| Prepaid expenses and other current assets                                                                                                                                                                                                      | 148,629       | 148,910              |
| Total Current Assets                                                                                                                                                                                                                           | 1,644,048     | 1,652,903            |
| Property, plant and equipment, at cost                                                                                                                                                                                                         | 1,814,663     | 1,757,983            |
| Accumulated depreciation                                                                                                                                                                                                                       | (1,115,821)   | (1,070,768)          |
|                                                                                                                                                                                                                                                | 698,842       | 687,215              |
| Goodwill                                                                                                                                                                                                                                       | 675,484       | 665,582              |
| Other intangible assets, net                                                                                                                                                                                                                   | 80,176        | 30,615               |
| Deferred income taxes                                                                                                                                                                                                                          | 151,830       | 154,437              |
| Other assets                                                                                                                                                                                                                                   | 150,153       | 140,979              |
| Total Assets                                                                                                                                                                                                                                   | \$3,400,533   | \$3,331,731          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                                                                                                                                                    |               |                      |
| Current Liabilities:                                                                                                                                                                                                                           |               |                      |
| Bank borrowings and overdrafts and current portion of long-term debt                                                                                                                                                                           | \$3,052       | \$149                |
| Accounts payable                                                                                                                                                                                                                               | 195,251       | 226,733              |
| Accrued payroll and bonus                                                                                                                                                                                                                      | 52,379        | 105,816              |
| Dividends payable                                                                                                                                                                                                                              | 31,672        | 31,740               |
| Restructuring and other charges                                                                                                                                                                                                                | 2,022         | 2,116                |
| Other current liabilities                                                                                                                                                                                                                      | 184,274       | 193,812              |
| Total Current Liabilities                                                                                                                                                                                                                      | 468,650       | 560,366              |
| Long-term debt                                                                                                                                                                                                                                 | 932,621       | 932,665              |
| Deferred gains                                                                                                                                                                                                                                 | 47,957        | 41,339               |
| Retirement liabilities                                                                                                                                                                                                                         | 238,531       | 238,225              |
| Other liabilities                                                                                                                                                                                                                              | 110,830       | 92,085               |
| Total Other Liabilities                                                                                                                                                                                                                        | 1,329,939     | 1,304,314            |
| Commitments and Contingencies (Note 12)                                                                                                                                                                                                        |               |                      |
| Shareholders' Equity:                                                                                                                                                                                                                          |               |                      |
| Common stock 12 1/2¢ par value; authorized 500,000,000 shares; issued 115,761,900 and 115,761,840 shares as of June 30, 2014 and December 31, 2013; and outstanding 81,177,534 and 81,384,246 shares as of June 30, 2014 and December 31, 2013 | 14,470        | 14,470               |
| Capital in excess of par value                                                                                                                                                                                                                 | 131,772       | 131,461              |
| Retained earnings                                                                                                                                                                                                                              | 3,229,301     | 3,075,657            |

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|                                                                                                                  |             |              |   |
|------------------------------------------------------------------------------------------------------------------|-------------|--------------|---|
| Accumulated other comprehensive loss                                                                             | (383,714    | ) (392,711   | ) |
| Treasury stock, at cost - 34,584,366 shares as of June 30, 2014 and<br>34,377,594 shares as of December 31, 2013 | (1,393,531  | ) (1,365,805 | ) |
| Total Shareholders' Equity                                                                                       | 1,598,298   | 1,463,072    |   |
| Noncontrolling interest                                                                                          | 3,646       | 3,979        |   |
| Total Shareholders' Equity including noncontrolling interest                                                     | 1,601,944   | 1,467,051    |   |
| Total Liabilities and Shareholders' Equity                                                                       | \$3,400,533 | \$3,331,731  |   |

See Notes to Consolidated Financial Statements

INTERNATIONAL FLAVORS & FRAGRANCES INC.  
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME  
(AMOUNT IN THOUSANDS EXCEPT PER SHARE AMOUNTS)  
(Unaudited)

|                                                    | Three Months Ended June 30, |            | Six Months Ended June 30, |             |
|----------------------------------------------------|-----------------------------|------------|---------------------------|-------------|
|                                                    | 2014                        | 2013       | 2014                      | 2013        |
| Net sales                                          | \$788,414                   | \$757,635  | \$1,558,638               | \$1,485,471 |
| Cost of goods sold                                 | 435,767                     | 423,649    | 864,579                   | 840,125     |
| Research and development expenses                  | 66,431                      | 64,672     | 127,934                   | 123,774     |
| Selling and administrative expenses                | 132,919                     | 124,813    | 256,653                   | 239,468     |
| Restructuring and other charges, net               | 182                         | 2,105      | 304                       | 2,105       |
| Interest expense                                   | 11,403                      | 12,860     | 23,080                    | 24,013      |
| Other income, net                                  | (4,641)                     | ) (11,209) | ) (3,198)                 | ) (12,282)  |
| Income before taxes                                | 146,353                     | 140,745    | 289,286                   | 268,268     |
| Taxes on income                                    | 36,068                      | 38,423     | 72,294                    | 75,248      |
| Net income                                         | 110,285                     | 102,322    | 216,992                   | 193,020     |
| Other comprehensive income (loss), after tax:      |                             |            |                           |             |
| Foreign currency translation adjustments           | 7,570                       | (17,051)   | ) (1,826)                 | ) (16,825)  |
| Gains (losses) on derivatives qualifying as hedges | 1,598                       | (2,174)    | ) 2,058                   | (2,302)     |
| Pension and postretirement net liability           | 4,400                       | 5,088      | 8,765                     | 10,220      |
| Other comprehensive income (loss)                  | 13,568                      | (14,137)   | ) 8,997                   | (8,907)     |
| Total comprehensive income                         | \$123,853                   | \$88,185   | \$225,989                 | \$184,113   |
| Net income per share - basic                       | \$1.35                      | \$1.25     | \$2.66                    | \$2.36      |
| Net income per share - diluted                     | \$1.35                      | \$1.24     | \$2.64                    | \$2.34      |
| Average number of shares outstanding - basic       | 80,949                      | 81,309     | 81,003                    | 81,300      |
| Average number of shares outstanding - diluted     | 81,430                      | 82,041     | 81,583                    | 82,018      |
| Dividends declared per share                       | \$0.39                      | \$0.34     | \$0.78                    | \$0.68      |
| See Notes to Consolidated Financial Statements     |                             |            |                           |             |

INTERNATIONAL FLAVORS & FRAGRANCES INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(DOLLARS IN THOUSANDS)  
(Unaudited)

|                                                                                                      | Six Months Ended June 30, |            |
|------------------------------------------------------------------------------------------------------|---------------------------|------------|
|                                                                                                      | 2014                      | 2013       |
| Cash flows from operating activities:                                                                |                           |            |
| Net income                                                                                           | \$216,992                 | \$193,020  |
| Adjustments to reconcile to net cash provided by operating activities:                               |                           |            |
| Depreciation and amortization                                                                        | 49,131                    | 39,807     |
| Deferred income taxes                                                                                | 10,228                    | 4,971      |
| Gain on disposal of assets                                                                           | (1,569)                   | ) (18,021) |
| Stock-based compensation                                                                             | 14,034                    | 14,050     |
| Changes in assets and liabilities, net of Aromor acquisition:                                        |                           |            |
| Trade receivables                                                                                    | (50,236)                  | ) (60,753) |
| Inventories                                                                                          | 1,850                     | 14,694     |
| Accounts payable                                                                                     | (30,831)                  | ) (10,198) |
| Accruals for incentive compensation                                                                  | (54,970)                  | ) (23,076) |
| Other current payables and accrued expenses                                                          | (12,382)                  | ) 13,919   |
| Other assets                                                                                         | 2,877                     | (21,727)   |
| Other liabilities                                                                                    | 8,906                     | (28,643)   |
| Net cash provided by operating activities                                                            | 154,030                   | 118,043    |
| Cash flows from investing activities:                                                                |                           |            |
| Cash paid for acquisition, net of cash received (including \$15 million of contingent consideration) | (102,500)                 | ) —        |
| Additions to property, plant and equipment                                                           | (60,244)                  | ) (60,689) |
| Proceeds from life insurance contracts                                                               | 17,750                    | 793        |
| Maturity of net investment hedges                                                                    | (472)                     | ) 626      |
| Proceeds from disposal of assets                                                                     | 2,074                     | 16,467     |
| Net cash used in investing activities                                                                | (143,392)                 | ) (42,803) |
| Cash flows from financing activities:                                                                |                           |            |
| Cash dividends paid to shareholders                                                                  | (63,417)                  | ) (27,733) |
| Net change in revolving credit facility borrowings and overdrafts                                    | 2,106                     | (284,061)  |
| Deferred financing costs                                                                             | (1,023)                   | ) (2,786)  |
| Proceeds from long-term debt                                                                         | —                         | 297,786    |
| Proceeds from issuance of stock under stock plans                                                    | 1,024                     | 3,566      |
| Excess tax benefits on stock-based payments                                                          | 5,788                     | 5,172      |
| Purchase of treasury stock                                                                           | (34,103)                  | ) (19,174) |
| Net cash used in financing activities                                                                | (89,625)                  | ) (27,230) |
| Effect of exchange rate changes on cash and cash equivalents                                         | 335                       | (6,535)    |
| Net change in cash and cash equivalents                                                              | (78,652)                  | ) 41,475   |
| Cash and cash equivalents at beginning of year                                                       | 405,505                   | 324,422    |
| Cash and cash equivalents at end of period                                                           | \$326,853                 | \$365,897  |
| Interest paid, net of amounts capitalized                                                            | \$23,709                  | \$20,955   |
| Income taxes paid                                                                                    | \$45,484                  | \$71,659   |
| See Notes to Consolidated Financial Statements                                                       |                           |            |

## Notes to Consolidated Financial Statements

## Note 1. Consolidated Financial Statements:

## Basis of Presentation

These interim statements and related management's discussion and analysis should be read in conjunction with the Consolidated Financial Statements and their related notes and management's discussion and analysis of results of operations, liquidity and capital resources included in our 2013 Annual Report on Form 10-K ("2013 Form 10-K"). These interim statements are unaudited. The year-end balance sheet data included in this Form 10-Q filing was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States of America. We have historically operated and continue to operate on a 52/53 week fiscal year ending on the Friday closest to the last day of the quarter. For ease of presentation, June 30 and December 31 are used consistently throughout this Form 10-Q and these interim financial statements and related notes to represent the period-end dates. For the 2014 and 2013 quarters, the actual closing dates were June 27 and June 28, respectively. The unaudited interim financial statements include all adjustments (consisting only of normal recurring adjustments) and accruals necessary in the judgment of management for a fair statement of the results for the periods presented. When used herein, the terms "IFF," the "Company," "we," "us" and "our" mean International Flavors & Fragrances Inc. and its consolidated subsidiaries.

## Recent Accounting Pronouncements

In March 2013, the Financial Accounting Standards Board ("FASB") issued authoritative guidance clarifying the accounting for the release of cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The guidance is effective prospectively for reporting periods beginning after December 15, 2013. The adoption of this statement did not have a significant impact on our financial position, results of operations or cash flows.

In July 2013, the FASB issued authoritative guidance related to the financial statement presentation of unrecognized tax benefits. This update clarifies that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose. In such situations, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The guidance is effective prospectively for reporting periods beginning after December 15, 2013. The adoption of this statement did not have a significant impact on our financial position, results of operations or cash flows.

In May 2014, the FASB issued authoritative guidance to clarify the principles to be used to recognize revenue. The guidance is applicable to all entities. The guidance is effective for annual and interim periods beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the impact that this new standard will have on its consolidated financial statements.

## Note 2. Net Income Per Share:

Net income per share is based on the weighted average number of shares outstanding. A reconciliation of the shares used in the computation of basic and diluted net income per share is as follows:

| (SHARES IN THOUSANDS)              | Three Months Ended June 30, |        | Six Months Ended June 30, |        |
|------------------------------------|-----------------------------|--------|---------------------------|--------|
|                                    | 2014                        | 2013   | 2014                      | 2013   |
| Basic                              | 80,949                      | 81,309 | 81,003                    | 81,300 |
| Assumed dilution under stock plans | 481                         | 732    | 580                       | 718    |
| Diluted                            | 81,430                      | 82,041 | 81,583                    | 82,018 |

There were no stock options and stock settled appreciation rights ("SSARs") excluded from the computation of diluted net income per share for the three and six months ended June 30, 2014 and 2013.

The Company has issued shares of purchased restricted common stock ("PRS") which contain rights to nonforfeitable dividends while these shares are outstanding and thus are considered participating securities which are required to be included in the computation of basic and diluted earnings per share pursuant to the two-class method. The Company did not present the

two-class method since the difference between basic and diluted net income per share for both unrestricted common shareholders and PRS shareholders was less than \$0.01 per share for each period presented and the number of PRS outstanding as of June 30, 2014 and 2013 was immaterial (approximately 0.7% of the total number of common shares outstanding as of June 30, 2014 and 2013). Net income allocated to such PRS was \$0.7 million during each of the three months ended June 30, 2014 and 2013, and \$1.4 million and \$1.3 million during the six months ended June 30, 2014 and 2013, respectively.

**Note 3. Restructuring and Other Charges, Net:**

**Fragrance Ingredients Rationalization**

During the third quarter of 2014, the Company closed its fragrance ingredients manufacturing facility in Augusta, Georgia and consolidated production into other Company facilities. In connection with this closure, the Company expects to incur charges of \$15 - \$17 million, consisting primarily of approximately \$11 million in accelerated depreciation of fixed assets, approximately \$3 million in personnel-related costs and \$2 - \$3 million in plant shutdown and other related costs. The Company recorded total charges of \$7.4 million during 2013, consisting of \$2.2 million of pre-tax charges related to severance included in Restructuring and other charges, net and \$5.2 million of non-cash charges related to accelerated depreciation included in Cost of goods sold. During the first quarter of 2014, the Company recorded an additional \$0.1 million of severance costs included in Restructuring and other charges, net and \$2.3 million of non-cash charges related to accelerated depreciation included in Cost of goods sold. During the second quarter of 2014, the Company recorded an additional \$0.2 million of plant shutdown and other related costs included in Restructuring and other charges, net and \$2.8 million of non-cash charges related to accelerated depreciation included in Cost of goods sold. The majority of the plant shutdown and other related costs are expected to be recognized over the balance of the year. As a result of this closure, 43 positions have been or will be eliminated. The Company estimates that approximately \$5 - \$7 million of the costs will be or have been cash expenditures. Changes in employee-related restructuring liabilities during the six months ended June 30, 2014 related to the Fragrance Ingredients Rationalization were as follows:

| (DOLLARS IN THOUSANDS)   | Employee-Related<br>Costs | Accelerated<br>Depreciation | Other | Total   |
|--------------------------|---------------------------|-----------------------------|-------|---------|
| December 31, 2013        | \$2,116                   | \$—                         | \$—   | \$2,116 |
| Additional charges, net  | (46)                      | ) 5,100                     | 350   | 5,404   |
| Non-cash charges         | —                         | (5,100)                     | ) —   | (5,100) |
| Payments and other costs | (48)                      | ) —                         | (350) | ) (398) |
| June 30, 2014            | \$2,022                   | \$—                         | \$—   | \$2,022 |

**Note 4. Other Intangible Assets, Net:**

Other intangible assets, net consist of the following amounts:

| (DOLLARS IN THOUSANDS)              | June 30,<br>2014 | December 31,<br>2013 |
|-------------------------------------|------------------|----------------------|
| Gross carrying value <sup>(1)</sup> | \$218,676        | \$165,406            |
| Accumulated amortization            | (138,500)        | ) (134,791)          |
| Total                               | \$80,176         | \$30,615             |

<sup>(1)</sup> Includes patents, trademarks, technological know-how and other intellectual property, valued at acquisition.

**Aromor**

On January 15, 2014, the Company completed the acquisition of 100% of the equity of Aromor Flavors and Fragrances Ltd. ("Aromor"), a privately held manufacturer and marketer of complex specialty ingredients that are used in fragrances and flavors. The acquisition was accounted for under the purchase method. The Company paid \$102.6 million (including \$0.1 million of cash acquired) for this acquisition, which was funded out of existing cash resources. Aromor is part of the IFF Fragrances Ingredients business and was acquired in order to strengthen this business and provide cost-effective quality materials for use in our formula creations. The purchase price exceeded the carrying value of existing net assets by approximately \$56 million. The excess was allocated principally to identifiable

intangible assets (approximately \$53 million), goodwill (approximately \$10 million) and approximately \$9 million to deferred tax liabilities. Separately identifiable intangible assets are principally related to technological know-how. The intangible assets are amortized using lives ranging from 13-19 years. Additionally, the consideration included \$15 million related to post-combination contingent consideration, held in escrow. This escrowed amount will be expensed by the Company as it is earned by the selling shareholders over three years

based upon the continued participation in the acquired business of certain key personnel. The purchase price allocation was completed during the second quarter. No pro forma financial information for 2013 is presented as the impact of the acquisition is immaterial.

#### Amortization

Amortization expense was \$2.8 million and \$1.5 million for the three months ended June 30, 2014 and 2013, respectively and \$3.9 million and \$3.0 million for the six months ended June 30, 2014 and 2013, respectively. Annual amortization is expected to be \$7.8 million for the year 2014, \$7.5 million for the years 2015 through 2017, \$7.3 million for the year 2018 and \$6.7 million for the year 2019.

#### Note 5. Borrowings:

Debt consists of the following:

| (DOLLARS IN THOUSANDS)                         | Rate | Maturities | June 30, 2014 | December 31, 2013 |
|------------------------------------------------|------|------------|---------------|-------------------|
| Senior notes - 2007                            | 6.40 | % 2017-27  | \$500,000     | \$500,000         |
| Senior notes - 2006                            | 6.14 | % 2016     | 125,000       | 125,000           |
| Senior notes - 2013                            | 3.20 | % 2023     | 299,767       | 299,736           |
| Bank overdrafts and other                      |      |            | 4,747         | 984               |
| Deferred realized gains on interest rate swaps |      |            | 6,159         | 7,094             |
|                                                |      |            | 935,673       | 932,814           |
| Less: Current portion of long-term debt        |      |            | (3,052)       | (149)             |
|                                                |      |            | \$932,621     | \$932,665         |

On April 4, 2014, the Company and certain of its subsidiaries amended and restated the Company's existing credit agreement with Citibank, N.A., as administrative agent, to, among other things (i) modify the available tranches of the revolving loan facility provided under the credit agreement (as amended, the "Credit Facility"), (ii) reduce the applicable margin on the interest rate on advances under the Credit Facility to a range of 0.0% to 0.750% for base rate advances and 0.750% to 1.750% for Eurocurrency rate advances, depending on the Company's public debt rating and (iii) extend the maturity date of the Credit Facility until April 4, 2019. Tranche A of the Credit Facility is available to borrowers in U.S. dollars, euros, Swiss francs, Japanese yen and British sterling in an aggregate amount up to an equivalent of approximately \$456 million, with a sublimit of \$25 million for swing line borrowings. Tranche B of the Credit Facility is available to borrowers in euros, Swiss francs, Japanese yen and British sterling in an aggregate amount up to an equivalent of approximately \$494 million.

#### Note 6. Income Taxes:

At June 30, 2014, the Company had \$23.2 million of unrecognized tax benefits recorded in Other liabilities. If these unrecognized tax benefits were recognized, the effective tax rate would be affected.

At June 30, 2014, the Company had accrued interest and penalties of \$2.3 million classified in Other liabilities. The Company regularly repatriates a portion of current year earnings from select non-U.S. subsidiaries. No provision is made for additional taxes on undistributed earnings of subsidiary companies that are intended and planned to be indefinitely invested in such subsidiaries. We intend to, and have plans to, reinvest these earnings indefinitely in our foreign subsidiaries to fund local operations and/or capital projects.

The Company has ongoing income tax audits and legal proceedings which are at various stages of administrative or judicial review, of which the most significant items are discussed below. In addition, the Company has other ongoing tax audits and legal proceedings that relate to indirect taxes, such as value-added taxes, capital tax, sales and use taxes and property taxes, which are discussed in Note 12.

As of June 30, 2014, the Company had one outstanding income tax case in Spain relating to fiscal year 2002. The Company has fully reserved the assessment originally asserted by the Spanish tax authority. The Company is awaiting a decision on its appeal, and in order to proceed with the appeal, the Company was required to post a bank guaranty, which as of June 30, 2014, was in the amount of Euro 1.8 million (\$2.5 million).

In addition to the above, the Company has also been a party to dividend withholding tax controversies in Spain. At June 30, 2014, the Company had Euro 4.6 million (\$6.2 million) reflected in income taxes payable in connection with three of these cases. The fourth and final remaining case is under appeal and has not yet been heard by the Spanish

Supreme Court, with

7

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an aggregate value of Euro 3.2 million (\$4.5 million), including estimated interest, which is fully reserved as of June 30, 2014. As of June 30, 2014, the Company had posted bank guarantees of Euro 7.8 million (\$10.7 million) associated with the appeals of these matters.

In addition to the Spanish tax controversy, the Company has several other tax audits in process and has open tax years with various taxing jurisdictions that range primarily from 2004 to 2013. Based on currently available information, we do not believe the ultimate outcome of any of these tax audits and other tax positions related to open tax years, when finalized, will have a material impact on our financial position.

As of June 30, 2014, the Company's aggregate provisions for uncertain tax positions, including interest and penalties, was \$25.5 million, which includes \$2.2 million associated with the tax positions taken by our Spanish subsidiaries for the 2002 fiscal year, \$3.8 million associated with our Spanish dividend withholding tax controversies and the remainder associated with various other tax positions asserted in foreign jurisdictions, none of which is individually material.

The effective tax rate for the three months ended June 30, 2014 was 24.6% compared with 27.3% for the three months ended June 30, 2013. The quarter-over-quarter decrease is largely due to higher earnings from low tax jurisdictions and the effect of favorable tax settlements, which were partially offset by higher repatriation costs. The effective tax rate for the six months ended June 30, 2014 was 25.0% compared with 28.0% for the six months ended June 30, 2013. The year-over-year decrease is primarily due to a benefit from a litigation ruling during the second quarter of 2014 as well as favorable mix of earnings and a \$6.2 million after-tax Spanish tax charge that was recorded in the first quarter of 2013, which were only partially offset by higher repatriation costs and the absence of the U.S. R&D tax credit in 2014.

#### Note 7. Stock Compensation Plans:

The Company has various plans under which its officers, senior management, other key employees and directors may be granted equity-based awards. Equity awards outstanding under the plans include PRS, restricted stock units ("RSUs"), stock options, SSARs and Long-Term Incentive Plan awards; liability-based awards outstanding under the plans are cash-settled RSUs.

Stock-based compensation expense and related tax benefits were as follows:

| (DOLLARS IN THOUSANDS)                            | Three Months Ended June 30, |         | Six Months Ended June 30, |          |
|---------------------------------------------------|-----------------------------|---------|---------------------------|----------|
|                                                   | 2014                        | 2013    | 2014                      | 2013     |
| Equity-based awards                               | \$9,338                     | \$9,527 | \$14,034                  | \$14,050 |
| Liability-based awards                            | 1,519                       | 600     | 2,764                     | 2,051    |
| Total stock-based compensation expense            | 10,857                      | 10,127  | 16,798                    | 16,101   |
| Less: tax benefit                                 | (3,345)                     | (3,114) | (5,071)                   | (5,021)  |
| Total stock-based compensation expense, after tax | \$7,512                     | \$7,013 | \$11,727                  | \$11,080 |

#### Note 8. Segment Information:

The Company is organized into two operating segments: Flavors and Fragrances. These segments align with the internal structure of the Company used to manage these businesses. Performance of these operating segments is evaluated based on segment profit which is defined as operating profit before Restructuring, global expenses (as discussed below) and certain non-recurring items, Interest expense, Other income, net and Taxes on income.

The Global expenses caption below represents corporate and headquarters-related expenses which include legal, finance, human resources, certain incentive compensation expenses and other R&D and administrative expenses that are not allocated to individual operating segments.

Reportable segment information is as follows:

|                                                         | Three Months Ended June 30, |           | Six Months Ended June 30, |             |
|---------------------------------------------------------|-----------------------------|-----------|---------------------------|-------------|
| (DOLLARS IN THOUSANDS)                                  | 2014                        | 2013      | 2014                      | 2013        |
| Net sales:                                              |                             |           |                           |             |
| Flavors                                                 | \$375,513                   | \$374,041 | \$742,018                 | \$730,401   |
| Fragrances                                              | 412,901                     | 383,594   | 816,620                   | 755,070     |
| Consolidated                                            | \$788,414                   | \$757,635 | \$1,558,638               | \$1,485,471 |
| Segment profit:                                         |                             |           |                           |             |
| Flavors                                                 | \$90,805                    | \$89,919  | \$178,869                 | \$172,955   |
| Fragrances                                              | 85,474                      | 71,913    | 172,638                   | 140,270     |
| Global expenses                                         | (19,869                     | ) (17,169 | ) (36,303                 | ) (29,761   |
| Restructuring and other charges, net                    | (182                        | ) (2,105  | ) (304                    | ) (2,105    |
| Operational improvement initiative costs <sup>(1)</sup> | (3,113                      | ) (162    | ) (5,732                  | ) (1,360    |
| Operating profit                                        | 153,115                     | 142,396   | 309,168                   | 279,999     |
| Interest expense                                        | (11,403                     | ) (12,860 | ) (23,080                 | ) (24,013   |
| Other income, net                                       | 4,641                       | 11,209    | 3,198                     | 12,282      |
| Income before taxes                                     | \$146,353                   | \$140,745 | \$289,286                 | \$268,268   |

(1) Operational improvement initiative costs relate to the closing of a smaller facility in Europe and certain manufacturing activities in Asia, while transferring production to larger facilities in each respective region.

Net sales are attributed to individual regions based upon the destination of product delivery. Net sales related to the U.S. for the three months ended June 30, 2014 and 2013 were \$173 million and \$175 million, respectively and for the six months ended June 30, 2014 and 2013 were \$332 million and \$333 million, respectively. Net sales attributed to all foreign countries in total for the three months ended June 30, 2014 and 2013 were \$615 million and \$583 million, respectively and for the six months ended June 30, 2014 and 2013 were \$1,227 million and \$1,153 million, respectively. No non-U.S. country had net sales in any period presented greater than 7.5% of total consolidated net sales.

# Note 9. Employee Benefits:

Pension and other defined contribution retirement plan expenses included the following components:

| U.S. Plans<br>(DOLLARS IN THOUSANDS)            | Three Months Ended June 30, |         | Six Months Ended June 30, |          |
|-------------------------------------------------|-----------------------------|---------|---------------------------|----------|
|                                                 | 2014                        | 2013    | 2014                      | 2013     |
| Service cost for benefits earned                | \$885                       | \$881   | \$1,769                   | \$1,762  |
| Interest cost on projected benefit obligation   | 6,232                       | 5,741   | 12,463                    | 11,482   |
| Expected return on plan assets                  | (6,913)                     | (6,557) | (13,826)                  | (13,114) |
| Net amortization and deferrals                  | 4,255                       | 5,869   | 8,509                     | 11,738   |
| Net periodic benefit cost                       | 4,459                       | 5,934   | 8,915                     | 11,868   |
| Defined contribution and other retirement plans | 1,791                       | 2,076   | 3,902                     | 3,946    |
| Total expense                                   | \$6,250                     | \$8,010 | \$12,817                  | \$15,814 |

| Non-U.S. Plans<br>(DOLLARS IN THOUSANDS)         | Three Months Ended June 30, |          | Six Months Ended June 30, |          |
|--------------------------------------------------|-----------------------------|----------|---------------------------|----------|
|                                                  | 2014                        | 2013     | 2014                      | 2013     |
| Service cost for benefits earned                 | \$4,002                     | \$4,027  | \$7,950                   | \$8,170  |
| Interest cost on projected benefit obligation    | 8,541                       | 7,612    | 16,952                    | 15,486   |
| Expected return on plan assets                   | (12,675)                    | (11,695) | (25,155)                  | (23,794) |
| Net amortization and deferrals                   | 3,000                       | 2,284    | 5,954                     | 4,652    |
| Loss due to settlements and special terminations | —                           | 35       | —                         | 75       |
| Net periodic benefit cost                        | 2,868                       | 2,263    | 5,701                     | 4,589    |
| Defined contribution and other retirement plans  | 1,444                       | 987      | 2,622                     | 2,278    |
| Total expense                                    | \$4,312                     | \$3,250  | \$8,323                   | \$6,867  |

The Company expects to contribute approximately \$21 million to its non-U.S. pension plans and approximately \$20 million to its qualified U.S. pension plans during 2014. In the three and six months ended June 30, 2014, \$4.5 million and \$9.8 million of contributions were made to the non-U.S. plans, respectively. In the three and six months ended June 30, 2014, \$1.0 million and \$2.1 million of benefit payments were made with respect to the Company's non-qualified U.S. pension plan, respectively.

Expense recognized for postretirement benefits other than pensions included the following components:

| (DOLLARS IN THOUSANDS)                        | Three Months Ended June 30, |       | Six Months Ended June 30, |         |
|-----------------------------------------------|-----------------------------|-------|---------------------------|---------|
|                                               | 2014                        | 2013  | 2014                      | 2013    |
| Service cost for benefits earned              | \$323                       | \$362 | \$645                     | \$724   |
| Interest cost on projected benefit obligation | 1,238                       | 1,168 | 2,475                     | 2,336   |
| Net amortization and deferrals                | (979)                       | (663) | (1,958)                   | (1,326) |
| Total postretirement benefit expense          | \$582                       | \$867 | \$1,162                   | \$1,734 |

The Company expects to contribute approximately \$5 million to its postretirement benefits other than pension plans during 2014. In the three and six months ended June 30, 2014, \$1.7 million and \$3.3 million of contributions were made, respectively.

# Note 10. Financial Instruments:

## Fair Value

Accounting guidance on fair value measurements specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1—Quoted prices for identical instruments in active markets.

Level 2—Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires us to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. We determine the fair value of structured liabilities (where performance is linked to structured interest rates, inflation or currency risks) using the LIBOR swap curve and forward interest and exchange rates at period end. Such instruments are classified as Level 2 based on the observability of significant inputs to the model. We do not have any instruments classified as Level 1 or Level 3, other than those included in pension asset trusts as discussed in Note 13 of our 2013 Form 10-K.

These valuations take into consideration our credit risk and our counterparties' credit risk. The estimated change in the fair value of these instruments due to such changes in our own credit risk (or instrument-specific credit risk) was immaterial as of June 30, 2014.

The amounts recorded in the balance sheet (carrying amount) and the estimated fair values of financial instruments at June 30, 2014 and December 31, 2013 consisted of the following:

|                                                      | June 30, 2014   |            | December 31, 2013 |            |
|------------------------------------------------------|-----------------|------------|-------------------|------------|
|                                                      | Carrying Amount | Fair Value | Carrying Amount   | Fair Value |
| (DOLLARS IN THOUSANDS)                               |                 |            |                   |            |
| Cash and cash equivalents <sup>(1)</sup>             | \$326,853       | \$326,853  | \$405,505         | \$405,505  |
| Credit facilities and bank overdrafts <sup>(2)</sup> | 4,747           | 4,747      | 984               | 984        |
| Long-term debt: <sup>(3)</sup>                       |                 |            |                   |            |
| Senior notes - 2007                                  | 500,000         | 596,115    | 500,000           | 590,024    |
| Senior notes - 2006                                  | 125,000         | 136,148    | 125,000           | 139,146    |
| Senior notes - 2013                                  | 299,767         | 292,620    | 299,736           | 278,770    |

(1) The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of those instruments.

(2) The carrying amount of our credit facilities and bank overdrafts approximates fair value as the interest rate is reset frequently based on current market rates as well as the short maturity of those instruments.

(3) The fair value of our long-term debt was calculated using discounted cash flows applying current interest rates and current credit spreads based on our own credit risk.

#### Derivatives

We periodically enter into foreign currency forward contracts with the objective of reducing exposure to cash flow volatility associated with our intercompany loans, foreign currency receivables and payables, and anticipated purchases of certain raw materials used in operations. These contracts generally involve the exchange of one currency for a second currency at a future date, have maturities not exceeding twelve months and are with counterparties which are major international financial institutions.

In 2003, we executed a 10-year Yen - U.S. dollar currency swap related to the monthly sale and purchase of products between the U.S. and Japan which had been designated as a cash flow hedge. This swap matured in January 2013.

During the six months ended June 30, 2014 and the year ended December 31, 2013, we entered into forward currency contracts which qualified as net investment hedges, in order to mitigate a portion of our net European investments from foreign currency risk. The effective portions of net investment hedges are recorded in Other comprehensive income ("OCI") as a component of Foreign currency translation adjustments in the accompanying Consolidated Statement of Comprehensive Income. Realized gains (losses) are deferred in AOCI where they will remain until the net investments in our European subsidiaries are divested. Three of these forward currency contracts matured during

the six months ended June 30, 2014. The outstanding forward currency contracts have remaining maturities of approximately one year.

During the six months ended June 30, 2014 and the year ended December 31, 2013, we entered into several forward currency contracts which qualified as cash flow hedges. The objective of these hedges is to protect against the currency risk

associated with forecasted U.S. dollar (USD) denominated raw material purchases made by Euro (EUR) functional currency entities which result from changes in the EUR/USD exchange rate. The effective portions of cash flow hedges are recorded in OCI as a component of Gains/(losses) on derivatives qualifying as hedges in the accompanying Consolidated Statement of Comprehensive Income. Realized gains/(losses) in AOCI related to cash flow hedges of raw material purchases are recognized as a component of Cost of goods sold in the accompanying Consolidated Statement of Comprehensive Income in the same period as the related costs are recognized.

During Q1 2013, we entered into three interest rate swaps to hedge the anticipated issuance of fixed-rate debt, which are designated as cash flow hedges. The effective portions of cash flow hedges are recorded in OCI as a component of Losses on derivatives qualifying as hedges in the accompanying Consolidated Statement of Comprehensive Income.

During the second quarter of 2013, we terminated these swaps and incurred a loss of \$2.7 million, which we will amortize as Interest expense over the life of the Senior Notes - 2013 (discussed in Note 8 of our 2013 Form 10-K).

During Q3 2013, we entered into multiple interest rate swap agreements that effectively converted the fixed rate on a portion of our long-term borrowings to a variable short-term rate based on the LIBOR plus an interest markup. These swaps are designated as fair value hedges. Amounts recognized in Interest expense were immaterial for the three and six months ended June 30, 2014.

The following table shows the notional amount of the Company's derivative instruments outstanding as of June 30, 2014 and December 31, 2013:

| (DOLLARS IN THOUSANDS)     | June 30, 2014 | December 31, 2013 |
|----------------------------|---------------|-------------------|
| Foreign currency contracts | \$204,500     | \$255,500         |
| Interest rate swaps        | \$375,000     | \$375,000         |

The following tables show the Company's derivative instruments measured at fair value (Level 2 of the fair value hierarchy), as reflected in the Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013:

| (DOLLARS IN THOUSANDS)           | June 30, 2014                                                           |                                                                             |                     |
|----------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------------------------------|---------------------|
|                                  | Fair Value of<br>Derivatives<br>Designated as<br>Hedging<br>Instruments | Fair Value of<br>Derivatives Not<br>Designated as<br>Hedging<br>Instruments | Total Fair<br>Value |
| Derivative assets <sup>(a)</sup> |                                                                         |                                                                             |                     |
| Foreign currency contracts       | \$1,234                                                                 | \$55                                                                        | \$1,289             |
| Interest rate swaps              | 1,726                                                                   | —                                                                           | 1,726               |
|                                  | \$2,960                                                                 | \$55                                                                        | \$3,015             |

|                                       |         |       |         |
|---------------------------------------|---------|-------|---------|
| Derivative liabilities <sup>(b)</sup> |         |       |         |
| Foreign currency contracts            | \$2,264 | \$308 | \$2,572 |

| (DOLLARS IN THOUSANDS)           | December 31, 2013                                                       |                                                                             |                     |
|----------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------------------------------|---------------------|
|                                  | Fair Value of<br>Derivatives<br>Designated as<br>Hedging<br>Instruments | Fair Value of<br>Derivatives Not<br>Designated as<br>Hedging<br>Instruments | Total Fair<br>Value |
| Derivative assets <sup>(a)</sup> |                                                                         |                                                                             |                     |
| Foreign currency contracts       | \$580                                                                   | \$8,896                                                                     | \$9,476             |
| Interest rate swaps              | 670                                                                     | —                                                                           | 670                 |
|                                  | \$1,250                                                                 | \$8,896                                                                     | \$10,146            |

|                                       |         |         |         |
|---------------------------------------|---------|---------|---------|
| Derivative liabilities <sup>(b)</sup> |         |         |         |
| Foreign currency contracts            | \$6,024 | \$2,909 | \$8,933 |

(a) Derivative assets are recorded to Prepaid expenses and other current assets in the Consolidated Balance Sheet.

(b) Derivative liabilities are recorded as Other current liabilities in the Consolidated Balance Sheet.

The following table shows the effect of the Company's derivative instruments which were not designated as hedging instruments in the Consolidated Statement of Comprehensive Income for the three and six months ended June 30, 2014 and 2013 (in thousands):

| Derivatives Not Designated as Hedging Instruments | Amount of Gain (Loss) Recognized in Income on Derivative |          | Location of Gain (Loss) Recognized in Income on Derivative |
|---------------------------------------------------|----------------------------------------------------------|----------|------------------------------------------------------------|
|                                                   | Three Months Ended June 30, 2014                         | 2013     |                                                            |
| Foreign currency contracts                        | \$3,465                                                  | \$4,330  | Other income, net                                          |
| Derivatives Not Designated as Hedging Instruments | Amount of Gain (Loss) Recognized in Income on Derivative |          | Location of Gain (Loss) Recognized in Income on Derivative |
|                                                   | Six Months Ended June 30, 2014                           | 2013     |                                                            |
| Foreign currency contracts                        | \$538                                                    | \$12,507 | Other income, net                                          |

Most of these net gains (losses) offset any recognized gains (losses) arising from the revaluation of the related intercompany loans during the same respective periods.

The following table shows the effect of the Company's derivative instruments designated as cash flow and net investment hedging instruments in the Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2014 and 2013 (in thousands):

|                                                         | Amount of (Loss) Gain<br>Recognized in OCI on<br>Derivative (Effective<br>Portion) |            | Location of (Loss) Gain<br>Reclassified from AOCI into<br>Income (Effective Portion) | Amount of (Loss) Gain<br>Reclassified from<br>Accumulated OCI into<br>Income (Effective<br>Portion) |          |
|---------------------------------------------------------|------------------------------------------------------------------------------------|------------|--------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|----------|
|                                                         | Three Months Ended June<br>30,<br>2014                                             |            |                                                                                      | Three Months Ended June<br>30,<br>2014                                                              |          |
| Derivatives in Cash Flow<br>Hedging Relationships:      |                                                                                    |            |                                                                                      |                                                                                                     |          |
| Cross currency swap <sup>(1)</sup>                      | \$—                                                                                | \$—        | Other income, net                                                                    | \$—                                                                                                 | \$(118 ) |
| Foreign currency contracts                              | 1,530                                                                              | (702 )     | Cost of goods sold                                                                   | (725 )                                                                                              | (151 )   |
| Interest rate swaps <sup>(2)</sup>                      | 68                                                                                 | (1,473 )   | Interest expense                                                                     | (68 )                                                                                               | (68 )    |
| Derivatives in Net Investment<br>Hedging Relationships: |                                                                                    |            |                                                                                      |                                                                                                     |          |
| Foreign currency contracts                              | 673                                                                                | (343 )     | N/A                                                                                  | —                                                                                                   | —        |
| Total                                                   | \$2,271                                                                            | \$(2,518 ) |                                                                                      | \$(793 )                                                                                            | \$(337 ) |
|                                                         | Amount of (Loss) Gain<br>Recognized in OCI on<br>Derivative (Effective<br>Portion) |            | Location of (Loss) Gain<br>Reclassified from AOCI into<br>Income (Effective Portion) | Amount of (Loss) Gain<br>Reclassified from<br>Accumulated OCI into<br>Income (Effective<br>Portion) |          |
|                                                         | Six Months Ended June<br>30,<br>2014                                               |            |                                                                                      | Six Months Ended June 30,<br>2014                                                                   |          |
| Derivatives in Cash Flow<br>Hedging Relationships:      |                                                                                    |            |                                                                                      |                                                                                                     |          |
| Cross currency swap <sup>(1)</sup>                      | \$—                                                                                | \$—        | Other income, net                                                                    | \$—                                                                                                 | \$(333 ) |
| Foreign currency contracts                              | 1,921                                                                              | 320        | Cost of goods sold                                                                   | (1,478 )                                                                                            | 1,562    |
| Interest rate swaps <sup>(2)</sup>                      | 137                                                                                | (2,667 )   | Interest expense                                                                     | (137 )                                                                                              | \$(68 )  |
| Derivatives in Net Investment<br>Hedging Relationships: |                                                                                    |            |                                                                                      |                                                                                                     |          |
| Foreign currency contracts                              | 298                                                                                | 1,642      | N/A                                                                                  | —                                                                                                   | —        |
| Total                                                   | \$2,356                                                                            | \$(705 )   |                                                                                      | \$(1,615 )                                                                                          | \$1,161  |

(1) Ten year swap executed in 2003.

(2) Interest rate swaps were entered into as pre-issuance hedges for the \$300 million bond offering.

No ineffectiveness was experienced in the above noted cash flow hedges during the three and six months ended June 30, 2014 and 2013. The ineffective portion of the net investment hedges was not material during the three and six months ended June 30, 2014 and 2013.

The Company expects that approximately \$2.3 million (net of tax) of derivative losses included in AOCI at June 30, 2014, based on current market rates, will be reclassified into earnings within the next 12 months. The majority of this amount will vary due to fluctuations in foreign currency exchange rates.



## Note 11. Accumulated Other Comprehensive Income (Loss):

The following tables present changes in the accumulated balances for each component of other comprehensive income, including current period other comprehensive income and reclassifications out of accumulated other comprehensive income:

|                                                                                    | Foreign<br>Currency<br>Translation<br>Adjustments | (Losses) Gains on<br>Derivatives<br>Qualifying as<br>Hedges | Pension and<br>Postretirement<br>Liability<br>Adjustment | Total          |
|------------------------------------------------------------------------------------|---------------------------------------------------|-------------------------------------------------------------|----------------------------------------------------------|----------------|
| (DOLLARS IN THOUSANDS)                                                             |                                                   |                                                             |                                                          |                |
| Accumulated other comprehensive (loss) income, net of tax, as of December 31, 2013 | \$(104,278)                                       | ) \$(4,012                                                  | ) \$(284,421                                             | ) \$(392,711 ) |
| OCI before reclassifications                                                       | (1,826                                            | ) 443                                                       | —                                                        | (1,383 )       |
| Amounts reclassified from AOCI                                                     | —                                                 | 1,615                                                       | 8,765                                                    | 10,380         |
| Net current period other comprehensive income (loss)                               | (1,826                                            | ) 2,058                                                     | 8,765                                                    | 8,997          |
| Accumulated other comprehensive (loss) income, net of tax, as of June 30, 2014     | \$(106,104)                                       | ) \$(1,954                                                  | ) \$(275,656                                             | ) \$(383,714 ) |

|                                                                                    | Foreign<br>Currency<br>Translation<br>Adjustments | (Losses) Gains on<br>Derivatives<br>Qualifying as<br>Hedges | Pension and<br>Postretirement<br>Liability<br>Adjustment | Total          |
|------------------------------------------------------------------------------------|---------------------------------------------------|-------------------------------------------------------------|----------------------------------------------------------|----------------|
| (DOLLARS IN THOUSANDS)                                                             |                                                   |                                                             |                                                          |                |
| Accumulated other comprehensive (loss) income, net of tax, as of December 31, 2012 | \$(93,722)                                        | ) \$(218                                                    | ) \$(309,685                                             | ) \$(403,625 ) |
| OCI before reclassifications                                                       | (16,825                                           | ) (1,141                                                    | ) —                                                      | (17,966 )      |
| Amounts reclassified from AOCI                                                     | —                                                 | (1,161                                                      | ) 10,220                                                 | 9,059          |
| Net current period other comprehensive income (loss)                               | (16,825                                           | ) (2,302                                                    | ) 10,220                                                 | (8,907 )       |
| Accumulated other comprehensive (loss) income, net of tax, as of June 30, 2013     | \$(110,547)                                       | ) \$(2,520                                                  | ) \$(299,465                                             | ) \$(412,532 ) |

The following table provides details about reclassifications out of accumulated other comprehensive income to the Consolidated Statement of Comprehensive Income:

|                                                                    | Six Months<br>Ended June 30,<br>2014 | Six Months<br>Ended June 30,<br>2013 | Affected Line Item in the<br>Consolidated Statement<br>of Comprehensive Income |
|--------------------------------------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------------------------------------------------|
| (DOLLARS IN THOUSANDS)                                             |                                      |                                      |                                                                                |
| (Losses) gains on derivatives qualifying as hedges                 |                                      |                                      |                                                                                |
| Cross currency swap                                                | \$—                                  | \$(333                               | ) Other income, net                                                            |
| Foreign currency contracts                                         | (2,038                               | ) 2,155                              | Cost of goods sold                                                             |
| Interest rate swaps                                                | (137                                 | ) (68                                | ) Interest expense                                                             |
|                                                                    | 560                                  | (593                                 | ) Provision for income taxes                                                   |
|                                                                    | \$(1,615                             | ) \$1,161                            | Total, net of income taxes                                                     |
| (Losses) gains on pension and postretirement liability adjustments |                                      |                                      |                                                                                |
| Settlements / Curtailments                                         | \$—                                  | \$(75                                | ) (a)                                                                          |
| Prior service cost                                                 | (14,729                              | ) 2,197                              | (a)                                                                            |
| Actuarial losses                                                   | 2,224                                | (17,261                              | ) (a)                                                                          |
|                                                                    | 3,740                                | 4,919                                | Provision for income taxes                                                     |
|                                                                    | \$(8,765                             | ) \$(10,220                          | ) Total, net of income taxes                                                   |

(a) The amortization of prior service cost and actuarial loss is included in the computation of net periodic benefit cost. Refer to Note 13 of our 2013 Form 10-K for additional information regarding net periodic benefit cost.

#### Note 12. Commitments and Contingencies:

##### Guarantees and Letters of Credit

The Company has various bank guarantees and letters of credit which are available for use regarding governmental requirements associated with pending litigation in various jurisdictions and to support its ongoing business operations. At June 30, 2014, we had total bank guarantees and standby letters of credit of approximately \$43.7 million with various financial institutions. Of this amount, Euro 9.6 million (\$13.2 million) in bank guarantees are related to governmental requirements on income tax disputes in Spain, as discussed in further detail in Note 9 of our 2013 Form 10-K. Also included in the above aggregate amount is a total of \$23.6 million in bank guarantees which the Company has posted for certain assessments in Brazil for other diverse income tax and indirect tax disputes related to fiscal years 1998-2011. There were no material amounts utilized under the standby letters of credit as of June 30, 2014. In order to challenge the assessments in these cases in Brazil, the Company has been required to, and has separately pledged assets, principally property, plant and equipment, to cover assessments in the amount of approximately \$20.6 million as of June 30, 2014.

##### Lines of Credit

The Company has various lines of credit which are available to support its ongoing business operations. At June 30, 2014, we had available lines of credit (in addition to the Credit Facility discussed in Note 5) of approximately \$86.8 million with various financial institutions. There were no significant amounts drawn down pursuant to these lines of credit as of June 30, 2014.

#### Litigation

The Company assesses contingencies related to litigation and/or other matters to determine the degree of probability and range of possible loss. A loss contingency is accrued in the Company's consolidated financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly sensitive and requires judgments about future events. On at least a quarterly basis, the Company reviews contingencies related to litigation to determine the adequacy of accruals. The amount of ultimate loss may differ from these estimates and further events may require the Company to increase or decrease the amounts it has accrued on any matter.

Periodically, we assess our insurance coverage for all known claims, where applicable, taking into account aggregate coverage by occurrence, limits of coverage, self-insured retentions and deductibles, historical claims experience and claims experience with our insurance carriers. The liabilities are recorded at management's best estimate of the probable outcome of the lawsuits and claims, taking into consideration the facts and circumstances of the individual matters as well as past experience on similar matters. At each balance sheet date, the key issues that management assesses are whether it is probable that a loss as to asserted or unasserted claims has been incurred and if so, whether the amount of loss can be reasonably estimated. We record the expected liability with respect to claims in Other liabilities and expected recoveries from our insurance carriers in Other assets. We recognize a receivable when we believe that realization of the insurance receivable is probable under the terms of the insurance policies and our payment experience to date.

#### Environmental

Over the past 20 years, various federal and state authorities and private parties have claimed that we are a Potentially Responsible Party ("PRP") as a generator of waste materials for alleged pollution at a number of waste sites operated by third parties located principally in New Jersey and have sought to recover costs incurred and to be incurred to clean up the sites.

We have been identified as a PRP at eight facilities operated by third parties at which investigation and/or remediation activities may be ongoing. We analyze our potential liability on at least a quarterly basis. We accrue for environmental liabilities when they are probable and estimable. We estimate our share of the total future cost for these sites to be less than \$5 million.

While joint and several liability is authorized under federal and state environmental laws, we believe the amounts we have paid and anticipate paying in the future for clean-up costs and damages at all sites are not material and will not have a material adverse effect on our financial condition, results of operations or liquidity. This assessment is based upon, among other things, the involvement of other PRPs at most of the sites, the status of the proceedings, including various settlement agreements and consent decrees, and the extended time period over which payments will likely be made. There can be no assurance, however, that future events will not require us to materially increase the amounts we anticipate paying for clean-up costs and damages at these sites, and that such increased amounts will not have a material adverse effect on our financial condition, results of operations or cash flows.

#### Other Contingencies

The Company has contingencies involving third parties (such as labor, contract, technology or product-related claims or litigation) as well as government-related items in various jurisdictions in which we operate pertaining to such items as value-added taxes, other indirect taxes, customs and duties and sales and use taxes. It is possible that cash flows or results of operations, in any period, could be materially affected by the unfavorable resolution of one or more of these contingencies.

The most significant government-related contingencies exist in Brazil. With regard to the Brazilian matters, we believe we have valid defenses for the underlying positions under dispute; however, in order to pursue these defenses, we are required to, and have provided, bank guarantees and pledged assets in the aggregate amount of \$44.2 million. The Brazilian matters take an extended period of time to proceed through the judicial process and there are a limited number of rulings to date.

In March 2012, ZoomEssence, Inc. filed a complaint against the Company in the U.S. District Court of New Jersey alleging trade secret misappropriation, breach of contract and unjust enrichment in connection with certain spray dry

technology disclosed to the Company. In connection with the claims, ZoomEssence is seeking an injunction and monetary damages. ZoomEssence initially sought a temporary restraining order and preliminary injunction, but the Court denied these applications in an order entered on September 27, 2013, finding that ZoomEssence had not demonstrated a likelihood of success on the merits of its claims. The Court subsequently referred the matter to mediation, however the private mediation session did not result in a resolution of the dispute. The case is currently proceeding through general discovery with a trial on the merits anticipated in mid-2015. The Company denies the allegations and will vigorously defend its position in Court. At this

preliminary stage of the litigation, based on the information currently available to the Company, management does not believe that this matter represents a material loss contingency.

Based on the information available as of June 30, 2014, we estimate a range of reasonably possible loss related to the matters above, collectively, is \$3-\$20 million.

Separately, the Spanish tax authorities are alleging claims for a capital tax in a case arising from similar allegations as the income tax cases (discussed in further detail in Note 9 of our 2013 Form 10-K). In connection with the 2002 income tax assessment ruling the Appellate Court rejected one of the two bases upon which we based our capital tax position. However, we believe that we still have a strong basis for our capital tax position and intend to continue to defend these claims. If there is an unfavorable ruling in this case, we estimate a reasonably possible loss of approximately \$13 million, which is fully reserved as of June 30, 2014. On January 22, 2014, we filed an appeal and in order to avoid future interest costs in the event our appeal is unsuccessful, we paid \$11.2 million (representing the principal amount) during the first quarter of 2014.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Overview

We create, manufacture and supply flavors and fragrances for the food, beverage, personal care and household-products industries either in the form of compounds or individual ingredients. Our flavors and fragrance compounds combine a large number of ingredients that are blended, mixed or reacted together to produce proprietary formulas created by our perfumers and flavorists.

Flavors are the key building blocks that impart taste in processed food and beverage products and, as such, play a significant role in determining consumer preference of the end products in which they are used. While we are a global leader, our flavors business is more regional in nature, with different formulas that reflect local tastes and ingredients. As a leading creator of flavors, we help our customers deliver on the promise of delicious and healthy foods and drinks that appeal to consumers. Our flavors compounds are ultimately used by our customers in four end-use categories: (1) Savory, (2) Beverages, (3) Sweet, pharmaceutical and oral care ("Sweet"), and (4) Dairy.

Our fragrances are a key component in the world's finest perfumes and best-known consumer brands, including beauty care, fabric care, personal wash and home care products. During the first quarter of 2014, we announced that we realigned our creative and commercial teams within our Fragrance Compounds activities to newly-defined broad market categories, (1) Fine Fragrances and (2) Consumer Fragrances. Consumer Fragrances consists of five end-use categories: Fabric Care, Home Care, Personal Wash, Hair Care and Toiletries. In addition, our Fragrance Ingredients are used internally and sold to third parties, including customers and competitors, for use in preparation of compounds. Previously, our Fragrance Compounds were aligned into two broad categories (1) Fine Fragrance and Beauty Care and (2) Functional Fragrances.

The flavors and fragrances market is part of a larger market which supplies a variety of ingredients and components that consumer products companies utilize in their products. The broader market includes large multinational companies or smaller regional and local participants which supply products such as seasonings, texturizers, spices, enzymes, certain food-related commodities, fortified products and cosmetic ingredients. The flavors and fragrances market is estimated to be approximately \$18 billion; however the exact size of the global market is not available due to fragmentation of data. We, together with the other top three companies, are estimated to comprise approximately two-thirds of the total estimated sales in the global flavors and fragrances sub-segment of the broader market.

In the second quarter of 2013, we announced our intention to close our fragrance ingredients manufacturing facility in Augusta, Georgia, supporting our objective to ensure operations are cost efficient and competitive. We closed the facility during the third quarter of 2014 and have consolidated production into other facilities, as further discussed in Note 3 to our Consolidated Financial Statements.

Net sales growth during the second quarter of 2014 was 4% on both a reported and local currency (LC) basis (which excludes the effects of changes in currency), with the acquisition of Aromor adding approximately 1% to both reported and local currency basis amounts. The LC growth reflects good new win performance (net of losses) in both Flavors and Fragrance Compounds as well as strong sales of specialty ingredients within Fragrance Ingredients, (including revenue from Aromor), offset by higher volume erosion on existing business, particularly in Flavors. We expect that the higher levels of erosion on base business in Flavors will continue in the near-term, particularly in the third quarter. As a result, we now expect that full year 2014 LC sales growth will be 4-6%.

Exchange rate fluctuations had no impact on net sales for the second quarter. The effect of exchange rates can vary by business and region, depending upon the mix of sales by destination country as well as the relative percentage of local sales priced in U.S. dollars versus local currencies.

Gross margins improved versus the second quarter of 2013. The improvement reflects cost savings initiatives, currency benefits and favorable net impact of input costs to pricing, partially offset by cost increases and a weaker sales mix when compared to the second quarter of 2013. The raw material cost environment was moderately favorable year over year, however the overall cost base remains elevated including certain key supplies where prices are still near all-time highs. While there continues to be economic uncertainty and market volatility of our crop-related raw materials, we continue to believe cost pressures will develop in the second half of the year. As a result, we continue to seek improvements in our margins through operational performance and mix enhancement. While we continue to target year-over-year expansion in our gross margins, we expect that the rate of improvement during 2014 versus 2013

will be substantially less given the strong improvement realized during 2013. Included in the second quarter of 2014 is \$3.3 million of costs associated with restructuring and operational improvement initiatives. During the fourth quarter of 2013, we completed the testing and start-up process at our Flavors compounding facility in China and began commercial production, which has resulted in higher depreciation expense and other operating costs associated with the commercial start-up. These incremental costs partially offset the benefits realized from the restructuring and operational improvement initiatives.

## FINANCIAL PERFORMANCE OVERVIEW

Reported and LC sales in the second quarter of 2014 increased approximately 4% (including 1% growth from the acquisition of Aromor) reflecting the strength of our broad and diverse portfolio of end-use product categories and geographies. The overall increase was driven by new win performance in both Flavors and Fragrance Compounds as well as strong sales of specialty ingredients within Fragrance Ingredients (which includes the benefit of the Aromor acquisition). These increases were offset by higher volume erosion on existing business, particularly in Flavors.

Flavors realized LC growth of 1% for the second quarter of 2014. Our Fragrance business achieved LC growth of 6%, compared with LC sales in the second quarter of 2013. Fragrances performance reflects new win performance in our Fragrance Compounds end-use categories, led by sales in Fabric Care, Personal Wash, Toiletries and Fine Fragrance. Overall, our second quarter 2014 results continued to be driven by our strong emerging market presence that represented 49% of sales and experienced 5% LC growth. From a geographic perspective, for the second quarter, the Latin America (LA), Europe, Africa and Middle East (EAME), Greater Asia (GA) and North America (NOAM) regions all delivered LC growth in 2014, led by LA, with 7% LC growth.

Operating profit increased \$10.7 million to \$153.1 million (19.4% of sales) in the 2014 second quarter compared to \$142.4 million (18.8% of sales) in the comparable 2013 period. The three months ended June 30, 2014 included restructuring and operational improvement initiative costs of \$3.3 million. Excluding these charges, adjusted operating profit was \$156.4 million (19.8% of sales) for the first quarter of 2014. The quarter-over-quarter improvement also reflects gross margin expansion that collectively more than offset the effects of higher R&D, selling and administrative costs. The results of Aromor were not significant to the consolidated financial performance of the Company for the second quarter of 2014.

Other income, net decreased \$6.6 million to \$4.6 million of income in the second quarter of 2014 compared to \$11.2 million of income in the second quarter of 2013. The year-over-year decrease is primarily driven by the inclusion of a \$16.1 million gain related to the sale of a non-operating asset in the second quarter of 2013, offset by year-over-year improvement on foreign currency gains (losses). Excluding the gain in the 2013 period, adjusted Other income, net increased \$9.5 million in 2014 compared to 2013.

Net income increased by \$8.0 million quarter-over-quarter to \$110.3 million for the first quarter of 2014. However, the prior year period included a \$16.1 million gain (\$10.5 million net of tax) on the sale of assets as discussed above. We continue to execute against our strategic priorities of leveraging our geographic reach, strengthening our innovation platform and maximizing our portfolio during the second quarter of 2014. By maintaining cost discipline and realizing productivity gains across many parts of the business, we believe that we can continue to fund investments in resources and capabilities in emerging markets, R&D and key technologies. In 2014, we believe that capital spending will approach 4-5% of sales as we continue to prioritize investments in emerging markets and Flavors.

Cash flows from operations for the six months ended June 30, 2014 were \$154.0 million or 9.9% of sales, compared to cash inflow from operations of \$118.0 million or 7.9% of sales for the six months ended June 30, 2013. The increase in cash flow from operations in 2014 primarily reflects the absence of the \$30 million pension contribution payment included in the 2013 period.

## Results of Operations

|                                                 | Three Months Ended June 30, |           |         |    | Six Months Ended June 30, |             |         |    |
|-------------------------------------------------|-----------------------------|-----------|---------|----|---------------------------|-------------|---------|----|
| (DOLLARS IN THOUSANDS EXCEPT PER SHARE AMOUNTS) | 2014                        | 2013      | Change  |    | 2014                      | 2013        | Change  |    |
| Net sales                                       | \$788,414                   | \$757,635 | 4       | %  | \$1,558,638               | \$1,485,471 | 5       | %  |
| Cost of goods sold                              | 435,767                     | 423,649   | 3       | %  | 864,579                   | 840,125     | 3       | %  |
| Gross profit                                    | 352,647                     | 333,986   |         |    | 694,059                   | 645,346     |         |    |
| Research and development (R&D) expenses         | 66,431                      | 64,672    | 3       | %  | 127,934                   | 123,774     | 3       | %  |
| Selling and administrative (S&A) expenses       | 132,919                     | 124,813   | 6       | %  | 256,653                   | 239,468     | 7       | %  |
| Restructuring and other charges, net            | 182                         | 2,105     | (91)    | )% | 304                       | 2,105       | (86)    | )% |
| Operating profit                                | 153,115                     | 142,396   |         |    | 309,168                   | 279,999     |         |    |
| Interest expense                                | 11,403                      | 12,860    | (11)    | )% | 23,080                    | 24,013      | (4)     | )% |
| Other expense (income), net                     | (4,641)                     | (11,209)  | (59)    | )% | (3,198)                   | (12,282)    | (74)    | )% |
| Income before taxes                             | 146,353                     | 140,745   |         |    | 289,286                   | 268,268     |         |    |
| Taxes on income                                 | 36,068                      | 38,423    | (6)     | )% | 72,294                    | 75,248      | (4)     | )% |
| Net income                                      | \$110,285                   | \$102,322 | 8       | %  | \$216,992                 | \$193,020   | 12      | %  |
| Diluted EPS                                     | \$1.35                      | \$1.24    | 9       | %  | \$2.64                    | \$2.34      | 13      | %  |
| Gross margin                                    | 44.7                        | % 44.1    | % 60    |    | 44.5                      | % 43.4      | % 110   |    |
| R&D as a percentage of sales                    | 8.4                         | % 8.5     | % (10)  | )  | 8.2                       | % 8.3       | % (10)  | )  |
| S&A as a percentage of sales                    | 16.9                        | % 16.5    | % 40    |    | 16.5                      | % 16.1      | % 40    |    |
| Operating margin                                | 19.4                        | % 18.8    | % 60    |    | 19.8                      | % 18.8      | % 100   |    |
| Adjusted operating margin (1)                   | 19.8                        | % 19.2    | % 60    |    | 20.2                      | % 19.1      | % 110   |    |
| Effective tax rate                              | 24.6                        | % 27.3    | % (270) | )  | 25.0                      | % 28.0      | % (300) | )  |
| Segment net sales                               |                             |           |         |    |                           |             |         |    |
| Flavors                                         | \$375,513                   | \$374,041 | 0       | %  | \$742,018                 | \$730,401   | 2       | %  |
| Fragrances                                      | 412,901                     | 383,594   | 8       | %  | 816,620                   | 755,070     | 8       | %  |
| Consolidated                                    | \$788,414                   | \$757,635 |         |    | \$1,558,638               | \$1,485,471 |         |    |

Adjusted operating margin excludes the Restructuring and other charges, net and operational improvement initiative costs of \$3.3 million and \$6.0 million for the three and six months ended June 30, 2014, respectively and (1) \$3.1 million and \$4.3 million of Restructuring and other charges, net and operational improvement initiative costs for the three and six months ended June 30, 2013, respectively.

Cost of goods sold includes the cost of materials and manufacturing expenses. R&D expenses relate to the development of new and improved products, technical product support and compliance with governmental regulations. S&A expenses include expenses necessary to support our commercial activities and administrative expenses supporting our overall operating activities.

## SECOND QUARTER 2014 IN COMPARISON TO SECOND QUARTER 2013

## Sales

Sales for the second quarter of 2014 totaled \$788.4 million, an increase of 4% from the prior year quarter for both reported and LC sales (including 1% growth from the acquisition of Aromor), as a result of new wins in both Flavors and Fragrance Compounds and strong Fragrance Ingredients LC sales, offset by higher volume erosion on existing business, particularly in Flavors. Overall LC growth was driven by 5% growth in emerging markets (prior to the impact of Aromor).

## Flavors Business Unit

Flavors reported sales growth was flat and LC sales growth was 1% during the second quarter of 2014 compared to the 2013 period. The overall performance reflects new wins offset by higher erosion on existing business. Overall modest growth in Sweet was largely offset by overall declines in Savory. The Flavors business delivered LC growth in LA and EAME, led by LA, while sales were flat in GA and declined in NOAM. Sales in LA were driven by high double-digit gains in Beverage. Sales in EAME were driven by mid single-digit gains in Beverage. The declines in NOAM were primarily driven by double-digit declines in Beverage.

## Fragrances Business Unit

The Fragrances business experienced an 8% increase in reported sales and a 6% increase in LC sales for the second quarter of 2014 compared to the second quarter of 2013 (including approximately 2% growth from the acquisition of Aromor). The overall increase was driven by new wins in our Fragrance Compounds categories as well as strong sales of specialty ingredients, including Aromor, within Fragrance Ingredients. Our Fragrance Compounds and Fragrance Ingredients categories saw LC sales grow 4% and 21%, respectively, over the prior year period. Fragrance Ingredients includes approximately 17% growth from Aromor. Within Fragrance Compounds, sales were driven by mid to high single-digit growth in Fabric Care, Personal Wash and Toiletries.

## Sales Performance by Region and Category

|       |                       | % Change in Sales-Second Quarter 2014 vs. Second Quarter 2013 |                        |             |             |         |       |   |
|-------|-----------------------|---------------------------------------------------------------|------------------------|-------------|-------------|---------|-------|---|
|       |                       | Fine<br>Fragrances                                            | Consumer<br>Fragrances | Ingredients | Total Frag. | Flavors | Total |   |
| NOAM  | Reported              | 0                                                             | % 15                   | % 4         | % 8         | % -4    | % 1   | % |
| EAME  | Reported              | -1                                                            | % 4                    | % 34        | % 8         | % 6     | % 7   | % |
|       | Local Currency<br>(1) | -7                                                            | % -1                   | % 28        | % 2         | % 2     | % 2   | % |
| LA    | Reported              | 10                                                            | % -1                   | % -4        | % 1         | % 11    | % 4   | % |
|       | Local Currency<br>(1) | 14                                                            | % 1                    | % -4        | % 4         | % 15    | % 7   | % |
| GA    | Reported              | 14                                                            | % 8                    | % 61        | % 14        | % -4    | % 3   | % |
|       | Local Currency<br>(1) | 14                                                            | % 10                   | % 63        | % 16        | % 0     | % 6   | % |
| Total | Reported              | 2                                                             | % 6                    | % 23        | % 8         | % 0     | % 4   | % |
|       | Local Currency<br>(1) | 0                                                             | % 5                    | % 21        | % 6         | % 1     | % 4   | % |

(1) Local currency sales growth is calculated by translating prior year sales at the exchange rates for the corresponding 2014 period.

NOAM Flavors sales decreased 4% as a result of low single-digit gains in Sweet and Dairy that were more than offset by double-digit declines in Beverage, driven by higher erosion on existing business. NOAM Fragrance sales increased 8% in the second quarter of 2014, principally due to high double-digit gains in Home Care and Personal Wash as well as double-digit gains in Fabric Care and Hair Care.

EAME Flavors LC sales growth of 2% was led by mid single-digit growth in Beverage and low single-digit growth in Sweet, which was only partially offset by low single-digit declines in Savory. EAME Fragrance LC sales increased 2% overall, driven mainly by double-digit growth in Toiletries and high single-digit growth in Fragrance Ingredients, which were partially offset by declines in the Home Care, Personal Wash and Fine Fragrance categories.

LA Flavors LC sales were up 15% as new wins drove high double-digit gains in Beverage, which were partially offset by low double-digit declines in Sweet. LA Fragrances LC sales increased 4% overall, principally led by double-digit gains in Fine Fragrance, Personal Wash and Hair Care categories, which were partially offset by single-digit declines in Home Care, Fabric Care and Fragrance Ingredients.

GA Flavors had flat LC sales growth as single-digit gains in Savory and Sweet were equally offset by single-digit declines in Beverage and Dairy. GA Fragrances LC sales growth of 16% was driven by high double-digit growth in Fragrance Ingredients as well as double-digit growth in Fabric Care, Personal Wash, Home Care and Fine Fragrance categories.

**Cost of Goods Sold**

Cost of goods sold, as a percentage of sales, decreased 60 bps to 55.3% in the second quarter of 2014 compared to 55.9% in the second quarter of 2013. The improvement versus last year was mainly driven by cost savings initiatives, currency benefits and favorable net impact of input costs to pricing, partially offset by cost increases and a weaker sales mix on a year-over-year basis.

**Research and Development (R&D) Expenses**

Overall R&D expenses, as a percentage of sales, remained relatively consistent with prior year at 8.4% in the second quarter of 2014 versus 8.5% in the second quarter of 2013.

**Selling and Administrative (S&A) Expenses**

S&A expenses increased \$8.1 million or 16.9%, as a percentage of sales, in the second quarter of 2014 versus 16.5% in the second quarter of 2013. The \$8.1 million increase reflects Aromor-related expenses, investment in commercial resources to support our three-pillar strategy, currency impacts and several discrete items in 2014 that were partially offset by lower incentive compensation accruals.

**Operating Results by Business Unit**

We evaluate the performance of business units based on segment profit which is defined as operating profit before Restructuring, global expenses (as discussed in Note 8 to our Consolidated Financial Statements) and certain non-recurring items, net, Interest expense, Other income, net and Taxes on income. See Note 8 to our Consolidated Financial Statements for the reconciliation to Income before taxes.

| (DOLLARS IN THOUSANDS)                   | Three Months Ended June 30, |           |          |   |
|------------------------------------------|-----------------------------|-----------|----------|---|
|                                          | 2014                        | 2013      |          |   |
| Segment profit:                          |                             |           |          |   |
| Flavors                                  | \$90,805                    | \$89,919  |          |   |
| Fragrances                               | 85,474                      | 71,913    |          |   |
| Global                                   | (19,869)                    | )         | (17,169) | ) |
| Restructuring and other charges, net     | (182)                       | )         | (2,105)  | ) |
| Operational improvement initiative costs | (3,113)                     | )         | (162)    | ) |
| Operating profit                         | \$153,115                   | \$142,396 |          |   |
| Profit margin                            |                             |           |          |   |
| Flavors                                  | 24.2                        | %         | 24.0     | % |
| Fragrances                               | 20.7                        | %         | 18.7     | % |
| Consolidated                             | 19.4                        | %         | 18.8     | % |

**Flavors Segment Profit**

Flavors segment profit grew approximately 1% to \$90.8 million in the second quarter of 2014, or 24.2% as a percentage of sales, compared to \$89.9 million, or 24.0% as a percentage of sales, in the comparable 2013 period. The improvement in segment profit and profit margin was driven primarily by lower incentive compensation expense.

**Fragrances Segment Profit**

Fragrances segment profit grew approximately 19% to \$85.5 million in the second quarter of 2014, or 20.7% as a percentage of sales, compared to \$71.9 million, or 18.7% as a percentage of sales, in the comparable 2013 period. The improvement in segment profit and profit margin was primarily driven by gross margin expansion.

**Global Expenses**

Global expenses represent corporate and headquarters-related expenses which include legal, finance, human resources and R&D and other administrative expenses that are not allocated to an individual business unit. In the second quarter of 2014, Global expenses were \$19.9 million compared to \$17.2 million during the second quarter of 2013. The increase primarily reflects expense associated with the deferred compensation plan arrangements as well as unfavorable impacts on our cash flow hedging program.

#### Restructuring and Other Charges, Net

Restructuring and other charges, net in 2014 consist of separation costs for employees, including severance, outplacement and other benefit costs, relating to the Fragrance Ingredients Rationalization that started in the second quarter of 2013 related to the closing of the fragrance ingredients manufacturing facility in Augusta, Georgia. The facility was closed during the third quarter of 2014. During the second quarter of 2014, the Company recorded \$0.2 million of plant shutdown and other related costs included in Restructuring and other charges, net and \$2.8 million of non-cash charges related to accelerated depreciation included in Cost of goods sold. As a result of this closure, 43 positions have been or will be eliminated. The Company estimates that approximately \$5 - \$7 million of the costs will be or have been cash expenditures.

#### Interest Expense

Interest expense decreased \$1.5 million to \$11.4 million in the second quarter of 2014 compared to the second quarter of 2013, as a result of the refinancing of our debt in 2013. Average cost of debt was 4.9% for the 2014 three month period compared to 4.4% in the 2013 three month period.

#### Other Income, Net

Other income, net decreased by approximately \$6.6 million to \$4.6 million of income in the second quarter of 2014 versus \$11.2 million of income in the comparable 2013 period. The decrease over the prior year period was driven largely by the 2013 period including a \$16.1 million gain related to the sale of a non-operating asset, offset by year-over-year improvement on foreign currency gains/(losses).

#### Income Taxes

The effective tax rate for the three months ended June 30, 2014 was 24.6% compared with 27.3% for the three months ended June 30, 2013. Excluding the impact of taxes related to restructuring and other charges in the current quarter, and the tax charge related to the sale of a non-operating asset in the prior year quarter, the second quarter 2014 adjusted effective tax rate was 24.9%, or 160 basis points lower than the second quarter 2013 adjusted effective tax rate of 26.5%. The decrease in the adjusted effective tax rate was primarily driven by higher earnings from low tax jurisdictions and the effect of favorable tax settlements, which were partially offset by higher repatriation costs.

#### FIRST SIX MONTHS OF 2014 IN COMPARISON TO FIRST SIX MONTHS OF 2013

##### Sales

Sales for the first six months of 2014 totaled \$1.6 billion, an increase of 5% from the prior year quarter for both reported and LC sales (including 1% growth from the acquisition of Aromor), as a result of new wins in both Flavors and Fragrance Compounds and strong Fragrance Ingredients LC sales. Overall LC growth was driven by 6% growth in emerging markets.

##### Flavors Business Unit

Flavors sales increased 2% for the first six months of 2014 compared to the 2013 period. Excluding the impact of foreign currency, LC sales for the Flavors business increased 3% during the first six month of 2014 compared to the 2013 period. The overall increase was driven by new wins and favorable sales mix. On an end-use product category basis, LC growth was led by mid single-digit growth in Beverage followed by low single-digit growth in Savory and Dairy. The Flavors business delivered LC growth in LA, GA and EAME, led by LA. Sales in LA were driven by high double-digit gains in Beverage. Sales in GA were driven by mid single-digit growth in Savory and Dairy and low single-digit growth in Sweet. Sales in EAME were driven by mid single-digit gains in Beverage and Dairy. Sales declines in NOAM were primarily driven by high single-digit declines in Beverage due to higher erosion on existing business and low single-digit declines in Sweet, Savory and Dairy.

##### Fragrances Business Unit

The Fragrances business experienced a 8% increase for the first six months of 2014 compared to the 2013 period. Excluding the impact of foreign currency, LC sales for the Fragrances business increased 7% versus 5% growth in LC sales during the first six months of 2013. Our Fragrance Compounds and Fragrance Ingredients categories saw LC sales grow 5% and 21%, respectively, over the prior year period. Approximately 2% of the Fragrance business unit and 15% of the Ingredients business growth was associated with the acquisition of Aromor. Within Fragrance Compounds, sales were driven by mid to high single-digit growth in Fabric Care, Hair Care, and Fine Fragrances.



## Sales Performance by Region and Category

|       |                       | % Change in Sales-First Six Months 2014 vs. First Six Months 2013 |                        |             |             |         |       |
|-------|-----------------------|-------------------------------------------------------------------|------------------------|-------------|-------------|---------|-------|
|       |                       | Fine<br>Fragrances                                                | Consumer<br>Fragrances | Ingredients | Total Frag. | Flavors | Total |
| NOAM  | Reported              | 11                                                                | % 10                   | % 1         | % 8         | % -4    | % 1   |
| EAME  | Reported              | 10                                                                | % 2                    | % 40        | % 11        | % 5     | % 9   |
|       | Local Currency<br>(1) | 5                                                                 | % -2                   | % 35        | % 7         | % 3     | % 5   |
| LA    | Reported              | -6                                                                | % -1                   | % -5        | % -3        | % 15    | % 3   |
|       | Local Currency<br>(1) | -2                                                                | % 0                    | % -5        | % -1        | % 19    | % 5   |
| GA    | Reported              | 4                                                                 | % 10                   | % 50        | % 14        | % -1    | % 5   |
|       | Local Currency<br>(1) | 4                                                                 | % 12                   | % 53        | % 16        | % 4     | % 8   |
| Total | Reported              | 6                                                                 | % 5                    | % 23        | % 8         | % 2     | % 5   |
|       | Local Currency<br>(1) | 5                                                                 | % 5                    | % 21        | % 7         | % 3     | % 5   |

(1) Local currency sales growth is calculated by translating prior year sales at the exchange rates for the corresponding 2014 period.

NOAM Flavors sales declined 4% as a result of high single-digit declines in Beverage due to higher erosion on existing business and low single-digit declines in Sweet and Savory. NOAM Fragrance sales grew 8% in the first six months of 2014, principally due to high double-digit gains in Home Care as well as double-digit gains in Fine Fragrance and Personal Wash and Hair Care categories.

EAME Flavors LC sales growth of 3% was led by mid single-digit growth in Beverage and Dairy. EAME Fragrance LC sales increased 7% overall, driven mainly by double-digit growth in Fragrance Ingredients as well as mid single-digit growth in Fine Fragrance, partially offset by declines in Home Care.

LA Flavors LC sales were up 19% as new wins drove high double-digit gains in Beverage, which were only partially offset by single-digit declines in Sweet. LA Fragrances LC sales decline of 1% was driven by double-digit sales growth in Hair Care, which was more than offset by double-digit declines in Home Care and Fragrance Ingredients. GA Flavors had 4% LC sales growth from mid single-digit gains in Savory, Sweet and Dairy. GA Fragrances had 16% LC growth from high double-digit growth in Fragrance Ingredients and Fabric Care as well as high single-digit growth in Personal Wash and Toiletries.

#### Cost of Goods Sold

Cost of goods sold, as a percentage of sales, decreased 110 bps to 55.5% in the first six months of 2014 compared to 56.6% in the first six months of 2013. The improvement versus last year was mainly driven by favorable net impact of input costs to pricing and other operational improvement initiatives on a year-over-year basis.

#### Research and Development (R&D) Expenses

Overall R&D expenses remained relatively consistent with prior year at 8.2% of sales in the first six months of 2014 compared to 8.3% in the first six months of 2013.

#### Selling and Administrative (S&A) Expenses

S&A expenses increased \$17.2 million or 16.5%, as a percentage of sales, in the first six months of 2014 versus 16.1% in the first six months of 2013. The \$17.2 million increase reflects the inclusion of Aromor-related expenses, investment in commercial resources to support our three-pillar strategy, currency impacts and several discrete items in 2014 that were partially offset by lower incentive compensation accruals.

#### Operating Results by Business Unit

We evaluate the performance of business units based on segment profit which is defined as operating profit before Restructuring, global expenses (as discussed in Note 8 to our Consolidated Financial Statements) and certain non-recurring items, Interest expense, Other income, net and Taxes on income. See Note 8 to our Consolidated Financial Statements for the reconciliation to Income before taxes.

| (DOLLARS IN THOUSANDS)                   | Six Months Ended June 30, |      |           |   |
|------------------------------------------|---------------------------|------|-----------|---|
|                                          | 2014                      | 2013 |           |   |
| Segment profit:                          |                           |      |           |   |
| Flavors                                  | \$178,869                 |      | \$172,955 |   |
| Fragrances                               | 172,638                   |      | 140,270   |   |
| Global                                   | (36,303)                  | )    | (29,761)  | ) |
| Restructuring and other charges, net     | (304)                     | )    | (2,105)   | ) |
| Operational improvement initiative costs | (5,732)                   | )    | (1,360)   | ) |
| Operating profit                         | \$309,168                 |      | \$279,999 |   |
| Profit margin                            |                           |      |           |   |
| Flavors                                  | 24.1                      | %    | 23.7      | % |
| Fragrances                               | 21.1                      | %    | 18.6      | % |
| Consolidated                             | 19.8                      | %    | 18.8      | % |

#### Flavors Segment Profit

Flavors segment profit grew approximately 3% to \$178.9 million in the first six months of 2014, or 24.1% as a percentage of sales, compared to \$173.0 million, or 23.7% as a percentage of sales, in the comparable 2013 period. The improvement in segment profit and profit margin was driven primarily by lower incentive compensation expense.

#### Fragrances Segment Profit

Fragrances segment profit grew approximately 23% to \$172.6 million in the first six months of 2014, or 21.1% as a percentage of sales, compared to \$140.3 million, or 18.6% as a percentage of sales, in the comparable 2013 period. The improvement in segment profit and profit margin was due to gross margin expansion.

#### Global Expenses

Global expenses represent corporate and headquarters-related expenses which include legal, finance, human resources and R&D and other administrative expenses that are not allocated to an individual business unit. In the first six months of 2014, Global expenses were \$36.3 million compared to \$29.8 million during the first six months of 2013. The increase primarily reflects unfavorable impacts on our cash flow hedging program.

#### Restructuring and Other Charges, Net

Restructuring and other charges, net in 2014 consist of separation costs for employees, including severance, outplacement and other benefit costs, relating to the Fragrance Ingredients Rationalization that started in the second quarter of 2013 related to the closing of the fragrance ingredients manufacturing facility in Augusta, Georgia. The facility was closed during the third quarter of 2014. During the first six months of 2014, the Company recorded \$0.2 million of plant shutdown and other related costs and \$0.1 million of severance costs included in Restructuring and other charges, net and \$5.1 million of non-cash charges related to accelerated depreciation included in Cost of goods sold. As a result of this closure, 43 positions have been or will be eliminated. The Company estimates that approximately \$5 - \$7 million of the costs will be or have been cash expenditures.

#### Interest Expense

Interest expense decreased \$0.9 million to \$23.1 million in the first six months of 2014 compared to the first six months of 2013. The decrease in interest expense principally reflects the refinancing of the Company's debt in 2013. Average cost of debt was 4.9% for the 2014 six month period compared to 4.7% in the 2013 six month period.

#### Other Income, Net

Other income, net decreased by approximately \$9.1 million to \$3.2 million of income in the first six months of 2014 versus \$12.3 million of income in the comparable 2013 period. The decrease over the prior year period is driven largely by the 2013 period including a \$16.1 million gain related to the sale of a non-operating asset, offset by year-over-year improvement on foreign currency gains/(losses).

#### Income Taxes

The effective tax rate for the six months ended June 30, 2014 was 25.0% compared with 28.0% for the six months ended June 30, 2013. The year-over-year decrease is primarily due to a benefit from a litigation ruling during the second quarter of 2014 as well as favorable mix of earnings and a \$6.2 million after-tax Spanish tax charge that was recorded in the first quarter of 2013, which were only partially offset by higher repatriation costs and the absence of the U.S. R&D tax credit in 2014. Excluding the impact of taxes related to restructuring and other charges in the current quarter, and the tax charge related to the sale of a non-operating asset in the prior year quarter, the adjusted effective tax rate was 25.2% for both 2014 and 2013.

#### Liquidity and Capital Resources

##### CASH AND CASH EQUIVALENTS

We had cash and cash equivalents of \$326.9 million at June 30, 2014 compared to \$405.5 million at December 31, 2013, of which \$239.2 million of the balance at June 30, 2014 was held outside the United States. Cash balances held in foreign jurisdictions are, in most circumstances, available to be repatriated to the United States; however, they would be subject to United States federal income taxes, less applicable foreign tax credits. We have not provided U.S. income tax expense on accumulated earnings of our foreign subsidiaries because we have the ability and plan to reinvest the undistributed earnings indefinitely.

Effective utilization of the cash generated by our international operations is a critical component of our tax strategy. Strategic dividend repatriation from foreign subsidiaries creates U.S. taxable income, which enables us to realize deferred tax assets. The Company regularly repatriates, in the form of dividends from its non-U.S. subsidiaries, a portion of its current year earnings to fund financial obligations in the U.S.

##### CASH FLOWS FROM OPERATING ACTIVITIES

Operating cash flows in the first six months of 2014 were \$154.0 million compared to \$118.0 million in the first six months of 2013. The increase in operating cash flows for the first six months of 2014 compared to 2013 reflect increased net income (\$24 million) offset by an increase in net cash outflow associated with our core working capital (trade receivables plus inventories, less accounts payable) (\$23.0 million). Additionally, operating cash flows versus the prior year period also reflect incremental year-over-year incentive compensation payments of \$31.9 million in 2014; a \$11.2 million payment in 2014 made to the Spanish tax authorities for a capital tax claim as discussed in Note 12 to the Consolidated Financial Statements partially offset by a \$30.0 million pension contribution in the first quarter of 2013 and a \$23.3 million payment related to the 2002-2003 Spanish tax cases during the second quarter of 2013. Working capital (current assets less current liabilities) totaled \$1,175.4 million at June 30, 2014, compared to \$1,092.5 million at December 31, 2013. The increase in working capital reflects strong cash generation partially offset by certain payments, principally for the Aromor acquisition, dividends and incentive compensation. We selectively participate in programs offered by certain of our global customers. When participating in these programs, we accelerate the receipt of cash by selling the selected accounts receivable positions with these customers, on a non-recourse basis, at a discount to designated third party banks. The cost of participating in these programs was immaterial to our results in all periods.

##### CASH FLOWS USED IN INVESTING ACTIVITIES

Net investing activities during the first six months of 2014 utilized \$143.4 million compared to \$42.8 million in the prior year period.

The Company paid \$102.5 million (net of \$0.1 million of cash acquired) for the acquisition of Aromor, which was funded from existing cash resources.

Additions to property, plant and equipment were \$60.2 million during the first six months of 2014 compared to \$60.7 million in the first six months of 2013. We expect additions to property, plant and equipment to approach 4-5% of our sales in 2014.

##### CASH FLOWS USED IN FINANCING ACTIVITIES

Net financing activities in the first six months of 2014 used \$89.6 million compared to \$27.2 million in the first six months of 2013. The increase in cash used for financing activities principally reflects two dividend payments during

2014 compared to one dividend payment during 2013 (there was no dividend payment made during the first quarter of 2013 as payment was made during the fourth quarter of 2012) as well as increased treasury stock purchases in 2014 as compared to 2013.

At June 30, 2014, we had \$935.7 million of debt outstanding compared to \$932.8 million outstanding at December 31, 2013.

We paid dividends totaling \$63.4 million in the 2014 period. We declared a cash dividend per share of \$0.39 in the second quarter of 2014 that was paid on July 8, 2014 to all shareholders of record as of June 26, 2014. We authorized a cash dividend of \$0.47 in the third quarter of 2014 that will be paid on October 7, 2014 to all shareholders of record as of September 25, 2014.

In December 2012, the Board of Directors authorized a \$250 million share repurchase program, which commenced in the first quarter of 2013. Based on the total remaining amount of \$164.0 million available under the repurchase program, approximately 1.6 million shares, or 2.0% of shares outstanding (based on the market price and shares outstanding as of June 30, 2014) could be repurchased under the program as of June 30, 2014. The purchases will be made from time to time on the open market or through private transactions as market and business conditions warrant. Repurchased shares will be placed into treasury stock. During the three months ended June 30, 2014, we repurchased 144,057 shares on the open market at an aggregate cost of \$14.0 million or an average of \$97.05 per share. We expect total purchases during 2014 to increase over the 2013 purchases of \$51 million. The ultimate level of purchases will be a function of the daily purchase limits established in the pre-approved program according to the share price at that time.

#### CAPITAL RESOURCES

Operating cash flow provides the primary source of funds for capital investment needs, dividends paid to shareholders and debt repayments. We anticipate that cash flows from operations and availability under our existing credit facilities are sufficient to meet our investing and financing needs for at least the next eighteen months. We regularly assess our capital structure, including both current and long-term debt instruments, as compared to our cash generation and investment needs in order to provide ample flexibility and to optimize our leverage ratios. We believe our existing cash balances are sufficient to meet our debt service requirements.

We supplement short-term liquidity with access to capital markets, mainly through bank credit facilities and issuance of commercial paper. We did not issue commercial paper during the first six months of 2014 or 2013.

On April 4, 2014, the Company and certain of its subsidiaries amended and restated the Company's existing credit agreement with Citibank, N.A., as administrative agent, to, among other things (i) modify the available tranches of the revolving loan facility provided under the credit agreement (as amended, the "Credit Facility"), (ii) reduce the applicable margin on the interest rate on advances under the Credit Facility to a range of 0.0% to 0.750% for base rate advances and 0.750% to 1.750% for Eurocurrency rate advances, depending on the Company's public debt rating and (iii) extend the maturity date of the Credit Facility until April 4, 2019. Tranche A of the Credit Facility is available to borrowers in U.S. dollars, euros, Swiss francs, Japanese yen and British sterling in an aggregate amount up to an equivalent of approximately \$456 million, with a sublimit of \$25 million for swing line borrowings. Tranche B of the Credit Facility is available to borrowers in euros, Swiss francs, Japanese yen and British sterling in an aggregate amount up to an equivalent of approximately \$494 million.

Although we have appealed the lower court ruling on our Spanish capital tax case, we made payment of \$11.2 million (representing the principal amount) to the Spanish government relating to the case during the first quarter of 2014, which will be refundable if we prevail on our appeal.

We expect to contribute approximately \$21 million to our non-U.S. pension plans and approximately \$20 million to its qualified U.S. pension plans during 2014. For the six months ended June 30, 2014, we have contributed \$9.8 million related to our non-U.S. pension plans and \$2.1 million related to our U.S. pension plans.

Under our revolving credit facility, we are required to maintain, at the end of each fiscal quarter, a ratio of net debt for borrowed money to adjusted EBITDA in respect of the previous 12-month period of not more than 3.25 to 1. Based on this ratio, at June 30, 2014 our covenant compliance provided overall borrowing capacity of \$1,580 million.

As of June 30, 2014 we had no borrowings under our revolving credit facility. The amount which we are able to draw down on under the facility is limited by financial covenants as described in more detail below. Our drawdown capacity on the facility was \$949.0 million at June 30, 2014.

At June 30, 2014, we were in compliance with all financial and other covenants, including the net debt to adjusted EBITDA ratio. At June 30, 2014 our Net Debt/adjusted EBITDA <sup>(1)</sup> ratio was 0.90 to 1 as defined by the debt

agreements, well below the financial covenants of existing outstanding debt. Failure to comply with the financial and other covenants under our debt agreements would constitute default and would allow the lenders to accelerate the maturity of all indebtedness under the related agreement. If such acceleration were to occur, we would not have sufficient liquidity available to repay the indebtedness. We would likely have to seek amendments under the agreements for relief from the financial covenants or repay

the debt with proceeds from the issuance of new debt or equity, and/or asset sales, if necessary. We may be unable to amend the agreements or raise sufficient capital to repay such obligations in the event the maturities are accelerated.

Adjusted EBITDA and Net Debt, which are non-GAAP measures used for these covenants, are calculated in accordance with the definition in the debt agreements. In this context, these measures are used solely to provide (1) information on the extent to which we are in compliance with debt covenants and may not be comparable to adjusted EBITDA and Net Debt used by other companies. Reconciliations of adjusted EBITDA to net income and net debt to total debt are as follows:

| (DOLLARS IN MILLIONS)          | Twelve Months Ended June 30, |         |
|--------------------------------|------------------------------|---------|
|                                | 2014                         | 2013    |
| Net income                     | \$377.5                      | \$277.4 |
| Interest expense               | 45.8                         | 44.5    |
| Income taxes                   | 128.8                        | 201.3   |
| Depreciation and amortization  | 95.9                         | 98.8    |
| Specified items <sup>(1)</sup> | 0.4                          | 2.1     |
| Non-cash items <sup>(2)</sup>  | 23.1                         | 4.9     |
| Adjusted EBITDA                | \$671.5                      | \$629.0 |

(1) Specified items for the 12 months ended June 30, 2014 of \$0.4 million consist of restructuring charges.

Non-cash items, defined as part of Adjusted EBITDA in the terms of the Company's credit facility agreement dated November 9, 2011, represent all other adjustments to reconcile net income to net cash provided by operations as (2) presented on the Statement of Cash Flows, including gain on disposal of assets, stock-based compensation and pension settlement/curtailment.

| (DOLLARS IN MILLIONS)                | June 30, |           |
|--------------------------------------|----------|-----------|
|                                      | 2014     | 2013      |
| Total debt                           | \$935.7  | \$1,033.0 |
| Adjustments:                         |          |           |
| Deferred gain on interest rate swaps | (6.1)    | (8.1)     |
| Cash and cash equivalents            | (326.9)  | (365.9)   |
| Net debt                             | \$602.7  | \$659.0   |

As discussed in Note 12 to the Consolidated Financial Statements, at June 30, 2014, we had entered into various guarantees and had undrawn outstanding letters of credit from financial institutions. These arrangements reflect ongoing business operations, including commercial commitments, and governmental requirements associated with audits or litigation that are in process with various jurisdictions. Based on the current facts and circumstances they are not reasonably likely to have a material impact on our consolidated financial condition, results of operations, or cash flows.

As discussed in Notes 6 and 12 to the Consolidated Financial Statements, we had Euro 9.6 million (\$13.2 million) in bank guarantees outstanding as of June 30, 2014 related to the tax disputes in Spain. These amounts will be reduced once we make the remaining payments pursuant to the settlement agreement and the dividend withholding tax cases.

#### Cautionary Statement Under the Private Securities Litigation Reform Act of 1995

This Quarterly Report includes "forward-looking statements" under the Federal Private Securities Litigation Reform Act of 1995, including statements regarding the Company's expectations concerning (i) our ability to meet long-term strategic targets in 2014, (ii) our competitive position in the market and financial performance in 2014, (iii) expected cost pressures in 2014, (iv) our ability to increase gross margins in 2014, (v) funding of investments in R&D, emerging markets and technologies, (vi) capital spending in 2014, (vii) cash flows to fund future operations and to meet debt service requirements, (viii) costs and expenditures associated with the closing of our Augusta facility, and (ix) the ultimate resolution of pending tax matters with the Spanish and Brazilian tax authorities. These forward-looking statements should be evaluated with consideration given to the many risks and uncertainties inherent

in the Company's business that could cause actual results and events to differ materially from those in the forward-looking statements. Certain of such forward-looking information may be identified by such terms as "expect," "anticipate," "believe," "outlook," "may," "estimate," "should" and "predict" similar terms or variations thereof. Such forward-looking statements are based on a series of expectations, assumptions, estimates and projections about the Company, are not guarantees of future results or performance, and involve significant risks, uncertainties and other factors, including assumptions and projections, for all forward periods. Actual results of the Company may differ

materially from any future results expressed or implied by such forward-looking statements. Such factors include, among others, the following:

- volatility and increases in the price of raw materials, energy and transportation;
- the economic climate for the Company's industry and demand for the Company's products;
- the ability of the Company to successfully implement its strategic plan and meet its long-term financial goals;
- fluctuations in the price, quality and availability of raw materials;
- the Company's ability to successfully integrate Aromor and realize the anticipated benefits of the Aromor acquisition on a timely basis, or at all;
- decline in consumer confidence and spending;
- changes in consumer preferences;
- the Company's ability to predict the short and long-term effects of global economic conditions;
- movements in interest rates;
- the Company's ability to implement its business strategy, including the achievement of anticipated cost savings, profitability, realization of price increases and growth targets;
- the Company's ability to benefit from its investments in emerging markets;
- the Company's ability to successfully develop new and competitive products that appeal to its customers and consumers;
- the effects of any unanticipated costs and construction or start-up delays in the expansion of any of the Company's facilities;
- the impact of currency fluctuations or devaluations in the Company's principal foreign markets;
- any adverse impact on the availability, effectiveness and cost of the Company's hedging and risk management strategies;
- uncertainties regarding the outcome of, or funding requirements, related to litigation or settlement of pending litigation, uncertain tax positions or other contingencies;
- the impact of possible pension funding obligations and increased pension expense, particularly as a result of changes in asset returns or discount rates, on the Company's cash flow and results of operations;
- the Company's ability to implement its Fragrance Ingredients Rationalization plan, including the achievement of anticipated cost savings;
- the effect of legal and regulatory proceedings, as well as restrictions imposed on the Company, its operations or its representatives by U.S. and foreign governments;
- adverse changes in federal, state, local and foreign tax legislation or adverse results of tax audits, assessments, or disputes;
- the Company's ability to attract and retain talented employees;
- the direct and indirect costs and other financial impact that may result from any business disruptions due to political instability, armed hostilities, incidents of terrorism, natural disasters, or the responses to or repercussion from any of these or similar events or conditions;
- the Company's ability to quickly and effectively implement its disaster recovery and crisis management plans; and
- adverse changes due to accounting rules or regulations.

New risks emerge from time to time and it is not possible for management to predict all such risk factors or to assess the impact of such risks on the Company's business. Accordingly, the Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Any public statements or disclosures by the Company following this report that modify or impact any of the forward-looking statements contained in or accompanying this report will be deemed to modify or supersede such outlook or other forward-looking statements in or accompanying this report.

The foregoing list of important factors does not include all such factors, nor necessarily present them in order of importance. In addition, you should consult other disclosures made by the Company (such as in our other filings with the SEC or in company press releases) for other factors that may cause actual results to differ materially from those

projected by the Company. Please refer to Part I. Item 1A., Risk Factors, of the 2013 Form 10-K for additional information regarding factors that could affect the Company's results of operations, financial condition and cash flow.

**Non-GAAP Financial Measures**

The Company uses non-GAAP financial operating measures in this Quarterly Report, including: (i) local currency sales (which eliminates the effects that result from translating its international sales in U.S. dollars), (ii) adjusted operating profit and adjusted operating profit margin (which excludes the operational improvement initiative and restructuring charges), (iii)

adjusted other income, net (which excludes the sale of a non-operating asset) and (iv) adjusted effective tax rate (which excludes restructuring charges and operational improvement initiative costs). The Company also provides the non-GAAP measures adjusted EBITDA (which excludes certain specified items and non-cash items as set forth in the Company's debt agreements) and net debt (which is adjusted for deferred gain on interest rate swaps and cash and cash equivalents) solely for the purpose of providing information on the extent to which the Company is in compliance with debt covenants contained in its debt agreements.

We have included each of these non-GAAP measures in order to provide additional information regarding our underlying operating results and comparable year-over-year performance. Such information is supplemental to information presented in accordance with GAAP and is not intended to represent a presentation in accordance with GAAP. In discussing our historical and expected future results and financial condition, we believe it is meaningful for investors to be made aware of and to be assisted in a better understanding of, on a period-to-period comparable basis, financial amounts both including and excluding these identified items, as well as the impact of exchange rate fluctuations. We believe such additional non-GAAP information provides investors with an overall perspective of the period-to-period performance of our business. In addition, management internally reviews each of these non-GAAP measures to evaluate performance on a comparative period-to-period basis in terms of absolute performance, trends and expected future performance with respect to our business. A material limitation of these non-GAAP measures is that such measures do not reflect actual GAAP amounts; for example, costs associated with operational improvements and restructuring activities involve actual cash outlays. We compensate for such limitations by using these measures as one of several metrics, including GAAP measures. These non-GAAP measures may not be comparable to similarly titled measures used by other companies.

#### Item 3. Quantitative and Qualitative Disclosures about Market Risk

There are no material changes in market risk from the information provided in the Company's 2013 Annual Report on Form 10-K.

#### Item 4. Controls and Procedures

The Chief Executive Officer and Chief Financial Officer with the assistance of other members of our management, have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

We have established controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and is accumulated and communicated to management, including the principal executive officer and the principal financial officer, to allow timely decisions regarding required disclosure.

The Chief Executive Officer and Chief Financial Officer have also concluded that there have not been any changes in our internal control over financial reporting during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### Item 5. Other Information

As previously disclosed in our Current Report on Form 8-K filed on May 28, 2014 (the "May 28 Form 8-K"), Andreas Fibig will assume the position of Chief Executive Officer of International Flavors & Fragrances Inc. (the "Company") effective September 1, 2014. On July 31, 2014, our Board of Directors determined that the value of the 2014 Equity Choice Program award provided for in the letter agreement filed with the May 28 Form 8-K would be \$750,000 and that the award would vest in accordance with the standard vesting schedule for Equity Choice Program awards granted in March 2014 as described in the Company's Definitive Proxy Statement filed with the SEC on March 25, 2014. Our Board of Directors also confirmed that Mr. Fibig's \$500,000 sign-on equity award under the Equity Choice Program will vest in April 2015, concurrently with the vesting of the Company's other Equity Choice Program awards. In addition, our Board of Directors has determined that upon Mr. Tough's stepping down as the Company's Chief Executive Officer on September 1, 2014, he will continue as an employee of the Company during a transition period through December 1, 2014, will receive his current salary, benefits and perquisites and be entitled to participate in the

Company's AIP and LTIP for 2014 on a pro rata basis through such date, and will receive his December salary as a lump sum of \$100,000 on December 1, 2014.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

We are subject to various claims and legal actions in the ordinary course of our business.

#### Tax Claims

We are currently involved in a legal proceeding with the Spanish tax authorities that challenges tax deductions taken in our Spanish subsidiaries' tax returns and alleges claims of tax avoidance. As of June 30, 2014, the Company had one outstanding income tax case in Spain relating to fiscal year 2002. The Company has fully reserved the assessment originally asserted by the Spanish tax authority. The Company is awaiting a decision on its appeal and in order to proceed with the appeal, the Company was required to post a bank guaranty. As of June 30, 2014, the Company had a remaining posted bank guaranty of Euro 1.8 million (\$2.5 million) associated with the 2002 appeal.

The Spanish tax authorities have also alleged claims related to capital tax positions arising from the business structure adopted by our Spanish subsidiaries. During the fourth quarter of 2013, the Company was notified that the Spanish High Court of Justice ruled against us in regards to the 2002 capital tax case. As a result, the Company recorded a charge of Euro 9.6 million (\$13.0 million, or \$9.1 million, after tax) for the year ended December 31, 2013. On January 22, 2014, we filed an appeal. In order to avoid future interest costs in the event our appeal is unsuccessful, we paid \$11.2 million (representing the principal amount) during the first quarter of 2014. Such amount will be refundable if we prevail in our appeal.

In addition to the above, the Company has also been a party to dividend withholding tax controversies in Spain. At June 30, 2014, the Company had Euro 4.6 million (\$6.2 million) reflected in income taxes payable in connection with three of these cases. The fourth and final remaining appeal has not yet been heard by the Spanish Supreme Court, with an aggregate value of Euro 3.2 million (\$4.5 million), including estimated interest, which is fully reserved as of June 30, 2014. As of June 30, 2014, the Company had posted bank guarantees of Euro 7.8 million (\$10.7 million) in order to proceed with the appeal in this controversy.

We do not currently believe that any of our pending tax assessments, even if ultimately resolved against us, would have a material impact on our financial condition.

#### Environmental

Over the past 20 years, various federal and state authorities and private parties have claimed that we are a Potentially Responsible Party ("PRP") as a generator of waste materials for alleged pollution at a number of waste sites operated by third parties located principally in New Jersey and have sought to recover costs incurred and to be incurred to clean up the sites.

We have been identified as a PRP at eight facilities operated by third parties at which investigation and/or remediation activities may be ongoing. We analyze our potential liability on at least a quarterly basis. We accrue for environmental liabilities when they are probable and estimable. We estimate our share of the total future cost for these sites to be less than \$5 million.

While joint and several liability is authorized under federal and state environmental laws, we believe the amounts we have paid and anticipate paying in the future for clean-up costs and damages at all sites are not material and will not have a material adverse effect on our financial condition, results of operations or liquidity. This assessment is based upon, among other things, the involvement of other PRPs at most of the sites, the status of the proceedings, including various settlement agreements and consent decrees, and the extended time period over which payments will likely be made. There can be no assurance, however, that future events will not require us to materially increase the amounts we anticipate paying for clean-up costs and damages at these sites, and that such increased amounts will not have a material adverse effect on our financial condition, results of operations or cash flows.

#### Other

In March 2012, ZoomEssence, Inc. filed a complaint against the Company in the U.S. District Court of New Jersey alleging trade secret misappropriation, breach of contract and unjust enrichment in connection with certain spray dry technology disclosed to the Company. In connection with the claims, ZoomEssence is seeking an injunction and monetary damages. ZoomEssence initially sought a temporary restraining order and preliminary injunction, but the

Court denied these applications in an order entered on September 27, 2013, finding that ZoomEssence had not demonstrated a likelihood of success on the merits of its claims. The Court subsequently referred the matter to mediation, however the private mediation session did not result in a resolution of the dispute. The case is currently proceeding through general discovery with a trial on

the merits anticipated in mid-2015. The Company denies the allegations and will vigorously defend its position in Court. At this preliminary stage of the litigation, based on the information currently available to the Company, management does not believe that this matter represents a material loss contingency.

We are also a party to other litigations arising in the ordinary course of our business. We do not expect the outcome of these cases, singly or in the aggregate, to have a material effect on our consolidated financial condition.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

### (c) Issuer Purchases of Equity Securities

The table below reflects shares of common stock we repurchased during the second quarter of 2014.

| Period             | Total Number of<br>Shares<br>Repurchased <sup>(1)</sup> | Average<br>Price Paid<br>per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Program | Approximate Dollar Value<br>of Shares That May Yet<br>be Purchased Under the<br>Program |
|--------------------|---------------------------------------------------------|------------------------------------|---------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------|
| April 1 - 30, 2014 | 51,593                                                  | \$94.19                            | 51,593                                                                          | \$ 173,154,863                                                                          |
| May 1 - 31, 2014   | 51,331                                                  | 97.41                              | 51,331                                                                          | 168,154,818                                                                             |
| June 1 - 30, 2014  | 41,133                                                  | 100.19                             | 41,133                                                                          | 164,033,642                                                                             |
| Total              | 144,057                                                 | \$97.05                            | 144,057                                                                         | \$ 164,033,642                                                                          |

Shares were repurchased pursuant to the repurchase program announced in December 2012, with repurchases beginning in the first quarter of 2013. Repurchases under the program are limited to \$250 million in total repurchase price, and the expiration date is December 31, 2016. Authorization of the repurchase program may be modified, suspended, or discontinued at any time.

## Item 6. Exhibits

|         |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|---------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1    | Credit Agreement, dated as of November 9, 2011, Amended and Restated as of April 4, 2014, among International Flavors & Fragrances Inc., International Flavors & Fragrances (Luxembourg) S.à r.l., International Flavors & Fragrances (Nederland) Holding B.V., International Flavors & Fragrances I.F.F. (Nederland) B.V., IFF Worldwide (Gibraltar) Limited and IFF Aroma Esans Sanayi Ve Ticaret Anonim Sirketi, as borrowers, the banks, financial institutions and other institutional lenders party thereto, and Citibank, N.A. as administrative agent, incorporated by reference to Exhibit 10.1 to Registrant's Report on Form 8-K filed on April 8, 2014. |
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| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTERNATIONAL FLAVORS & FRAGRANCES INC.

Dated: August 5, 2014

By: /s/ Douglas D. Tough  
Douglas D. Tough  
Chairman of the Board and Chief Executive Officer

Dated: August 5, 2014

By: /s/ Kevin C. Berryman  
Kevin C. Berryman  
Executive Vice President and Chief Financial Officer

## EXHIBIT INDEX

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