Innophos Holdings, Inc.
Form 10-Q
August 01, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
OR
o 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 001-33124

INNOPHOS HOLDINGS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	20-1380758
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
259 Prospect Plains Road Cranbury, New Jersey	08512
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (609) 495-2495

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 x No o

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 x No o

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

Large Accelerated Filer	x	Accelerated Filer	o
Non-accelerated filer	o	(Do not check if a smaller reporting company)	
		Smaller reporting company	o
		Emerging growth company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

As of July 21, 2017, the registrant had 19,526,167 shares of common stock outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Unless the context requires otherwise, references to “Innophos,” “the Company,” “we,” “us” or “our” in this Quarterly Report o Form 10-Q refer to Innophos Holdings, Inc. and its consolidated subsidiaries.

This Quarterly Report on Form 10-Q contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve substantial risks and uncertainties. In some cases, you can identify forward-looking statements by the words “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “ “might,” “objective,” “ongoing,” “plan,” “predict,” “project,” “potential,” “should,” “will,” or “would,” and/or the negative of t or other comparable terminology intended to identify statements about the future. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from the information expressed or implied by these forward-looking statements.

Although we believe that we have a reasonable basis for each forward-looking statement contained in this Quarterly Report on Form 10-Q, we caution you that these statements are based on a combination of facts and factors currently known by us and our expectations of the future, about which we cannot be certain.

The forward-looking statements in this Quarterly Report on Form 10-Q may include, among other things, statements about our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, plans or intentions relating to acquisitions, the demand for our products and services, the markets in which we compete and other information that is not historical information

You should refer to “Part I, Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2016, filed with the Securities and Exchange Commission on February 28, 2017, for a discussion of important factors that may cause our actual results to differ materially from those expressed or implied by our forward-looking statements. As a result of these factors, we cannot assure you that the forward-looking statements in this Quarterly Report on Form 10-Q will prove to be accurate. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider any such list to be a complete discussion of all potential risks or uncertainties that may substantially impact our business. Moreover, we operate in a competitive and rapidly changing environment. New factors emerge from time to time and it is not possible to predict the impact of all of these factors on our business, financial condition or results of operations.

Furthermore, if our forward-looking statements prove to be inaccurate, the inaccuracy may be material. In light of the significant uncertainties in these forward-looking statements, you should not regard these statements as a representation or warranty by us or any other person that we will achieve our objectives and plans in any specified time frame or at all. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

You should read this Quarterly Report on Form 10-Q and any documents that we reference in this report completely and with the understanding that our actual future results may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
INNOPHOS HOLDINGS, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets (Unaudited)
(Dollars in thousands, except per share amounts, the number of shares or where otherwise noted)

	June 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$33,496	$ 53,487
Accounts receivable, net	85,493	77,692
Inventories	126,652	128,295
Other current assets	30,090	23,894
Total current assets	275,731	283,368
Property, plant and equipment, net	206,683	205,459
Goodwill	84,373	84,373
Intangibles and other assets, net	64,889	69,811
Total assets	$631,676	$ 643,011
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade and other	$45,458	$ 51,611
Other current liabilities	40,934	43,605
Total current liabilities	86,392	95,216
Long-term debt	180,000	185,000
Other long-term liabilities	14,139	15,569
Total liabilities	$280,531	$ 295,785
Commitments and contingencies (note 12)		
Common stock, par value $.001 per share; authorized 100,000,000; issued 22,857,178 and 22,777,690; outstanding 19,526,167 and 19,455,011 shares	20	19
Paid-in capital	136,015	134,694
Common stock held in treasury, at cost (3,331,011 and 3,322,679 shares)	(175,789)	(175,051)
Retained earnings	392,448	389,048
Accumulated other comprehensive loss	(1,549)	(1,484)
Total stockholders' equity	351,145	347,226
Total liabilities and stockholders' equity	$631,676	$ 643,011

See notes to condensed consolidated financial statements

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INNOPHOS HOLDINGS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income (Unaudited)
(Dollars in thousands, except per share amounts, the number of shares or where otherwise noted)

	Three months ended		Six months ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Net sales	$179,140	$181,888	$345,084	$371,518
Cost of goods sold	140,064	145,738	269,465	294,652
Gross profit	39,076	36,150	75,619	76,866
Operating expenses:				
Selling, general and administrative	19,867	15,732	39,175	33,967
Research & development expenses	818	1,021	1,648	2,017
Total operating expenses	20,685	16,753	40,823	35,984
Operating income	18,391	19,397	34,796	40,882
Interest expense, net	1,452	1,913	2,805	3,712
Foreign exchange (gain) loss	(78)	355	(135)	316
Income before income taxes	17,017	17,129	32,126	36,854
Provision for income taxes	5,794	5,025	9,980	11,908
Net income	$11,223	$12,104	$22,146	$24,946
Net income attributable to participating common shareholders	$11,154	$12,015	$22,027	$24,808
Per share data (note 2):				
Income per participating share:				
Basic	$0.58	$0.62	$1.14	$1.29
Diluted	$0.57	$0.61	$1.12	$1.27
Weighted average participating shares outstanding:				
Basic	19,396,531	19,241,074	19,386,533	19,235,360
Diluted	19,692,690	19,613,807	19,693,682	19,521,960
Other comprehensive (loss) income, net of tax:				
Change in interest rate swaps, (net of tax of $3, $50, ($53), and $269)	$(5)	$(80)	$87	$(438)
Change in pension and post-retirement plans, (net of tax of $58, ($16), $68, and $34)	(147)	52	(152)	(90)
Other comprehensive loss, net of tax	$(152)	$(28)	$(65)	$(528)
Comprehensive income	$11,071	$12,076	$22,081	$24,418

See notes to condensed consolidated financial statements

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INNOPHOS HOLDINGS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (Unaudited)
(Dollars in thousands)

	Six months ended	
	June 30, 2017	June 30, 2016
Cash flows provided from operating activities		
Net income	$22,146	$24,946
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	19,131	18,564
Amortization of deferred financing charges	215	337
Deferred income tax provision	14	363
Gain on sale of building	(153)	—
Share-based compensation	2,285	1,301
Changes in assets and liabilities:		
Increase in accounts receivable	(7,797)	(5,302)
Decrease in inventories	1,650	16,480
(Increase) decrease in other current assets	(5,975)	5,947
(Decrease) increase in accounts payable	(6,389)	2,328
Decrease in other current liabilities	(2,688)	(18,327)
Changes in other long-term assets and liabilities	(3,083)	(4,598)
Net cash provided from operating activities	19,356	42,039
Cash flows used for investing activities:		
Capital expenditures	(16,077)	(18,538)
Proceeds from sale of building	1,028	—
Net cash used for investing activities	(15,049)	(18,538)
Cash flows used for financing activities:		
Proceeds from exercise of stock options	—	9
Long-term debt borrowings	14,000	36,000
Long-term debt repayments	(19,000)	(19,002)
Excess tax deficiency from exercise of stock options	—	(331)
Restricted stock forfeitures	(738)	(318)
Dividends paid	(18,722)	(18,564)
Net cash used for financing activities	(24,460)	(2,206)
Effect of foreign exchange rate changes on cash and cash equivalents	162	12
Net change in cash	(19,991)	21,307
Cash and cash equivalents at beginning of period	53,487	17,905
Cash and cash equivalents at end of period	$33,496	$39,212

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INNOPHOS HOLDINGS, INC. AND SUBSIDIARIES
Statement of Stockholders' Equity (Unaudited)
(Dollars and shares in thousands)

	Number of Common Shares	Common Stock	Retained Earnings (Deficit)	Paid-in Capital / Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total Shareholders' Equity
Balance, December 31, 2015	19,290	$ 19	$ 378,321	$ (42,286)	$ (2,794)	$ 333,260
Net income			47,971			47,971
Other comprehensive income, (net of tax $(725))					1,310	1,310
Proceeds from stock award exercises and issuances	192			(1,428)		(1,428)
Share-based compensation				3,732		3,732
Excess tax deficiency from exercise of stock options				(9)		(9)
Restricted stock forfeitures	(27)			(366)		(366)
Dividends declared			(37,244)			(37,244)
Balance, December 31, 2016	19,455	$ 19	$ 389,048	$ (40,357)	$ (1,484)	$ 347,226
Net income			22,146			22,146
Other comprehensive loss, (net of tax $15)					(65)	(65)
Proceeds from stock award exercises and issuances	80	1		(964)		(963)
Share-based compensation				2,285		2,285
Restricted stock forfeitures	(9)			(738)		(738)
Dividends declared			(18,746)			(18,746)
Balance, June 30, 2017	19,526	$ 20	$ 392,448	$ (39,774)	$ (1,549)	$ 351,145

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INNOPHOS HOLDINGS, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Dollars in thousands, except per share amounts, the number of shares or where otherwise noted)

1. Basis of Statement Presentation
Summary of Significant Accounting Policies
The accompanying unaudited condensed consolidated financial statements of Innophos have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP) for interim financial reporting and do not include all disclosures required by US GAAP for annual financial reporting, and should be read in conjunction with the audited consolidated and combined financial statements of the Company at December 31, 2016 and for the three years then ended.
The accompanying unaudited condensed consolidated financial statements of the Company reflect all adjustments which management considers necessary for a fair statement of the results of operations for the interim periods and is subject to year-end adjustments. The results of operations for the interim periods are not necessarily indicative of the results for the full year. The December 31, 2016 condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by US GAAP.
Recently Issued Accounting Standards
Adopted
In July 2015, the FASB issued guidance which requires entities to measure most inventory “at the lower of cost and net realizable value (“NRV”),” thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. Under the new guidance, inventory is “measured at the lower of cost and net realizable value,” which eliminates the need to determine replacement cost and evaluate whether it is above the ceiling (NRV) or below the floor (NRV less a normal profit margin). The guidance defines NRV as the “estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.” The guidance is effective for annual periods beginning after December 15, 2016, and interim periods therein. Early application is permitted. The adoption of this standard did not have a material impact on our financial position, results of operations and related disclosures.
In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends Accounting Standards Codification ("ASC") Topic 718, Compensation - Stock Compensation. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years and early adoption is permitted. The adoption of this standard did not have a material impact on our financial position, results of operations and related disclosures.
In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. Under the new standard, goodwill impairment would be measured as the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying value of goodwill. This ASU eliminates existing guidance that requires an entity to determine goodwill impairment by calculating the implied fair value of goodwill by hypothetically assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted on testing dates after January 1, 2017. We have elected to early adopt for testing dates after January 1, 2017 and the adoption of this standard did not have a material impact on our financial position, results of operations and related disclosures.
Issued but not yet adopted
In May 2014, the FASB issued guidance on revenue from contracts with customers that will supersede most current revenue recognition guidance, including industry-specific guidance. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. Other major provisions include capitalization of certain contract

costs, consideration of time value of money in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. In July 2015, the FASB approved the deferral of the effective date of this guidance by one year (with an option to early adopt at the original effective date), making it effective for the interim and annual periods beginning on or after December 15, 2017. As a result, this guidance will be effective for the Company beginning in fiscal year 2018, with an option to early adopt in fiscal year 2017. The guidance permits the use of either a retrospective or modified retrospective transition method. We will adopt the standard using the modified retrospective transition method on January 1, 2018 and are currently evaluating the impact of the amended guidance on our consolidated financial position, results of operations and related disclosures. Our ongoing evaluation of the impact of the guidance includes the revenue recognition of certain free on board destination point sales across all of our businesses.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. We are currently in the process of evaluating the impact of adoption of the ASU on our financial position, results of operations and related disclosures.

In March 2016, the FASB issued ASU 2016-15, Clarification on Classification of Certain Cash Receipts and Cash Payments on the Statement of Cash Flows. ASU 2016-15 clarifies the classification of certain cash receipts and cash payments in the statement of cash flows, including debt prepayment or extinguishment costs, settlement of contingent consideration arising from a business combination, insurance settlement proceeds, and distributions from certain equity method investees. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. We are evaluating the impact of adopting this new accounting guidance on our consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory, which reduces the complexity in the accounting standards by allowing the recognition of current and deferred income taxes for an intra-entity asset transfer, other than inventory, when the transfer occurs. Historically, recognition of the income tax consequence was not recognized until the asset was sold to an outside party. This amendment should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. There are no new disclosure requirements. This ASU is effective for annual reporting periods beginning after December 15, 2017. Early adoption is permitted in the first interim period of 2017. The adoption of this guidance is not expected to have a significant effect on our financial position, results of operations and related disclosures.

In November 2016, the FASB issued ASU No. 2016-18, Restricted Cash, which clarifies guidance on the classification and presentation of restricted cash in the statement of cash flows. Under the ASU, changes in restricted cash and restricted cash equivalents would be included along with those of cash and cash equivalents in the statement of cash flows. As a result, entities would no longer present transfers between cash/equivalents and restricted cash/equivalents in the statement of cash flows. In addition, a reconciliation between the balance sheet and the statement of cash flows would be disclosed when the balance sheet includes more than one line item for cash/equivalents and restricted cash/equivalents. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. We do not anticipate the adoption of the new accounting rules will have a material impact on our financial position, results of operations and related disclosures.

In January 2017, the FASB issued ASU No. 2017-01, Clarifying the Definition of a Business, which narrows the existing definition of a business and provides a framework for evaluating whether a transaction should be accounted for as an acquisition (or disposal) of assets or a business. The ASU requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets; if so, the set of transferred assets and activities (collectively, the set) is not a business. To be considered a business, the set would need to include an input and a substantive process that together significantly contribute to the ability to create outputs. The standard also narrows the definition of outputs. The definition of a business affects areas of accounting such as acquisitions, disposals and goodwill. Under the new guidance, fewer acquired sets are expected to be considered businesses. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. We would apply this guidance to applicable transactions after the adoption date.

In March 2017, the FASB issued ASU No. 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires that only the service cost component of net periodic benefit costs be recorded as compensation cost in the operating expense section of the income statement. All other components of net periodic benefit cost (interest cost, expected return on plan assets and amortization of net loss) will be presented in other income - net. This standard update is effective beginning with the first quarter 2018 and must be applied retrospectively. We are evaluating the impact of adopting this new accounting guidance on our consolidated financial statements.

INNOPHOS HOLDINGS, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Dollars in thousands, except per share amounts, share amounts or where otherwise noted)

In May 2017, the FASB issued ASU No. 2017-09, Stock Compensation - Scope of Modification Accounting, which requires all modifications to be accounted for as a modification unless the fair value, vesting conditions and classification of the award as equity or liability are the same as the classification of the original award immediately before the original award is modified. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017 and for interim periods therein. The adoption of this guidance is not expected to have a significant effect on our financial position, results of operations and related disclosures.

2. Earnings per Share (EPS)
The Company accounts for earnings per share in accordance with ASC 260, which requires two calculations of earnings per share (EPS) to be disclosed: basic EPS and diluted EPS. Under ASC Subtopic 260-10-45, as of January 1, 2009 unvested awards of share-based payments with rights to receive dividends or dividend equivalents, such as our restricted stock, are considered participating securities for purposes of calculating EPS. Under the two-class method, a portion of net income is allocated to these participating securities and therefore is excluded from the calculation of EPS allocated to common stock, as shown in the table below.
The numerator for basic and diluted earnings per share is net earnings attributable to shareholders reduced by dividends attributable to unvested shares. The denominator for basic earnings per share is the weighted average number of common stock outstanding during the period. The denominator for diluted earnings per share is weighted average shares outstanding adjusted for the effect of dilutive outstanding stock options, performance share awards and restricted stock awards.
The following is a reconciliation of the weighted average basic number of common shares outstanding to the diluted number of common and common stock equivalent shares outstanding and the calculation of earnings per share using the two-class method:

	Three Months Ended		Six Months Ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Net income	$11,223	$ 12,104	$22,146	$ 24,946
Less: earnings attributable to unvested shares	(69)	(89)	(119)	(138)
Net income available to participating common shareholders	$11,154	$ 12,015	$22,027	$ 24,808
Weighted average number of participating common and potential common shares outstanding:				
Basic number of participating common shares outstanding	19,396,531	19,241,074	19,386,533	19,235,360
Dilutive effect of stock equivalents	296,159	372,733	307,149	286,600
Diluted number of weighted average participating common shares outstanding	19,692,690	19,613,807	19,693,682	19,521,960
Earnings per participating common share:				
Earnings per participating common share—Basic	$0.58	$ 0.62	$1.14	$ 1.29
Earnings per participating common share—Diluted	$0.57	$ 0.61	$1.12	$ 1.27
Total outstanding options, performance share awards and unvested restricted stock not included in the calculation of diluted earnings per share as the effect would be anti-dilutive	463,396	482,803	452,406	568,936

INNOPHOS HOLDINGS, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Dollars in thousands, except per share amounts, share amounts or where otherwise noted)

3. Dividends
The following is the dividend activity for the three and six months ended June 30, 2017 and June 30, 2016:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2017	2016	2017	2016
Dividends declared – per share	$0.48	$0.48	$0.96	$0.96
Dividends declared – aggregate	9,373	9,863	18,722	18,564
Dividends paid – per share	0.48	0.48	0.96	0.96
Dividends paid – aggregate	9,373	9,863	18,722	18,564

Innophos Holdings, Inc. is a holding company that does not conduct any business operations of its own. As a result, it is dependent upon cash dividends, distributions and other transfers from its subsidiaries, most directly Innophos, Inc., its primary operating subsidiary, and Innophos Investments Holdings, Inc., a direct, wholly-owned subsidiary of Innophos Holdings, Inc. and the parent of Innophos, Inc., to make dividend payments on its common stock.

4. Stockholders' Equity / Stock-Based Compensation
Restricted Stock
In April and May 2017, there were a total of 30,612 restricted shares granted to certain employees with a fair value of $1.6 million. These awards are classified as equity awards and vest annually over three years. The related compensation expense is based on the date of grant share prices of $52.51 and $48.42 for April and May, respectively. The compensation expense is amortized on a straight-line basis over the requisite vesting period and accelerated for those employees that are retirement eligible during the vesting period.
Stock Options
In April and May 2017, the Company granted a total of 102,607 non-qualified stock options at exercise prices of $52.51 and $48.42 for April and May, respectively, to certain employees with a fair value of $1.2 million. The non-qualified stock options vest annually over three years with April 3, 2027 and May 1, 2027 expiration dates.
The fair values of the options granted in 2017 were determined using the Black-Scholes option-pricing model. The blended assumptions used in the Black-Scholes option-pricing model were as follows for the April 3, 2017 and May 1, 2017 grants:

Non-qualified stock options		
Expected Volatility	31.3	%
Dividend Yield	3.6	%
Risk-free interest rate	2.09	%
Expected term (years)	6.6	
Weighted average grant date fair value of stock options	$11.54	

For the 2017 grants, the expected volatility and the expected term are based on the Company's historical data. The dividend yield is the expected annual dividend payments divided by the average stock price since announcement of the latest dividend change up to the date of grant. The risk-free interest rates are derived from the U.S. Treasury securities in effect on the date of grant whose maturity period equals the options expected term. The Company applies an expected forfeiture rate to stock-based compensation expense. The estimate of the forfeiture rate is based primarily upon historical experience of employee turnover. As actual forfeitures become known, stock-based compensation expense is adjusted accordingly.

INNOPHOS HOLDINGS, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Dollars in thousands, except per share amounts, share amounts or where otherwise noted)

Performance Share Awards

In April and May 2017, the Company granted 22,958 performance shares to certain employees with a fair value of $1.3 million. The performance shares vest at the end of the three year performance cycle and the number of shares distributable depends on the extent to which the Company attains pre-established performance goals. Amounts equivalent to declared dividends will accrue on the performance shares and will vest over the same period.

Stock Grants

In May 2017, the seven external members of the Board of Directors were granted a combined total of 13,916 shares of the Company's common stock with an aggregated fair value of approximately $0.6 million which immediately vested as part of their director fees.

The following table summarizes the components of stock-based compensation expense, all of which has been classified as selling, general and administrative expense:

	Three Months Ended		Six Months Ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Stock options	$299	$311	$604	$85
Restricted stock	472	510	912	340
Performance shares	167	(124)	139	281
Stock grants	630	595	630	595
Total share-based compensation expense (a)	$1,568	$1,292	$2,285	$1,301

(a) The six months ended June 30, 2016 includes a benefit of $524 for a change in estimate due to restructuring activities.

5. Inventories

Inventories consist of the following:

	June 30, 2017	December 31, 2016
Raw materials	$38,775	$ 33,185
Finished products	73,733	81,369
Spare parts	14,144	13,741
	$126,652	$ 128,295

Inventory reserves for excess quantities, obsolescence or shelf-life expiration as of June 30, 2017 and December 31, 2016 were $13,809 and $13,422, respectively.

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INNOPHOS HOLDINGS, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Dollars in thousands, except per share amounts, share amounts or where otherwise noted)

6. Other Current Assets
Other current assets consist of the following:

	June 30, 2017	December 31, 2016
Creditable taxes (value added taxes)	$7,899	$ 9,722
Vendor inventory deposits (prepaid)	15,195	3,750
Prepaid income taxes	3,954	4,659
Prepaid insurance	641	2,248
Other	2,401	3,515
	$30,090	$ 23,894

7. Intangibles and Other Assets, net
Intangibles and other assets consist of the following:

	Useful life (years)	June 30, 2017	December 31, 2016
Developed technology and application patents, net of accumulated amortization of $29,247 for 2017 and $27,778 for 2016	7-20	$17,028	$ 18,497
Customer relationships, net of accumulated amortization of $19,950 for 2017 and $18,569 for 2016	5-15	18,862	20,243
Trade names and license agreements, net of accumulated amortization of $11,000 for 2017 and $10,315 for 2016	5-20	6,661	7,346
Non-compete agreements, net of accumulated amortization of $1,280 for 2017 and $1,268 for 2016	3-10	53	65
Total intangibles		$42,604	$ 46,151
Deferred income taxes		$18,417	$ 18,432
Deferred financing costs, net of accumulated amortization of $3,687 for 2017 and $3,473 for 2016 (see note 9)		1,935	2,150
Other tax assets		—	997
Other assets		1,933	2,081
Total other assets		$22,285	$ 23,660
		$64,889	$ 69,811

8. Other Current Liabilities
Other current liabilities consist of the following:

	June 30, 2017	December 31, 2016
Payroll related	$11,163	$ 11,852
Taxes other than income taxes	2,590	2,624
Benefits and pensions	4,744	5,419
Freight and rebates	3,368	3,579
Income taxes	8,630	9,278

Restructuring and management transition reserve	2,926	4,737
Other	7,513	6,116
	$40,934	$ 43,605

(Dollars in thousands, except per share amounts, share amounts or where otherwise noted)

9. Short-Term Borrowings, Long-Term Debt, and Interest Expense

Short-term borrowings and long-term debt consist of the following:

	June 30, 2017	December 31, 2016
Revolver borrowings under the credit facility due 2022	$180,000	$ 185,000
Total borrowings	$180,000	$ 185,000
Less current portion	—	—
Long-term debt	$180,000	$ 185,000

The Company's credit facility includes a revolving line of credit from the lenders of up to $450.0 million, including a $20.0 million letter of credit sub-facility and a $20.0 million swingline loan facility, all maturing on December 22, 2022. The credit agreement governing this facility also provides for possible additional revolving indebtedness under an incremental facility of up to $150.0 million (for an aggregate of revolving capacity up to $600.0 million) upon future request by the Company to existing lenders (and depending on their consent) or from other willing financial institutions invited by the Company and reasonably acceptable to the administrative agent to join in the credit agreement. This revolving credit facility increase, if implemented, may provide for higher applicable margins to either the increased portion or possibly the entire revolving credit facility, with limitations, than those in effect for the original revolving commitments under the credit agreement.

As of June 30, 2017, $180.0 million was outstanding under the revolving line of credit, which approximates fair value (determined using level 2 inputs within the fair value hierarchy) with total availability at $269.0 million, taking into account $1.0 million in face amount of letters of credit issued under the sub-facility. The current weighted average interest rate for all debt is 2.8%.

Among its affirmative covenants, the credit agreement governing this credit facility requires the Company to maintain the following consolidated ratios (as defined and calculated according to the credit agreement) as of the end of each fiscal quarter:

(a) “Total Leverage Ratio” less than or equal to 3.50 to 1.00.

(b) “Interest Coverage Ratio” greater than or equal to 3.00 to 1.00.

As of June 30, 2017, the Company was in full compliance with all debt covenant requirements.

In December 2012, Innophos entered into an interest rate swap, swapping the LIBOR exposure on $100.0 million floating rate debt, which is currently outstanding under the credit agreement, to a fixed rate to maturity obligation of 0.9475% expiring in December 2017. This interest rate swap has been designated as a cashflow hedge (Level 2) with the changes in value recorded through other comprehensive income. The fair value of this interest rate swap of approximately $0.2 million is recorded in other long-term assets as of June 30, 2017. Based on $80.0 million outstanding borrowings as floating rate debt (amount not covered by the swap), an immediate increase of one percentage point would cause an increase to interest expense of approximately $0.8 million per year.

We manage our interest rate risk by balancing the amount of fixed-rate and floating-rate debt to the extent practicable consistent with our credit status.

Total interest paid by the Company for all indebtedness for the six months ended June 30, 2017 and June 30, 2016 was $2.7 million and $3.5 million, respectively.

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Interest expense, net consists of the following:

	Three months ended		Six months ended	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Interest expense	$1,450	$1,790	$2,765	$3,501
Deferred financing cost	108	169	215	337
Interest income	(11)	(10)	(20)	(24)
Less: amount capitalized for capital projects	(95)	(36)	(155)	(102)
Total interest expense, net	$1,452	$1,913	$2,805	$3,712

10. Other Long-Term Liabilities
Other long-term liabilities consist of the following:

	June 30, 2017	December 31, 2016
Deferred income taxes	$419	$ 1,282
Pension and post retirement liabilities	8,425	7,689
Restructuring and management transition reserve	210	1,618
Uncertain tax positions	1,974	1,974
Environmental liabilities	1,100	1,100
Other liabilities	2,011	1,906
	$14,139	$ 15,569

11. Income Taxes
The effective income tax rate on income before taxes was approximately 31% for the six months ended June 30, 2017 compared to approximately 32% for the comparable period in 2016. The change in the components of the effective tax rate are primarily due to the adoption of a new accounting pronouncement changing the accounting for tax benefits from stock option exercises and vesting of restricted stock and performance awards, which decreased the effective tax rate by 2%, a permanent adjustment attributable to an inventory obsolescence reserve in Mexico in the prior year, which decreased the effective tax rate by 2% as compared to last year and prior year tax return true-ups which increased the effective tax rate by 3% as compared to last year.
Business is conducted in various countries throughout the world and is subject to tax in numerous jurisdictions. A significant number of tax returns are filed and subject to examination by various federal, state and local tax authorities. Tax examinations are often complex, as tax authorities may disagree with the treatment of items reported requiring several years to resolve. As such, the Company maintains liabilities for possible assessments by tax authorities resulting from known tax exposures for uncertain income tax positions. The Company’s policy is to accrue associated penalties in selling, general and administrative expenses and to accrue interest in net interest expense.
Currently, the Company is under examination, or has been contacted for examination on income tax returns, for the years 2009 through 2015. Also, certain state income tax assessments are under protest and the Company believes its financial position is sustainable. The Company estimates the liability for unrecognized tax benefits may decrease by approximately $0.7 million during the next twelve months as a result of possible settlements of income tax authority examinations. Other than the items mentioned above, as of June 30, 2017, no material adjustments have been

proposed to the Company's tax positions and the Company currently does not anticipate any adjustments that would result in a material change to its financial position during the next twelve months.
Income taxes paid were $11.4 million and $26.4 million for the six months ended June 30, 2017 and June 30, 2016, respectively.

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12. Commitments and Contingencies

Environmental

The Company's operations are subject to extensive and changing federal, state, local and international environmental laws, rules and regulations. The Company's manufacturing sites have an extended history of industrial use, and soil and groundwater contamination have or may have occurred in the past and might occur or be discovered in the future. Environmental efforts are difficult to assess for numerous reasons, including the discovery of new remedial sites, discovery of new information and scarcity of reliable information pertaining to certain sites, improvements in technology, changes in environmental laws and regulations, numerous possible remedial techniques and solutions, difficulty in assessing the involvement of and the financial capability of other potentially responsible parties and the extended time periods over which remediation occurs. Other than the items listed below, the Company is not aware of material environmental liabilities which are probable and estimable. As the Company's environmental contingencies are more clearly determined, it is reasonably possible that amounts may need to be accrued. However, management does not believe, based on current information, that environmental remediation requirements will have a material impact on the Company's results of operations, financial position or cash flows.

Future environmental spending is probable at our site in Nashville, TN, the eastern portion of which had been used historically as a landfill, and a western parcel therein, previously acquired from a third party, which reportedly had housed, but no longer does, a fertilizer and pesticide manufacturing facility. We have an estimated liability with a range of $0.9 million-$1.3 million. The remedial action plan for that site has yet to be finalized, and as such, the Company has recorded a liability, which represents the Company's best estimate, of $1.1 million as of June 30, 2017.

Litigation

2008 RCRA Civil Enforcement - Geismar, Louisiana plant

On January 12, 2017, the Company entered into a settlement with the United States Environmental Protection Agency, or EPA, and the Louisiana Department of Environmental Quality, or LDEQ, with respect to certain manufacturing processes at the Company’s Geismar, Louisiana plant, including the Company’s handling of (i) filter material from an enclosed intermediate filtration step to further process merchant green phosphoric acid, or MGA, that the Company receives as raw material via pipeline from the adjacent site operated by PCS and (ii) the Company’s raffinate co-product that is separated in connection with its PPA production at the plant. The EPA and LDEQ, collectively with the United States Department of Justice, or DOJ, are collectively referred to as the Government Parties. This settlement resulted from years of negotiations between the Company and the Government Parties following several inspections of the plant by the Government Parties in which they raised certain violations of the federal Resource, Conservation and Recovery Act. Prior to this settlement, in the course of discussions with the Government Parties, the EPA and the DOJ required that the Company undertake, as an interim measure, the construction of a new filter unit to replace the enclosed system and allow the removal and separate handling of the filter material. The Company built that unit, which has been operating since 2012. As part of the settlement, Innophos is implementing a deep well injection system, a solution approved by the EPA and LDEQ to handle the raffinate separated at the plant. Such system is expected to be completed by early 2018. The Company previously returned the raffinate to PCS under a long-term contract it has with PCS and can continue to do so until there is a resolution of the deep well system. In connection with this settlement, the Company will pay a $1.4 million civil penalty, which is accrued in other current liabilities. The settlement is currently pending in the United States District Court for the Middle District of Louisiana.

Other Legal Matters

In addition, we are party to legal proceedings and contractual disputes that arise in the ordinary course of our business. Except as to the matters specifically discussed, management believes the likelihood that the ultimate disposition of these matters will have a material adverse effect on our business, results of operations, financial condition and/or cash flows is remote. However, these matters cannot be predicted with certainty and an unfavorable resolution of one or more of them could have a material adverse effect on our business, results of operations, financial condition, and/or cash flows.

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13. Pension Plans and Postretirement Benefits

Net periodic benefit expense for the United States plans:

	For the three months ended June 30, 2017			For the three months ended June 30, 2016		
	Pension benefits	Other benefits	Total	Pension benefits	Other benefits	Total
Service cost	$—	$ 33	$33	$—	$ 46	$46
Interest cost	26	30	56	30	45	75
Expected return on assets	(35)	—	(35)	(36)	—	(36)
Amortization of						
prior service cost	—	—	—	—	—	—
unrecognized (gain) loss	—	(49)	(49)	2	(13)	(11)
net transition obligation	—	—	—	—	—	—
Net periodic cost	$(9)	$ 14	$5	$(4)	$ 78	$74

	For the six months ended June 30, 2017			For the six months ended June 30, 2016		
	Pension benefits	Other benefits	Total	Pension benefits	Other benefits	Total
Service cost	$—	$ 67	$67	$—	$ 92	$92
Interest cost	51	61	112	59	89	148
Expected return on assets	(70)	—	(70)	(72)	—	(72)
Amortization of						
prior service cost	—	—	—	—	—	—
unrecognized (gain) loss	—	(99)	(99)	4	(26)	(22)
net transition obligation	—	—	—	—	—	—
Net periodic cost	$(19)	$ 29	$10	$(9)	$ 155	$146

Innophos has no minimum contribution requirements and does not plan to make cash contributions for its US defined benefit pension plan in 2017.
Innophos made its entire cash contribution of $2.9 million for the US defined contribution plan during the first quarter of 2017 for the plan year 2016.

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Net periodic benefit expense for the Canadian plans:

	For the three months ended June 30, 2017			For the three months ended June 30, 2016		
	Pension benefits	Other benefits	Total	Pension benefits	Other benefits	Total
Service cost	$93	$ 12	$105	$93	$ 12	$105
Interest cost	125	14	139	125	14	139
Expected return on assets	(199)	—	(199)	(197)	—	(197)
Amortization of						
actuarial loss (gain)	43	—	43	53	—	53
prior service cost	26	—	26	28	—	28
net transition obligation	—	5	5	—	5	5
Exchange rate changes	(98)	31	(67)	(12)	(1)	(13)
Net periodic cost	$(10)	$ 62	$52	$90	$ 30	$120

	For the six months ended June 30, 2017			For the six months ended June 30, 2016		
	Pension benefits	Other benefits	Total	Pension benefits	Other benefits	Total
Service cost	$187	$ 25	$212	$180	$ 24	$204
Interest cost	252	27	279	243	26	269
Expected return on assets	(400)	—	(400)	(382)	—	(382)
Amortization of						
actuarial loss (gain)	86	—	86	103	—	103
prior service cost	53	—	53	53	—	53
net transition obligation	—	11	11	—	11	11
Exchange rate changes	(146)	45	(101)	(300)	77	(223)
Net periodic cost	$32	$ 108	$140	$(103)	$ 138	$35

Innophos Canada, Inc. plans to make cash contributions to its Canadian defined benefit plan of approximately $0.5 million in 2017.

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14. Accumulated Other Comprehensive Income (Loss)
Changes in accumulated other comprehensive income (loss) by Component:

For the three months ended June 30, 2017	Pension and Other Postretirement Adjustments	Changes in Fair Value of Effective Cash Flow Hedges	Total
Balance at March 31, 2017	$ (1,498)	$ 101	$(1,397)
Other comprehensive loss before reclassifications	(147)	(5)	(152)
Amounts reclassified from accumulated other comprehensive income	—	—	—
Net current period other comprehensive loss	(147)	(5)	(152)
Balance at June 30, 2017	$ (1,645)	$ 96	$(1,549)

For the three months ended June 30, 2016	Pension and Other Postretirement Adjustments	Changes in Fair Value of Effective Cash Flow Hedges	Total
Balance at March 31, 2016	$ (2,984)	$ (310)	$(3,294)
Other comprehensive income (loss) before reclassifications	52	(80)	(28)
Amounts reclassified from accumulated other comprehensive income	—	—	—
Net current period other comprehensive income (loss)	52	(80)	(28)
Balance at June 30, 2016	$ (2,932)	$ (390)	$(3,322)

For the six months ended June 30, 2017	Pension and Other Postretirement Adjustments	Changes in Fair Value of Effective Cash Flow Hedges	Total
Balance at December 31, 2016	$ (1,493)	$ 9	$(1,484)
Other comprehensive (loss) income before reclassifications	(152)	87	(65)
Amounts reclassified from accumulated other comprehensive income	—	—	—
Net current period other comprehensive (loss) income	(152)	87	(65)
Balance at June 30, 2017	$ (1,645)	$ 96	$(1,549)

For the six months ended June 30, 2016	Pension and Other Postretirement	Changes in Fair Value of	Total

	Adjustments	Effective Cash Flow Hedges	
Balance at December 31, 2015	$ (2,842)	$ 48	$(2,794)
Other comprehensive loss before reclassifications	(90)	(438)	(528)
Amounts reclassified from accumulated other comprehensive income	—	—	—
Net current period other comprehensive loss	(90)	(438)	(528)
Balance at June 30, 2016	$ (2,932)	$ (390)	$(3,322)

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15. Restructuring Costs

During 2015 management evaluated several initiatives to improve the overall operating efficiency of the organization. As a result of this evaluation we launched an initiative to reduce our cost structure by implementing various staff reduction actions during the third quarter of 2015.

In addition, during the fourth quarter of 2015, the Company experienced a management transition of certain high-level positions, most notably the Chief Executive Officer and the Chief Financial Officer.

The following table summarizes the fiscal year 2017 activities related to these restructuring initiatives for severance and benefits:

For the three months ended June 30, 2017	Restructuring Costs
Balance at March 31, 2017	$ 3,939
Expense recorded	—
Payments made	(803)
Balance at June 30, 2017	$ 3,136

For the six months ended June 30, 2017	Restructuring Costs
Balance at December 31, 2016	$ 6,356
Expense recorded	—
Payments made	(3,220)
Balance at June 30, 2017	$ 3,136

16. Segment Reporting

The Company discloses certain financial and supplementary information about its reportable segments, revenue by products and revenues by geographic area. Operating segments are defined as components of an enterprise about which separate discrete financial information is evaluated regularly by the chief operating decision maker, in order to decide how to allocate resources and assess performance. The primary performance indicators for the chief operating decision maker are sales and EBITDA (defined as net income (loss) before interest, income taxes, depreciation and amortization). All references to sales in this Quarterly Report on Form 10-Q are recognized when title and risk of loss passes to the customer, which occurs either upon shipment or delivery, depending upon the agreed sales terms with customers.

The Company's chief executive officer is the chief operating decision maker and, as of the first quarter of 2017, has determined to assess the Company's performance and allocate the appropriate resources based on the following operating segments: (1) Food, Health and Nutrition, (2) Industrial Specialties and (3) Other. The new reporting segments accurately reflect the underlying business dynamics and align with the strategic direction of the Company. Prior to the first quarter of 2017, the reporting segments were (1) Specialty Phosphates US & Canada, (2) Specialty Phosphates Mexico and (3) GTSP & Other, versus the current market view.

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For the three months ended June 30, 2017	Food, Health & Nutrition	Industrial Specialties	Other	Total
Sales	$92,198	$ 67,368	$19,574	$179,140
EBITDA	$17,032	$ 8,654	$2,333	$28,019
Depreciation and amortization expense	$5,498	$ 3,486	$566	$9,550

For the three months ended June 30, 2016	Food, Health & Nutrition	Industrial Specialties	Other	Total
Sales	$94,662	$ 71,912	$15,314	$181,888
EBITDA	$19,744	$ 10,136	$(1,556)	$28,324
Depreciation and amortization expense	$5,252	$ 3,538	$492	$9,282

For the six months ended June 30, 2017	Food, Health & Nutrition	Industrial Specialties	Other	Total
Sales	$183,281	$ 131,040	$30,763	$345,084
EBITDA	$32,656	$ 18,175	$3,231	$54,062
Depreciation and amortization expense	$11,220	$ 6,858	$1,053	$19,131

For the six months ended June 30, 2016	Food, Health & Nutrition	Industrial Specialties	Other	Total
Sales	$193,074	$ 146,467	$31,977	$371,518
EBITDA	$39,677	$ 19,697	$(244)	$59,130
Depreciation and amortization expense	$10,043	$ 6,597	$1,924	$18,564

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A reconciliation of net income to EBITDA follows:

	Three months ended	
	June 30, 2017	June 30, 2016
Net income	$11,223	$12,104
Provision for income taxes	5,794	5,025
Interest expense, net	1,452	1,913
Depreciation and amortization	9,550	9,282
EBITDA	$28,019	$28,324

	Six months ended	
	June 30, 2017	June 30, 2016
Net income	$22,146	$24,946
Provision for income taxes	9,980	11,908
Interest expense, net	2,805	3,712
Depreciation and amortization	19,131	18,564
EBITDA	$54,062	$59,130

17. Subsequent Events

On July 28, 2017, Innophos Holdings, Inc. and its newly-formed, indirect wholly-owned subsidiary, Thor Merger Sub, Inc., entered into an Agreement and Plan of Merger with GenNx Novel Holdings, Inc. (“GenNx”), the ultimate parent of Novel Ingredients, LLC (“Novel”). Pursuant to this agreement, at the closing of the transaction contemplated thereby, Thor Merger Sub, Inc. will merge with and into GenNx, with GenNx being the surviving corporation and a wholly-owned subsidiary of Innophos, Inc.

Novel is a supplier of botanicals, proteins, amino acids and other healthy ingredient solutions serving the nutrition market including immune health, heart health, sports nutrition and energy, bone and joint health, antioxidant properties and cognitive health. The Novel acquisition will strengthen Innophos’ position in the Food, Health & Nutrition segment.

The Company will pay holders of GenNx common stock and options aggregate consideration of $125 million in cash, subject to specified adjustments. The Company expects to finance the merger with cash on hand and borrowings under the Company’s credit facility.

The merger agreement contains representations and warranties, as well as covenants and agreements, by each party, including, among other things, covenants (i) with respect to the conduct of the business of Novel during the period between the signing of the merger agreement and the closing of the merger and (ii) regarding each party’s obligation to use reasonable best efforts to obtain governmental approvals and to take other actions necessary to consummate the merger. The merger agreement may be terminated by either party if the merger has not been consummated by September 26, 2017; however if the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements (“HSR Act”) has not occurred by such date, either party may extend the termination date to October 26, 2017.

Closing of the merger is subject to customary closing conditions, including the expiration or termination of the applicable waiting period under the HSR Act. The Company anticipates that the merger will close during the third quarter of 2017. There can be no assurance that all of the conditions to closing the merger will be satisfied, or that the merger will be consummated.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Innophos is a leading international producer of specialty ingredient solutions that deliver versatile benefits for the food, health, nutrition and industrial markets. Innophos combines more than a century of experience in specialty phosphate manufacturing with a broad range of other specialty nutritional ingredients. Many of Innophos' products are application-specific compounds engineered to meet customer performance requirements and are often critical to the taste, texture and performance of foods, beverages, pharmaceuticals, oral care products and other applications. For example, Innophos products act as flavor enhancers in beverages, electrolytes in sports drinks, texture additives in cheeses, leavening agents in baked goods, pharmaceutical excipients, cleaning agents in toothpaste, and they also provide a wide range of nutritional fortification solutions for food, beverage and nutritional supplement manufacturers.

Recent Trends and Outlook

Q3 2017

Sales in Q3 are expected to be similar to the second quarter 2017, down approximately 4% year-over-year, but with an anticipated mix improvement towards Food, Health & Nutrition.

Earnings in the third quarter are forecast to be positively impacted sequentially by reduced implementation fees and first time cost savings from our Phase 2 Operational Excellence initiatives. Input costs are expected to be in line with second quarter 2017.

The Company anticipates that the tax rate will remain at the more normalized level of approximately 33% in the third quarter.

Full Year

The Company is reiterating its revenue and earnings guidance for full-year 2017, excluding the impact of the Novel Ingredients acquisition.

On a full year basis, overall market conditions and the competitive landscape for 2017 are expected to be similar to 2016.

The Company anticipates that the Phase 2 Operational Excellence fees incurred in the first half of the year will be more than offset by the Phase 2 savings, of which $5 million is estimated to take effect in the second half of 2017.

As a result of these factors, the Company continues to expect full year revenues to be down by approximately 4% compared with 2016. The Company further continues to expect full-year earnings to be broadly in line with 2016, reflecting the impact of management's focus on cost actions and productivity initiatives given the challenging market conditions.

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Results of Operations

The following table sets forth a summary of the Company's operations and their percentages of total revenue for the periods indicated (dollars in millions):

	Three Months Ended		Three Months Ended	
	June 30, 2017		June 30, 2016	
	Amount	%	Amount	%
Net sales	$179.1	100.0	$181.9	100.0
Cost of goods sold	140.0	78.2	145.7	80.1
Gross profit	39.1	21.8	36.2	19.9
Operating expenses:				
Selling, general and administrative	19.9	11.1	15.8	8.7
Research & development	0.8	0.4	1.0	0.5
Income from operations	18.4	10.3	19.4	10.7
Interest expense, net	1.5	0.8	1.9	1.0
Foreign exchange (gain) loss, net	(0.1)	(0.1)	0.4	0.2
Provision for income taxes	5.8	3.2	5.0	2.7
Net income	$11.2	6.3	$12.1	6.7

	Six Months Ended		Six Months Ended	
	June 30, 2017		June 30, 2016	
	Amount	%	Amount	%
Net sales	$345.1	100.0	$371.5	100.0
Cost of goods sold	269.5	78.1	294.6	79.3
Gross profit	75.6	21.9	76.9	20.7
Operating expenses:				
Selling, general and administrative	39.2	11.4	33.9	9.1
Research & development	1.6	0.4	2.1	0.6
Income from operations	34.8	10.1	40.9	11.0
Interest expense, net	2.8	0.8	3.7	1.0
Foreign exchange (gain) loss, net	(0.1)	—	0.3	0.1
Provision for income taxes	10.0	2.9	12.0	3.2
Net income	22.1	6.4	24.9	6.7

Three months ended June 30, 2017 compared to the three months ended June 30, 2016

Net Sales

Net sales represent the selling price of the products, net of any customer-related rebates, plus freight and any other items invoiced to customers. Net sales for the three months ended June 30, 2017 were $179.1 million, a decrease of $2.8 million, or 1.5%, as compared to $181.9 million for the same period in 2016, with prices down 5.1% but volumes up 3.6%. Food, Health & Nutrition sales were down 2.6%, or $2.5 million, with selling prices lower by 4.5%, or $4.3 million, but volumes higher by 1.9%, or $1.8 million. Industrial Specialties sales were down 6.3%, or $4.6 million, with selling prices lower by 6.5%, or $4.7 million, but volumes higher by 0.2%, or $0.1 million. Other sales were higher by 27.8%, or $4.3 million, with volumes higher by 30.5%, or $4.7 million, but prices lower by 2.7%, or $0.4 million.

The Company calculates pure selling price dollar variances as the selling price for the current year to date period minus the selling price for the prior year to date period, and then multiplies the resulting selling price difference by the prior year to date period volume. Volume variance is calculated as the total sales variance minus the selling price variance and refers to the revenue effect of changes in tons sold at the relative prices applicable to the variation in tons, otherwise known as volume/mix.

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The following table illustrates for the three months ended June 30, 2017 the percentage changes in net sales by reportable segment compared with the same period of the prior year, including the effect of price and volume/mix changes upon revenue:

	Price	Volume/Mix	Total
Food, Health & Nutrition	(4.5)%	1.9 %	(2.6)%
Industrial Specialties	(6.5)%	0.2 %	(6.3)%
Other	(2.7)%	30.5 %	27.8 %
Total	(5.1)%	3.6 %	(1.5)%

Gross Profit

Gross profit represents net sales less cost of goods sold. Gross profit for the three months ended June 30, 2017 was $39.1 million, an increase of $2.9 million, or 8.0%, as compared to $36.2 million for the same period in 2016. Gross profit percentage of net sales increased to 21.8% for the three months ended June 30, 2017 versus 19.9% for the same period in 2016 due to improving mix into higher value products. Gross profit in 2017 was favorably affected by $13.0 million lower raw material costs, mainly phosphate rock and MGA, and $0.4 million higher sales volumes. These favorable effects were partially offset by $9.4 million lower selling prices, $2.5 million expenses for the implementation of Phase 2 of Operational Excellence initiatives, $0.7 million higher manufacturing costs, and $0.3 million higher depreciation. Included in 2016 gross profit was $2.4 million planned maintenance outage expense at our Coatzacoalcos, Mexico manufacturing facility.

Operating Expenses and Research and Development

Operating expenses consist primarily of selling, general and administrative and research and development expenses. Operating expenses for the three months ended June 30, 2017 were $20.7 million, an increase of $3.9 million, or 23.2%, as compared to $16.8 million for the same period in 2016. The increase was due to $1.3 million increased employee related costs, $1.7 million for strategic initiatives and a $0.9 million increase in all other expenses.

Operating Income

Operating income for the three months ended June 30, 2017 was $18.4 million, a decrease of $1.0 million, or 5.2%, as compared to $19.4 million for the same period in 2016. Operating income as a percentage of net sales decreased to 10.3% versus 10.7% for the same period in 2016, for the reasons noted above.

Interest Expense, net

Net interest expense, including deferred financing amortization expense, for the three months ended June 30, 2017 was $1.5 million, a decrease of $0.4 million, or 21.1%, as compared to $1.9 million for the same period in 2016. The decrease was primarily due to lower average external loan balances and lower interest rates from our updated credit facility entered into in December 2016.

Foreign Exchange

Foreign exchange for the three months ended June 30, 2017 was a gain of $0.1 million as compared to a loss of $0.4 million for the same period in 2016. The US Dollar is the functional currency of our Mexican and Canadian operations. The Company has greater foreign denominated asset balances (largely Mexican Peso and Canadian Dollar), such as VAT receivables and prepaid income taxes in foreign jurisdictions, than offsetting foreign denominated liability balances. As the US Dollar strengthened throughout the prior year period versus the Mexican Peso and the Canadian Dollar, the remeasurement of the net foreign asset denominated balances contributed to a net foreign exchange loss. Consequently, foreign exchange gain or loss is recorded on remeasurement of non-US Dollar denominated monetary assets and liabilities. Such gains and losses fluctuate from period to period as the foreign currencies strengthen or weaken against the US Dollar and the amount of non-US Dollar denominated assets and liabilities increases or decreases.

Provision for Income Taxes

The effective income tax rate was 34% for the three months ended June 30, 2017 compared to 29% for the same period in 2016. The variances in the effective tax rate are primarily due to prior year tax return true-ups which increased the effective tax rate by 6% as compared to the same period last year and changes in foreign exchange rates which increased the effective tax rate by 3% in the current quarter. The increases in the effective tax rate were offset by a permanent adjustment attributable to an inventory obsolescence reserve in Mexico in the prior year which decreased the effective tax rate by 2% as compared to the same period last year and increased income in lower tax rate jurisdictions which decreased the effective tax rate by 2% in the current quarter.

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Net Income

Net income for the three months ended June 30, 2017 was $11.2 million, a decrease of $0.9 million, as compared to $12.1 million for the same period in 2016, due to the factors described above.

Six months ended June 30, 2017 compared to the six months ended June 30, 2016

Net Sales

Net sales represent the selling price of the products, net of any customer-related rebates, plus freight and any other items invoiced to customers. Net sales for the six months ended June 30, 2017 were $345.1 million, a decrease of $26.4 million, or 7.1%, as compared to $371.5 million for the same period in 2016, with prices down 5.2% and volumes down 1.9%. Food, Health & Nutrition sales were down 5.1%, or $9.8 million, with selling prices lower by 3.7%, or $7.1 million, and volumes lower by 1.4%, or $2.7 million. Industrial Specialties sales were down 10.5%, or $15.4 million, with selling prices lower by 6.8%, or $9.9 million, and volumes lower by 3.7%, or $5.5 million. Other sales were lower by 3.8%, or $1.2 million, with prices lower by 6.9%, or $2.2 million, but volumes higher by 3.1%, or $1.0 million.

The Company calculates pure selling price dollar variances as the selling price for the current year to date period minus the selling price for the prior year to date period, and then multiplies the resulting selling price difference by the prior year to date period volume. Volume variance is calculated as the total sales variance minus the selling price variance and refers to the revenue effect of changes in tons sold at the relative prices applicable to the variation in tons, otherwise known as volume/mix.

The following table illustrates for the six months ended June 30, 2017 the percentage changes in net sales by reportable segment compared with the same period of the prior year, including the effect of price and volume/mix changes upon revenue:

	Price	Volume/Mix	Total
Food, Health & Nutrition	(3.7)%	(1.4)%	(5.1)%
Industrial Specialties	(6.8)%	(3.7)%	(10.5)%
Other	(6.9)%	3.1 %	(3.8)%
Total	(5.2)%	(1.9)%	(7.1)%

Gross Profit

Gross profit represents net sales less cost of goods sold. Gross profit for the six months ended June 30, 2017 was $75.6 million, a decrease of $1.3 million, or 1.7%, as compared to $76.9 million for the same period in 2016. Gross profit percentage of net sales increased to 21.9% for the six months ended June 30, 2017 versus 20.7% for the same period in 2016 due to improving mix into higher value products. Gross profit in 2017 was unfavorably affected by $19.2 million lower selling prices, $5.4 million lower sales volumes, $3.2 million expenses for the implementation of Phase 2 Operational Excellence initiatives, and $0.6 million higher depreciation. These unfavorable effects were partially offset by $21.5 million lower raw material costs, mainly phosphate rock and MGA, $1.6 million lower manufacturing costs, and $0.7 million favorable exchange rates mostly from our Mexican peso based costs. Included in 2016 gross profit was $2.4 million planned maintenance outage expense at our Coatzacoalcos, Mexico manufacturing facility and a $0.9 million charge for a GTSP lower of cost or market reserve.

Operating Expenses and Research and Development

Operating expenses consist primarily of selling, general and administrative expenses and research and development expenses. Operating expenses for the six months ended June 30, 2017 were $40.8 million, an increase of $4.8 million, or 13.3%, as compared to $36.0 million for the same period in 2016. The increase was due to $2.7 million for strategic initiatives, $1.4 million higher severance costs and a $0.7 million increase in all other costs.

Operating Income

Operating income for the six months ended June 30, 2017 was $34.8 million, a decrease of $6.1 million, or 14.9%, as compared to $40.9 million for the same period in 2016. Operating income as a percentage of net sales decreased to

10.1% versus 11.0% for the same period in 2016 for the reasons noted above.

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Interest Expense, net

Net interest expense, including deferred financing amortization expense, for the six months ended June 30, 2017 was $2.8 million, a decrease of $0.9 million, or 24.3%, as compared to $3.7 million for the same period in 2016. The decrease was primarily due to lower average loan balances, lower leverage ratios and lower applicable margins in our updated credit facility entered into in December 2016.

Foreign Exchange

Foreign exchange for the six months ended June 30, 2017 was a gain of $0.1 million as compared to a loss of $0.3 million for the same period in 2016. The US Dollar is the functional currency of our Mexican and Canadian operations. The Company has greater foreign denominated asset balances (largely Mexican Peso and Canadian Dollar), such as VAT receivables and prepaid income taxes in foreign jurisdictions, than offsetting foreign denominated liability balances. As the US Dollar strengthened throughout the prior year period versus the Mexican Peso and the Canadian Dollar, the remeasurement of the net foreign asset denominated balances contributed to a net foreign exchange loss. Consequently, foreign exchange gain or loss is recorded on remeasurement of non-US Dollar denominated monetary assets and liabilities. Such gains and losses fluctuate from period to period as the foreign currencies strengthen or weaken against the US Dollar and the amount of non-US Dollar denominated assets and liabilities increases or decreases.

Provision for Income Taxes

The effective income tax rate was 31% for the six months ended June 30, 2017 compared to 32% for the same period in 2016. The change in the components of the effective tax rate are primarily due to the adoption of a new accounting pronouncement changing the accounting for tax benefits from stock option exercises and vesting of restricted stock and performance awards, which decreased the effective tax rate by 2%, a permanent adjustment attributable to an inventory obsolescence reserve in Mexico in the prior year, which decreased the effective tax rate by 2% as compared to last year and prior year tax return true-ups which increased the effective tax rate by 3% as compared to last year.

Net Income

Net income for the six months ended June 30, 2017 was $22.1 million, a decrease of $2.8 million, as compared to $24.9 million for the same period in 2016, due to the factors described above.

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Segment Reporting

The Company's chief executive officer is the chief operating decision maker and, as of the first quarter of 2017, has determined to assess the Company's performance and allocate the appropriate resources based on the following operating segments: (1) Food, Health and Nutrition, (2) Industrial Specialties and (3) Other. The new reporting segments accurately reflect the underlying business dynamics and align with the strategic direction of the Company. The primary performance indicators for the chief operating decision maker are sales and EBITDA. The following table sets forth the results of these indicators by segment for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended		
	June 30, 2017	June 30, 2016	Net Sales % Change
Segment Net Sales			
Food, Health & Nutrition	$92,198	$94,662	(2.6)%
Industrial Specialties	67,368	71,912	(6.3)%
Other	19,574	15,314	27.8 %
Total	$179,140	$181,888	(1.5)%
Segment EBITDA			
Food, Health & Nutrition	$17,032	$19,744	
Industrial Specialties	8,654	10,136	
Other	2,333	(1,556)	
Total	$28,019	$28,324	
Segment EBITDA % of net sales			
Food, Health & Nutrition	18.5 %	20.9 %	
Industrial Specialties	12.8 %	14.1 %	
Other	11.9 %	(10.2)%	
Total	15.6 %	15.6 %	

Depreciation and amortization expense