INTERNATIONAL FLAVORS & FRAGRANCES INC
Form 10-Q
May 07, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2018

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	13-1432060
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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 þ 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 þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See 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	þ	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨
		Emerging growth company	¨

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. ¨

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

Number of shares outstanding as of April 24, 2018: 78,943,811

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS.
INTERNATIONAL FLAVORS & FRAGRANCES INC.
CONSOLIDATED BALANCE SHEET
(Unaudited)

(DOLLARS IN THOUSANDS)	March 31, 2018	December 31, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	$305,276	$368,046
Trade receivables (net of allowances of $13,484 and $13,392, respectively)	734,378	663,663
Inventories: Raw materials	346,948	326,140
Work in process	22,357	16,431
Finished goods	318,512	306,877
Total Inventories	687,817	649,448
Prepaid expenses and other current assets	242,870	215,387
Total Current Assets	1,970,341	1,896,544
Property, plant and equipment, at cost	2,139,372	2,090,755
Accumulated depreciation	(1,251,889)	(1,210,175)
	887,483	880,580
Goodwill	1,166,022	1,156,288
Other intangible assets, net	414,055	415,787
Deferred income taxes	88,231	99,777
Other assets	155,144	149,950
Total Assets	$4,681,276	$4,598,926
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Short term borrowings	$36,819	$6,966
Accounts payable	324,262	338,188
Accrued payroll and bonus	51,194	88,361
Dividends payable	54,404	54,420
Other current liabilities	250,073	280,833
Total Current Liabilities	716,752	768,768
Long-term debt	1,676,211	1,632,186
Deferred gains	36,930	37,344
Retirement liabilities	226,937	228,936
Other liabilities	245,484	242,398
Total Other Liabilities	2,185,562	2,140,864
Commitments and Contingencies (Note 13)		
Shareholders' Equity:		
Common stock 12 1/2¢ par value; 500,000,000 shares authorized; 115,858,190 shares issued as of March 31, 2018 and December 31, 2017; and 78,920,199 and 78,947,381 shares outstanding as of March 31, 2018 and December 31, 2017, respectively	14,470	14,470
Capital in excess of par value	166,517	162,827
Retained earnings	3,947,791	3,870,621
Accumulated other comprehensive loss	(620,579)	(637,482)
Treasury stock, at cost (36,937,991 and 36,910,809 shares as of March 31, 2018 and December 31, 2017, respectively)	(1,735,049)	(1,726,234)
Total Shareholders' Equity	1,773,150	1,684,202

Noncontrolling interest	5,812	5,092
Total Shareholders’ Equity including noncontrolling interest	1,778,962	1,689,294
Total Liabilities and Shareholders’ Equity	$4,681,276	$4,598,926

See Notes to Consolidated Financial Statements
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INTERNATIONAL FLAVORS & FRAGRANCES INC.
CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended March 31,	
(AMOUNTS IN THOUSANDS EXCEPT PER SHARE AMOUNTS)	2018	2017
Net sales	$930,928	$828,293
Cost of goods sold	525,119	465,210
Gross profit	405,809	363,083
Research and development expenses	78,476	72,126
Selling and administrative expenses	142,644	143,704
Amortization of acquisition-related intangibles	9,185	7,066
Restructuring and other charges, net	717	10,143
Gain on sales of fixed assets	(69)	(21)
Operating profit	174,856	130,065
Interest expense	16,595	12,807
Other (income), net	(576)	(21,229)
Income before taxes	158,837	138,487
Taxes on income	29,421	22,723
Net income	129,416	115,764
Other comprehensive income (loss), after tax:		
Foreign currency translation adjustments	14,803	(3,257)
(Losses) on derivatives qualifying as hedges	(529)	(1,751)
Pension and postretirement net liability	2,629	3,635
Other comprehensive income (loss)	16,903	(1,373)
Total comprehensive income	$146,319	$114,391
Net income per share - basic	$1.63	$1.46
Net income per share - diluted	$1.63	$1.45
Average number of shares outstanding - basic	79,018	79,098
Average number of shares outstanding - diluted	79,393	79,409
Dividends declared per share	$0.69	$0.64

See Notes to Consolidated Financial Statements
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INTERNATIONAL FLAVORS & FRAGRANCES INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
(DOLLARS IN THOUSANDS)	2018	2017
Cash flows from operating activities:		
Net income	$129,416	$115,764
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization	33,384	26,802
Deferred income taxes	18,404	(3,766)
Gain on disposal of assets	(69)	(21)
Stock-based compensation	7,620	5,819
Pension contributions	(4,387)	(25,263)
Product recall claim settlement	(12,969)	—
Foreign currency gain on liquidation of entity	—	(12,214)
Changes in assets and liabilities, net of acquisitions:		
Trade receivables	(61,301)	(60,858)
Inventories	(30,185)	(109)
Accounts payable	(8,435)	(1,978)
Accruals for incentive compensation	(36,583)	(23,485)
Other current payables and accrued expenses	(18,540)	(7,586)
Other assets	(26,035)	30,284
Other liabilities	(1,715)	(24,894)
Net cash (used in) provided by operating activities	(11,395)	18,495
Cash flows from investing activities:		
Cash paid for acquisitions, net of cash received	(22)	(138,093)
Additions to property, plant and equipment	(33,105)	(26,662)
Maturity of net investment hedges	(2,405)	1,948
Proceeds from disposal of assets	293	619
Net cash used in investing activities	(35,239)	(162,188)
Cash flows from financing activities:		
Cash dividends paid to shareholders	(54,420)	(50,677)
Increase in revolving credit facility borrowings and overdrafts	23,762	100,481
Increase in commercial paper	29,926	107,441
Loss on pre-issuance hedges	—	300
Employee withholding taxes paid	(3,266)	(3,000)
Purchase of treasury stock	(10,617)	(37,612)
Net cash (used in) provided by financing activities	(14,615)	116,933
Effect of exchange rate changes on cash and cash equivalents	(1,521)	2,835
Net change in cash and cash equivalents	(62,770)	(23,925)
Cash and cash equivalents at beginning of year	368,046	323,992
Cash and cash equivalents at end of period	$305,276	$300,067
Cash paid for:		
Interest paid, net of amounts capitalized	$20,236	$25,590
Income taxes paid	$24,939	$20,043
Noncash investing activities:		
Accrued capital expenditures	$18,868	$5,433

See Notes to Consolidated Financial Statements

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INTERNATIONAL FLAVORS & FRAGRANCES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
NOTE 1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
Basis of Presentation
These interim statements and related management's discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the related notes and management's discussion and analysis of results of operations, liquidity and capital resources included in our 2017 Annual Report on Form 10-K ("2017 Form 10-K").
These interim statements are unaudited. The year-end balance sheet data included in this Form 10-Q 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, March 31 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 2018 and 2017 quarters, the actual closing dates were March 30 and March 31, 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.
Use of Estimates
The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Reclassifications and Revisions
Certain prior year amounts have been reclassified and revised to conform to current year presentation.
As discussed below and in conformity with the Financial Accounting Standards Board's ("FASB") amendments to the Compensation - Retirement Benefits guidance, the Company has reclassified certain components of net periodic benefit expense (income) to Other income (expense), net.
Additionally, approximately $5.4 million of expense was recorded during the first quarter of 2017 for a tax assessment relating to prior periods. The Consolidated Statement of Cash Flows for the three months ended March 31, 2017 has been revised to properly reclassify $3.2 million from Net cash used in financing activities to reduce Net cash provided by operating activities, and has also been revised to correctly state the amount of Cash paid for interest, net of amounts capitalized, for the three months ended March 31, 2017. These adjustments were not material to the current or previously-issued financial statements.
U.S. Tax Reform
On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act") that significantly revised the U.S. tax code effective January 1, 2018 by, among other things, lowering the corporate income tax rate from a top marginal rate of 35% to a flat 21%, limiting deductibility of interest expense and performance based incentive compensation, transitioning to a territorial system and creating new taxes associated with global operations.
In the fourth quarter of 2017, the Company recorded approximately $139.2 million in charges related to the impact of the Tax Act. Given the significant complexity of the Tax Act, anticipated guidance from the U.S. Treasury about implementing the Tax Act and the potential for additional guidance from the SEC or the FASB, the amount recorded by the Company in the fourth quarter of 2017 was provisional and will continue to be adjusted during 2018. The impact of the Tax Act is expected to be finalized no later than the fourth quarter of 2018. The aforementioned guidance and additional information regarding the Tax Act may also impact the Company's 2018 effective income tax rate, exclusive of any adjustment to the provisional charge. Any material revisions in our computations could adversely affect our cash flows and results of operations.
During the first quarter of 2018, the Company recorded an additional charge of $0.6 million to adjust an accrual related to withholding taxes on planned repatriations.

Accounts Receivable
The Company sells certain accounts receivable on a non-recourse basis to unrelated financial institutions under “factoring” agreements that are sponsored, solely and individually, by certain customers. The Company accounts for these transactions as sales of receivables, removes the receivables sold from its financial statements, and records cash proceeds when received by the Company. The beneficial impact on cash provided by operations from participating in these programs decreased approximately $11.0 million for the three months ended March 31, 2018 compared to a decrease of approximately $27.1 million for the three months ended March 31, 2017. The cost of participating in these programs was immaterial to our results in all periods.
Recent Accounting Pronouncements
In February 2018, FASB issued amendments to the Income Statement - Reporting Comprehensive Income guidance which allows for a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act, in addition to requiring certain disclosures about stranded tax effects. This guidance is effective for periods beginning after December 15, 2018, with an election to adopt early. The Company is currently evaluating the impact this guidance may have on its Consolidated Financial Statements.
In August 2017, FASB issued amendments to the Derivatives and Hedging guidance which eliminates the requirement to separately measure and present hedge ineffectiveness and aligns the presentation of hedge gains and losses with the underlying hedge item. This guidance is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. The amended presentation and disclosure requirements are to be applied prospectively while the amendments to cash flow and net investment hedge relationships are to be applied on a modified retrospective basis. The Company is currently evaluating the impact this guidance will have on its Consolidated Financial Statements, but does not expect this guidance to have a material impact on its Consolidated Financial Statements.
In May 2017, the FASB issued amendments to the Compensation - Stock Compensation guidance which clarifies changes to the terms or conditions of a share-based payment award that require an entity to apply modification accounting. This guidance is effective for the current year. The Company has determined that this guidance does not have an impact on its Consolidated Financial Statements as it is not the Company's practice to modify the terms or conditions of a share-based payment award after it has been granted.
In March 2017, the FASB issued amendments to the Compensation - Retirement Benefits guidance which requires employers who present a measure of operating income in their statement of income to include only the service cost component of net periodic pension cost and postretirement costs in operating expenses. This guidance is effective, and as required, has been applied on a full retrospective basis. The impact of the adoption of this standard on January 1, 2018, was a decrease in operating profit of $7.3 million for the three months ended March 31, 2017, and an increase in income within Other (income) expense, net, as presented in the Company's Consolidated Statement of Income and Comprehensive Income. There was no impact to Net income or Net Income per share in either period. See Note 10 of the Consolidated Financial Statements for further details.
The new guidance also limits the amount of net periodic benefit cost eligible for capitalization to assets. The new guidance permits only the service cost component of net periodic benefit cost to be eligible for capitalization. The Company applied the practical expedient that permits the use of amounts previously disclosed as the basis for retrospective application and, as provided under the practical expedient, has not presented the income statement impact based on the capitalization of the applicable costs.
In August 2016, the FASB issued authoritative guidance which requires changes to the classification of certain activities within the statement of cash flows. This guidance is effective for the current year, and the Company has determined that this adoption does not have a significant impact on its Consolidated Statement of Cash Flows.
In June 2016, the FASB issued authoritative guidance which requires issuers to measure expected credit losses for financial assets based on historical experience, current conditions and reasonable and supportable forecasts. As such, an entity will use forward-looking information to estimate credit losses. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact this guidance may have on its consolidated financial statements, but does not expect this guidance to have a material impact on its Consolidated Financial

Statements.

In February 2016, the FASB issued authoritative guidance which requires changes to the accounting for leases. The new guidance establishes a new lease accounting model that requires entities to record assets and liabilities related to leases on the balance sheet for certain types of leases. The guidance will be effective for annual and interim periods beginning after December 15, 2018. The Company expects to adopt this guidance effective December 30, 2018, the first day of the Company's 2019 fiscal year, and that the adoption of this guidance will result in significant increases to assets and liabilities on its Consolidated Balance Sheet. The Company is still evaluating the impact of this guidance on its Consolidated Statement of Income and Comprehensive Income and Consolidated Statement of Cash Flows. The Company has begun to evaluate the nature of its leases and has compiled a preliminary analysis of the type and location of its leases. The Company expects that the significant portion of its lease liabilities will relate to property, with additional lease and corresponding right of use assets in existence that relate to vehicles and machinery.

Adoption of ASC Topic 606, Revenue from Contracts with Customers

In May 2014, the FASB issued authoritative guidance that provides for a comprehensive model to be used in accounting for revenue arising from contracts with customers (ASC Topic 606, Revenue from Contracts with Customers) (the "Revenue Standard"). Under the Revenue Standard, revenue is recognized to reflect the transfer of goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. Companies have the option to apply the new guidance under a retrospective approach to each prior reporting period presented or a modified retrospective approach with the cumulative effect of initially applying the new guidance recognized at the date of initial application within the Consolidated Balance Sheet. The new Revenue Standard became effective for annual reporting periods beginning after December 15, 2017, and the Company has adopted the new revenue standard using the modified retrospective approach on December 30, 2017, the first day of the Company's 2018 fiscal year.

The Company creates and manufactures flavors and fragrances. Approximately 90% of its products, principally Flavors compounds and Fragrances compounds, are customized to customer specifications and have no alternative use other than the sale to the specific customer ("Compounds products"). The remaining revenue is derived largely from Fragrance Ingredients products that, generally, are commodity products with alternative uses and not customized ("Ingredients products").

With respect to the vast majority of the Company's contracts for Compounds products, the Company currently recognizes revenue on the transfer of control of the product at a point in time as the Company does not have an "enforceable right to payment for performance to date" (as set out in the Revenue Standard). With respect to a small number of contracts for the sale of Compounds, the Company has an "enforceable right to payment for performance to date" and as the products do not have an alternative use, the Company recognizes revenue for these contracts over time and records a contract asset using the output method. The output method recognizes revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract.

With respect to the Company's contracts related to Ingredients products, the Company currently recognizes revenue on the transfer of control of the product at a point in time as such products generally have alternative uses and the Company does not have an "enforceable right to payment for performance to date."

As the Company adopted the Revenue Standard using the modified retrospective method effective the first day of its 2018 fiscal year, results for its 2018 fiscal year are presented under the Revenue Standard while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under ASC Topic 605, which required that revenue was accounted for when the earnings process was complete.

The Company recorded a net increase to retained earnings of $2.1 million as of the first day of its 2018 fiscal year due to the cumulative impact of adopting the Revenue Standard. In connection with the adjustment to retained earnings, the Company also recorded an increase of $4.4 million in contract assets (which are included in Prepaid expenses and other assets), a decrease of $1.7 million in inventory, and an increase in taxes payable of $0.6 million.

The impact to revenues, gross profit and net income for three months ended March 31, 2018 were reductions of $0.6 million, $0.4 million and $0.3 million, respectively, as a result of applying the Revenue Standard as compared to the amounts that would have been recognized under ASC Topic 605.

Revenue Recognition

The Company recognizes revenue when control of the promised goods is transferred to its customers in an amount that reflects the consideration it expects to be entitled to in exchange for those goods. Sales, value add, and other taxes the Company collects are excluded from revenues. The Company receives payment in accordance with standard customer terms.

The following table presents the Company's revenues disaggregated by business unit:

	Three Months Ended March 31,	
(DOLLARS IN THOUSANDS)	2018	2017[(a)]
Flavor Compounds	449,019	406,164
Fragrance Compounds		
Consumer Fragrances	280,238	252,695
Fine Fragrances	98,395	87,705
Fragrance Ingredients	103,276	81,729
Total revenues	930,928	828,293

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(a) Prior period amounts have not been adjusted based on the modified retrospective method.

The following table presents our revenues disaggregated by region, based on the region of our customers:

	Three Months Ended March 31,	
(DOLLARS IN THOUSANDS)	2018	2017[(a)]
Europe, Africa and Middle East	309,312	257,684
Greater Asia	243,557	222,820
North America	241,146	218,828
Latin America	136,913	128,961
Total revenues	930,928	828,293

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(a) Prior period amounts have not been adjusted based on the modified retrospective method.

Flavors and Fragrances Compounds Revenues

The Company accounts for a contract when it has approval and commitment from both parties, the rights of the parties and payment terms (which vary by customer) are identified, the contract has commercial substance, and collectability of consideration is probable. Consistent with our past practice, the amount of revenue recognized is adjusted at the time of sale for expected discounts and rebates (“Variable Consideration”).

The Company generates revenues primarily by manufacturing customized Flavor compounds and Fragrance compounds for the exclusive use of our customers. The Company combines the shipment of goods with their manufacture to account for both shipment and manufacture as the sole performance obligation.

With respect to the vast majority of the Company’s contracts for Compounds products, the Company recognizes a sale at the point in time when it ships the product from its manufacturing facility to its customer, as this is the time when control of the goods has transferred to the customer. The amount of consideration received and revenue recognized is impacted by the Variable Consideration the Company has agreed with its customers. The Company estimates Variable Consideration amounts for each customer based on the specific agreement, an analysis of historical volumes and the current activity with that customer. The Company reassesses its estimates of Variable Consideration at each reporting date throughout the contract period and updates the estimate until the uncertainty is resolved. During the current period, changes to estimates of Variable Consideration have been immaterial.

With respect to a small number of contracts for the sale of Compounds products, the Company recognizes revenue over time as it manufactures customized compounds that do not have an alternative use and for which the contracts provide the Company with an enforceable right to payment, including a reasonable profit, at all times during the contract term commencing with the manufacturing of the goods. When revenue is recognized over time, the amount of revenue recognized is based on the extent of progress towards completion of the promised goods. The Company generally uses the output method to measure progress for its contracts as this method reflects the transfer of goods to the customer. Once customization begins, the manufacturing process is generally completed within a two week period. Due to the short time frame for production, there is little estimation uncertainty in the process. In addition, due to the customized nature of our products, our returns are not material.

Fragrance Ingredients Revenues

The Company accounts for a contract when it has approval and commitment from both parties, the rights of the parties and payment terms (which vary by customer) are identified, the contract has commercial substance, and collectability of consideration is probable.

The Company generates revenues primarily by manufacturing Ingredients products for the use of our customers. The Company combines the shipment of goods with their manufacture to account for both shipment and manufacture as the sole performance obligation.

Generally, the Company recognizes a sale at the time when it ships the product from their manufacturing facility to their customer, as this is the point when control of the goods or services has transferred to the customer. The amount of consideration received and revenue recognized is impacted by discounts offered to its customers. The Company estimates discounts based on an analysis of historical experience and current activity. The Company assesses its estimates of discounts at each reporting date throughout the contract period and updates its estimates until the uncertainty has been resolved. During the current period, changes to estimates of discounts have been immaterial.

Contract Asset and Accounts Receivable

The following table reflects the changes in our contract assets and accounts receivable for the three months ended March 31, 2018 and December 31, 2017:

(DOLLARS IN THOUSANDS)	March 31, 2018	At adoption
Receivables (included in Trade receivables)	747,862	677,055
Contract asset - Short term	3,839	4,449

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:

	Three Months Ended March 31,	
(SHARES IN THOUSANDS)	2018	2017
Basic	79,018	79,098
Assumed dilution under stock plans	375	311
Diluted	79,393	79,409

There were no stock options or stock-settled appreciation rights (“SSARs”) excluded from the computation of diluted net income per share for the three months ended March 31, 2018 and 2017.

The Company has issued shares of purchased restricted common stock and purchased restricted common stock units (collectively “PRSUs”) which contain rights to nonforfeitable dividends while these shares are outstanding and thus are considered participating securities. Such securities 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 PRSU shareholders was less than $0.01 per share for each period presented, and the number of PRSUs outstanding as of March 31, 2018 and 2017 was immaterial. Net income allocated to such PRSUs was $0.3 million for both the three months ended March 31, 2018 and 2017.

NOTE 3. ACQUISITIONS

PowderPure

On April 7, 2017, the Company completed the acquisition of 100% of the outstanding shares of Columbia PhytoTechnology, LLC d/b/a PowderPure ("PowderPure"), a privately-held flavors company with facilities in North America. The acquisition was accounted for under the purchase method. PowderPure was acquired to expand expertise in, and product offerings of, clean label solutions within the Flavors business. The Company paid approximately $54.6 million, including $0.4 million of cash acquired for this acquisition, which was funded from existing resources. Additionally, the Company recorded an accrual of approximately $1.4 million representing the estimate at acquisition of additional contingent consideration payable to the former owners of PowderPure (the maximum earnout payable is $10 million upon satisfaction of certain performance metrics).

The purchase price exceeded the preliminary fair value of existing net assets by approximately $48.0 million. The excess was allocated principally to identifiable intangible assets including approximately $27.5 million to proprietary technology, approximately $4.5 million to trade name, approximately $0.8 million to customer relationships, and approximately $15.2 million of goodwill which is deductible for tax purposes. Goodwill is the excess of the purchase price over the fair value of net assets acquired and represents the value the Company expects to achieve from its increased exposure to clean label products within the existing Flavors business. The intangible assets are being amortized over the following estimated useful lives: proprietary technology, 14 years; trade name, 14 years; and customer relationships, 2 years.
The purchase price allocation was completed in the first quarter of 2018. No material adjustments have been made to the purchase price allocation since the preliminary valuation performed in the second quarter of 2017. The estimated amount of the contingent consideration payable was revised during the first quarter of 2018 and resulted in a decrease in administrative expense of approximately $0.6 million.
No pro forma financial information for 2017 is presented as the acquisition was not material to the consolidated financial statements.
Fragrance Resources
On January 17, 2017, the Company completed the acquisition of 100% of the outstanding shares of Fragrance Resources, Inc., Fragrance Resources GmbH, and Fragrance Resources SAS (collectively "Fragrance Resources"), a privately-held fragrance company with facilities in Germany, North America, France, and China. The acquisition was accounted for under the purchase method. Fragrance Resources was acquired to strengthen the North American and German Fragrances business.
The Company paid approximately €143.4 million (approximately $151.9 million) including approximately €13.7 million (approximately $14.4 million) of cash acquired for this acquisition, which was funded from existing resources including use of its revolving credit facility. Of the total paid, approximately €142.0 million (approximately $150.5 million) was paid at closing and an additional €1.4 million (approximately $1.5 million) was paid in connection with the finalization of the working capital adjustment. The purchase price exceeded the fair value of existing net assets by approximately $122.0 million. The excess was allocated principally to identifiable intangible assets including approximately $51.7 million related to customer relationships, approximately$13.6 million related to proprietary technology and trade name, and approximately $72.0 million of goodwill (which is not deductible for tax purposes) and approximately $15.3 million of net deferred tax liability. Goodwill is the excess of the purchase price over the fair value of net assets acquired and represents synergies from the addition of Fragrance Resources to the Company's existing Fragrances business. The intangible assets are being amortized over the following estimated useful lives: trade name, 2 years; proprietary technology, 5 years; and customer relationships, 12 - 16 years.
The purchase price allocation was finalized in the fourth quarter of 2017. Certain measurement period adjustments were made subsequent to the initial purchase price allocation including adjustments related to the finalization of the purchase price, the allocation of certain intangibles and the calculation of applicable deferred taxes. The additional amortization of intangibles required as a result of the measurement period adjustments was not material.
No pro forma financial information for 2016 is presented as the acquisition was not material to the consolidated financial statements.
NOTE 4.   RESTRUCTURING AND OTHER CHARGES, NET
Restructuring and other charges primarily consist of separation costs for employees including severance, outplacement and other benefit costs.
2017 Productivity Program
On February 15, 2017, the Company announced that it was adopting a multi-year productivity program designed to improve overall financial performance, provide flexibility to invest in growth opportunities and drive long-term value creation. In connection with this program, the Company expects to optimize its global footprint and simplify its organizational structures globally. In connection with this initiative, the Company expects to incur cumulative, pre-tax cash charges of between $30-$35 million, consisting primarily of $24-$26 million in personnel-related costs and an estimated $6 million in facility-related costs, such as lease termination, and integration-related costs.

The Company recorded $21.3 million of charges related to personnel costs and lease termination costs through the first quarter of 2018, with the remainder of the personnel related and other costs expected to be recognized by the end of 2018. The Company recorded $0.7 million and $10.1 million of charges related to personnel costs and lease termination costs during the three months ended March 31, 2018 and 2017, respectively.

The Company made payments of $1.7 million related to severance in 2018. The overall charges were split approximately evenly between Flavors and Fragrances. This initiative is expected to result in the reduction of approximately 370 members of the Company's global workforce, including acquired entities, in various parts of the organization.

Changes in employee-related restructuring liabilities during the three months ended March 31, 2018, were as follows:

(DOLLARS IN THOUSANDS)	Employee-Related Costs	Other	Total
Balance at December 31, 2017	$ 7,539	$418	$7,957
Additional charges (reversals), net	717	—	717
Non-cash charges	—	—	—
Payments	(1,696)	—	(1,696)
Balance at March 31, 2018	$ 6,560	$418	$6,978

NOTE 5. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Goodwill

Movements in goodwill during 2018 were as follows:

(DOLLARS IN THOUSANDS)	Goodwill
Balance at December 31, 2017	$1,156,288
Acquisitions	22
Foreign exchange	9,712
Balance at March 31, 2018	$1,166,022

Other Intangible Assets

Other intangible assets, net consisted of the following amounts:

(DOLLARS IN THOUSANDS)	March 31, 2018	December 31, 2017
Asset Type		
Customer relationships	$414,684	$407,636
Trade names & patents	39,556	38,771
Technological know-how	162,515	161,856
Other	24,909	24,814
Total carrying value	641,664	633,077
Accumulated Amortization		
Customer relationships	(111,796)	(104,800)
Trade names & patents	(16,175)	(15,241)
Technological know-how	(79,929)	(76,766)
Other	(19,709)	(20,483)
Total accumulated amortization	(227,609)	(217,290)
Other intangible assets, net	$414,055	$415,787

Amortization

Amortization expense was $9.2 million and $7.1 million for the three months ended March 31, 2018 and 2017, respectively. Annual amortization is expected to be $36.7 million for the full year 2018, $35.2 million for the year 2019, $34.5 million for the year 2020, $29.7 million for the year 2021, $25.5 million for the year 2022 and $25.4 million for the year 2023.

NOTE 6. BORROWINGS

Debt consists of the following:

(DOLLARS IN THOUSANDS)	Effective Interest Rate		March 31, 2018	December 31, 2017
Senior notes - 2007 [(1)]	6.40% - 6.82%		$249,800	$249,765
Senior notes - 2013 [(1)]	3.39	%	298,747	298,670
Euro Senior notes - 2016 [(1)]	1.99	%	611,030	589,848
Senior notes - 2017 [(1)]	4.50	%	492,880	492,819
Credit facility	LIBOR + 1.125%	(2)	24,617	—
Commercial paper	—	% (3)	29,926	—
Bank overdrafts and other			5,973	7,993
Deferred realized gains on interest rate swaps			57	57
			1,713,030	1,639,152
Less: Short term borrowings [(4)]			(36,819)	(6,966)
			$1,676,211	$1,632,186

(1) Amount is net of unamortized discount and debt issuance costs.

(2) Represents the rate on drawn down and outstanding balances. Deferred debt issuance costs are immaterial.

(3) The effective interest rate of commercial paper issuances fluctuate as short term interest rates and demand fluctuate, and deferred debt issuance costs are immaterial. Additionally, the effective interest rate of commercial paper is not meaningful as issuances do not materially differ from short term interest rates.

(4) Includes bank borrowings, commercial paper, overdrafts and current portion of long-term debt.

Commercial Paper

Commercial paper issued by the Company generally has terms of 90 days or less. As of March 31, 2018, there was $29.9 million of commercial paper outstanding and no commercial paper outstanding as of December 31, 2017. The revolving credit facility is used as a backstop for the Company's commercial paper program. The maximum amount of commercial paper outstanding for the three months ended March 31, 2018 and 2017 was $40.0 million and $107.5 million, respectively.

NOTE 7. INCOME TAXES

U.S. Tax Reform

In the fourth quarter of 2017, the Company recorded approximately $139.2 million in charges related to the impact of the Tax Act. Given the significant complexity of the Tax Act, anticipated guidance from the U.S. Treasury about implementing the Tax Act and the potential for additional guidance from the SEC or the FASB, the amount recorded by the Company in the fourth quarter of 2017 was provisional and will continue to be adjusted during 2018. The impact of the Tax Act is expected to be finalized no later than the fourth quarter of 2018. The aforementioned guidance and additional information regarding the Tax Act may also impact the Company's 2018 effective income tax rate, exclusive of any adjustment to the provisional charge. Any material revisions in our computations could adversely affect our cash flows and results of operations.

During the first quarter of 2018, the Company recorded an additional charge of $0.6 million to adjust an accrual related to withholding taxes on planned repatriations.

Uncertain Tax Positions

At March 31, 2018, the Company had $28.5 million of unrecognized tax benefits recorded in Other liabilities and $5 million in Other current liabilities. If these unrecognized tax benefits were recognized, the effective tax rate would be affected.

At March 31, 2018, the Company had accrued interest and penalties of $2.3 million classified in Other liabilities and $0.5 million in Other current liabilities.

As of March 31, 2018, the Company's aggregate provisions for uncertain tax positions, including interest and penalties, was $36.3 million associated with various tax positions asserted in various jurisdictions, none of which is individually material.

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. In addition, the Company has open tax years with various taxing jurisdictions that range primarily from 2008 to 2017. 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.

The Company also has other ongoing tax audits and legal proceedings that relate to indirect taxes, such as value-added taxes, sales and use taxes and property taxes, which are discussed in Note 13.

Effective Tax Rate

The effective tax rate for the three months ended March 31, 2018 was 18.5% compared with 16.4% for the three months ended March 31, 2017. The year-over-year increase was largely due to the impact of U.S. tax reform and increased loss provisions, partially offset by mix of earnings, a lower cost of repatriation (principally due to tax reform) and the release of a State valuation allowance that related to prior years.

NOTE 8. 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 PRSUs, restricted stock units (RSUs), 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:

	Three Months Ended March 31,	
(DOLLARS IN THOUSANDS)	2018	2017
Equity-based awards	$7,620	$5,819
Liability-based awards	155	1,753
Total stock-based compensation expense	7,775	7,572
Less: tax benefit	(1,563)	(2,213)
Total stock-based compensation expense, after tax	$6,212	$5,359

NOTE 9. 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 and other charges, net; Global expenses and certain non-recurring items; Interest expense; Other income (expense), 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:

(DOLLARS IN THOUSANDS)	Three Months Ended March 31, 2018	2017
Net sales:		
Flavors	$449,019	$406,164
Fragrances	481,909	422,129
Consolidated	$930,928	$828,293
Segment profit:		
Flavors	$111,564	$94,556
Fragrances	93,277	77,875
Global expenses	(23,825)	(16,293)
Operational Improvement Initiatives (a)	(1,026)	(621)
Acquisition Related Costs (b)	514	(8,788)
Integration Related Costs (c)	—	(1,192)
Tax Assessment (d)	—	(5,350)
Restructuring and Other Charges, net (e)	(717)	(10,143)
Gain on Sale of Assets	69	21
FDA Mandated Product Recall (f)	(5,000)	—
Operating profit	174,856	130,065
Interest expense	(16,595)	(12,807)
Other income (expense)	576	21,229
Income before taxes	$158,837	$138,487

(a) For 2018, represents accelerated depreciation related to a plant relocation in India and a lab closure in Taiwan. For 2017, represents accelerated depreciation and idle labor costs in Hangzhou, China.

(b) For 2018, represents adjustments to the contingent consideration payable for PowderPure, and transaction costs related to Fragrance Resources and PowderPure within Selling and administrative expenses. For 2017, represents the amortization of inventory "step-up" related to the acquisitions of David Michael and Fragrance Resources, included in cost of goods sold and transaction costs related to the acquisitions of David Michael, Fragrance Resources and PowderPure, included in Selling and administrative expenses.

(c) Represents costs related to the integration of the David Michael and Fragrance Resources acquisitions.

(d) Represents the reserve for payment of a tax assessment related to commercial rent for prior periods.

(e) Represents severance costs related to the 2017 Productivity Program and Taiwan lab closure.

(f) Represents management's best estimate of losses related to the previously disclosed FDA mandated recall.

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 March 31, 2018 and 2017 were $230.2 million and $227.6 million, respectively. Net sales attributed to all foreign countries in total for the three months ended March 31, 2018 and 2017 were $700.7 million and $600.7 million, respectively. No country other than the U.S. had net sales in any period presented greater than 6% of total consolidated net sales.

NOTE 10. EMPLOYEE BENEFITS

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

(DOLLARS IN THOUSANDS)	U.S. Plans Three Months Ended March 31, 2018	2017	Location of Pension Benefit (Income)
Service cost for benefits earned	$596	$698	Included as a component of Operating Profit
Interest cost on projected benefit obligation	4,790	4,560	Included as a component of Other Income (Expense), net
Expected return on plan assets	(7,739)	(9,246)	Included as a component of Other Income (Expense), net
Net amortization and deferrals	1,549	1,793	Included as a component of Other Income (Expense), net
Net periodic benefit income	(804)	(2,195)	
Defined contribution and other retirement plans	2,690	2,255	Included as a component of Operating Profit
Total expense	$1,886	$60	

(DOLLARS IN THOUSANDS)	Non-U.S. Plans Three Months Ended March 31, 2018	2017	Location of Pension Benefit (Income)
Service cost for benefits earned	$4,470	$5,514	Included as a component of Operating Profit
Interest cost on projected benefit obligation	4,338	3,848	Included as a component of Other Income (Expense), net
Expected return on plan assets	(12,032)	(12,133)	Included as a component of Other Income (Expense), net
Net amortization and deferrals	2,972	3,923	Included as a component of Other Income (Expense), net
Net periodic benefit (income) cost	(252)	1,152	
Defined contribution and other retirement plans	1,551	1,297	Included as a component of Operating Profit
Total expense	$1,299	$2,449	

The Company expects to contribute a total of approximately $4.1 million to its U.S. pension plans and a total of $17.1 million to its Non-U.S. Plans during 2018. During the three months ended March 31, 2018, no contributions were made to the qualified U.S. pension plans, $3.3 million of contributions were made to the non-U.S. pension plans, and $1.1 million of benefit payments were made with respect to the Company's non-qualified U.S. pension plan.

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

(DOLLARS IN THOUSANDS)	Three Months Ended March 31, 2018	2017
Service cost for benefits earned	$195	$221
Interest cost on projected benefit obligation	654	588
Net amortization and deferrals	(1,189)	(1,046)
Total postretirement benefit income	$(340)	$(237)

The components of net periodic benefit (income) other than the service cost component are included in Other (income) expense, net in the Consolidated Statement of Income and Comprehensive Income. Beginning in 2018, under the revised FASB guidance adopted in the first quarter, only the service cost component of net periodic benefit

(income) cost is a component of operating profit in the Consolidated Statements of Income and Comprehensive Income and the other components of net periodic benefit cost are now included in Other (income), net. As a result of this change, Other income increased by approximately $6.1 million and $7.3 million in the three months ended March 31, 2018 and 2017, respectively, compared to what the Other (income) expense, net would have been under the previous method. The retroactive $7.3 million reduction in operating profit for the three months ended March 31, 2017 was reflected as a $1.6 million increase in cost of goods sold, a $2.4 million increase in research and development expenses, and a $3.3 million increase in selling and administrative expenses.
The Company expects to contribute approximately $5.0 million to its postretirement benefits other than pension plans during 2018. In the three months ended March 31, 2018, $0.9 million of contributions were made.

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NOTE 11. 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 the Company's 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 the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. The Company determines the fair value of structured liabilities (where performance is linked to structured interest rates, inflation or currency risks) using the London Interbank Offer Rate ("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. The Company does not have any instruments classified as Level 1 or Level 3, other than those included in pension asset trusts as discussed in Note 14 of our 2017 Form 10-K.

These valuations take into consideration the Company's credit risk and its counterparties' credit risk. The estimated change in the fair value of these instruments due to such changes in its own credit risk (or instrument-specific credit risk) was immaterial as of March 31, 2018.

The principal amounts and the estimated fair values of financial instruments at March 31, 2018 and December 31, 2017 consisted of the following:

	March 31, 2018		December 31, 2017	
(DOLLARS IN THOUSANDS)	Principal	Fair Value	Principal	Fair Value
Cash and cash equivalents(1)	$305,276	$305,276	$368,046	$368,046
Credit facilities and bank overdrafts(2)	30,589	30,589	7,993	7,993
Commercial paper (2)	29,926	29,926	—	—
Long-term debt:(3)				
Senior notes - 2007	250,000	285,062	250,000	293,232
Senior notes - 2013	300,000	297,535	300,000	304,219
Euro Senior notes - 2016	615,400	642,921	594,400	627,782
Senior notes - 2017	500,000	497,689	500,000	525,906

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

(2) The carrying amount 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 the Company's long-term debt was calculated using discounted cash flows applying current interest rates and current credit spreads based on its own credit risk.

Derivatives

The Company periodically enters into foreign currency forward contracts with the objective of reducing exposure to cash flow volatility associated with its 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.

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During the three months ended March 31, 2018 and the year ended December 31, 2017, the Company entered into several forward currency contracts which qualified as net investment hedges, in order to mitigate a portion of its 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 Income and Comprehensive Income. Realized gains/(losses) are deferred in accumulated other comprehensive income (loss) ("AOCI") where they will remain until the net investments in the Company's European subsidiaries are divested. The outstanding forward currency contracts have remaining maturities of less than one year. Three of these forward currency contracts matured during the three months ended March 31, 2018.

Subsequent to the issuance of the Euro Senior Notes - 2016 during the first quarter of 2016, the Company designated the debt as a hedge of a portion of its net European investments. Accordingly, the change in the value of the debt that is attributable to foreign exchange movements is recorded in OCI as a component of Foreign currency translation adjustments in the accompanying Consolidated Statement of Income and Comprehensive Income.

During the three months ended March 31, 2018 and the year ended December 31, 2017, the Company 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 Income and 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 Income and Comprehensive Income in the same period as the related costs are recognized.

The Company maintains various interest rate swap agreements that effectively convert the fixed rate on a portion of its 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 months ended March 31, 2018 and 2017.

The Company has previously entered into interest rate swap agreements to hedge the anticipated issuance of fixed-rate debt, which are designated as cash flow hedges. The amount of gains and losses realized upon termination of these agreements is amortized over the life of the corresponding debt issuance.

The following table shows the notional amount of the Company’s derivative instruments outstanding as of March 31, 2018 and December 31, 2017:

(DOLLARS IN THOUSANDS)	March 31, 2018	December 31, 2017
Forward currency contracts	$777,134	$896,947
Interest rate swaps	$150,000	$150,000

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 Sheet as of March 31, 2018 and December 31, 2017:

	March 31, 2018		
(DOLLARS IN THOUSANDS)	Fair Value of Derivatives Designated as Hedging Instruments	Fair Value of Derivatives Not Designated as Hedging Instruments	Total Fair Value
Derivative assets [(a)]			
Foreign currency contracts	$1,053	$ 6,307	$ 7,360
Derivative liabilities [(b)]			
Foreign currency contracts	$6,425	$ 743	$ 7,168
Interest rate swaps	3,169	—	3,169
Total Derivative liabilities	$9,594	$ 743	$ 10,337

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(DOLLARS IN THOUSANDS)	December 31, 2017 Fair Value of Derivatives Designated as Hedging Instruments	Fair Value of Derivatives Not Designated as Hedging Instruments	Total Fair Value
Derivative assets [(a)]			
Foreign currency contracts	$ 1,159	$ 3,978	$ 5,137
Derivative liabilities [(b)]			
Foreign currency contracts	$ 7,842	$ 4,344	$ 12,186
Interest rate swaps	1,369	—	1,369
Total Derivative liabilities	$ 9,211	$ 4,344	$ 13,555

(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 Income and Comprehensive Income for the three months ended March 31, 2018 and 2017 (in thousands):

(DOLLARS IN THOUSANDS)	Amount of Gain (Loss)	Location of Gain (Loss) Recognized in Income on Derivative