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IPHS - Q1 2017 Innophos Holdings Inc Earnings Call

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PRESENTATION

Operator

Welcome to the First Quarter 2017 Innophos Earnings Conference Call. My name is Ellen, and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded. I will now turn the call over to Mark Feuerbach. Mr. Feuerbach, you may begin.

Mark Feuerbach - *Innophos Holdings, Inc. - Former VP of IR, Treasury, Financial Planning & Analysis*

Good morning, and thank you for joining us today for Innophos' First Quarter 2017 Results Conference Call. Joining me on the call today are Kim Ann Mink, Chairman, President and Chief Executive Officer; and Han Kieftenbeld, Chief Financial Officer.

During the course of this call, management may make or reiterate forward-looking statements made in our May 1 press release regarding financial performance and future events. We will attempt to identify these statements by use of words such as expects, believes, anticipates, intends and other words that denote future events. These forward-looking statements are subject to material risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.

We caution you to consider the important risks and other factors as set forth in the forward-looking statements section and in Item 1A Risk Factors in our Annual Report on Form 10-K, as filed with the SEC, that could cause actual results to differ from those in the forward-looking statements made in this conference call.

Also, I would like to remind you that during the course of this conference call, management will discuss non-GAAP measures in talking about the company's performance. Reconciliations to the most directly comparable GAAP financial measures are provided in the tables in yesterday's press release and in the appendix of today's presentation.

We will make a replay of this conference call available for a limited time over the telephone at the numbers set forth in the press release and via webcast available on the company website.

In addition, please note that the date of this conference call is May 2, 2017, and the presentation for this call can be found on our website at www.innophos.com in the Investor Relations Events section.

Any forward-looking statements we may make today are based on assumptions that we believe to be reasonable as of this date, and we undertake no obligation to update these statements.



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With that, please turn to Slide 4 as I turn the call over to Dr. Kim Ann Mink.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Thanks, Mark. And good morning, everyone, and thank you for joining us today.

This is an important transformational time for our company as we execute against our strategy to expand our presence as the growing global supplier of vital ingredient solutions for the food, health and nutrition markets. Over the past 15 months, we focused on strengthening the foundation of our business, delivering significant bottom line improvement and laying the groundwork for growth. And I'm very, very proud of the incredible work that our team has achieved in such a short time.

Although 2017 is expected to be a transition year for Innophos, we're confident that our strategic framework provides a clear path to revitalized growth and sustained profitability.

We're pleased with our Q1 performance, which was at the high end of our preliminary results range. By remaining focused on cost discipline and Operational Excellence across the organization and leveraging favorable product mix, we delivered year-over-year adjusted EBITDA margin growth despite a 12% decrease in sales due to portfolio pruning and continued market headwinds.

The start of the fiscal year was highlighted by several significant strategic advancements as well, including the strengthening of my executive team with the hiring of Mark Santangelo as Senior Vice President of Manufacturing, Engineering and EH&S; the continued progress against our 3 strategic pillars; and the introduction of our Strategic Growth Roadmap, Vision 2022, that targets revenue growth to \$1.25 billion and a 250 basis point improvement in adjusted EBITDA by 2022.

Before turning the call to Han to cover the quarterly financials in more detail, I'd like to take a few moments to expand on these strategic accomplishments, starting on Slide 5. At our April 5 Investor Day, we unveiled our new long-term growth road map, Vision 2022. Vision 2022 establishes the clear goal of becoming a larger, more profitable Innophos with an enhanced growth profile, asset-light investment need and a leadership position as a vital ingredients provider to attractive and growing segments of the food, health and nutrition markets. This growth will be built on our solid foundation and the value we bring to customers through our existing capabilities and relationships. Through organic and inorganic strategic growth efforts, we will more deeply align Innophos with consumer mega trends and broaden the breadth of value-added and innovative technology-based vital ingredient solutions we offer the food, health and nutrition markets. We will also retain a select cash-generating Industrial Specialties business.

Now across our efforts, we will continue to leverage our significant work in operational excellence and commercial excellence to deliver best-in-class practices, an agile supply chain and cost-effective operations with the ultimate goal of delivering enhanced value to our customers and to our shareholders.

We're confident that by executing against our plans, we will deliver on our Vision 2022 and transform Innophos into a \$1.25 billion company with a 20% adjusted EBITDA margin profile by 2022.

Let's turn to Slide 6 now. We continue to make significant progress across the 3 pillars of operational excellence, commercial excellence and strategic growth, which are at the heart of Vision 2022.

Turning to Slide 7. I will review our operational excellence pillar, which remains a top priority. In fact, it has yielded considerable savings already with Phase 1 efforts resulting in \$16 million of procurement savings, \$12 million of which were realized in 2016 and \$2 million in Q1. We expect to recognize the final \$2 million of Phase 1 savings in Q2.

We've now moved on to the second phase efforts where we're driving out costs by implementing a strategic purchasing process focused on logistics, packaging and MRO parts and labor. These Phase 2 efforts are expected to yield an incremental \$13 million of savings, of which \$5 million is expected to be generated in the second half of 2017.



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Now over the past 15 months, we have moved from a local purchasing and logistics structure to a global, central-led organization positioned to evolve further to a fully integrated supply chain, and we're proud of what we accomplished and are committed to our continuous improvement mindset.

Moving on to commercial excellence on Slide 8 where we're actively executing several key strategic initiatives. This includes our new customer segmentation strategy where we're embracing a diversified cost-to-serve approach by allocating resources more strategically and efficiently to our customers. We've also put in place our market-focused global sales organization, which aligns our sales team with key end markets and sales channels. And we've implemented our 3-in-the-box go-to-market model that joins our technical, commercial and marketing resources. Combined, these efforts enhance Innophos' position as a valued solutions provider across our core portfolio of food, health and nutrition as well as industrial specialties. In addition, they ensure that we both deliver and derive value deep and wide across our global and diverse customer base.

Moving to Slide 9. We're actively executing our newly defined and actionable strategic growth roadmap, which sets us on a course for delivering meaningful expansion through targeted organic and disciplined inorganic growth. Looking through our newly refocused market lens, we will selectively defend and maintain our Industrial Specialties business while at the same time we continue to evaluate our product portfolio and selectively prune low-margin, lower-value businesses.

Our focus in food, health and nutrition will be on aggressively defending and maintaining our current business, delivering organic growth via product application development and positioning ourselves for meaningful M&A in high-growth sub-segments with attractive margins that expand and diversify our solution capability beyond phosphate.

Now our M&A pipeline is active and we are very excited about the potential candidates that we're evaluating. Prospects include growth-oriented recognized leaders in the markets that they serve. They have the potential to provide revenue synergies from customer portfolio overlap and offer technology and science-based assets that are underpinned by intellectual property. We're looking to add up to \$475 million of total top line growth through acquisitions over the next several years. We're evaluating deals that range from bolt-ons to more meaningful and transformative opportunities and we're confident in our ability to integrate and manage deals across this spectrum. We have a refreshed and energized executive team that has a proven track record and significant experience in all stages of M&A, from systematically evaluating prospects to due diligence to the critical integration process.

In addition, we've established formalized due diligence and integration processes that are designed to increase accountability, establish key milestones and provide early warning signals as we move through the critical post acquisition stage.

I want to emphasize that we are very, very different, more efficient and strategically aligned Innophos today than we were even just a year ago. We have a proven and deeply instilled DNA of operational excellence, sophisticated supply chain and procurement processes and deep bench strength across the organization. This transformation has positioned Innophos to be ready to take on this next stage of our growth.

As we move forward in 2017, although we expect to face significant market headwinds, we remain confident that by executing against our strategy and focusing on the factors that we can control, we will continue to deliver value in the near, mid- and long term as we positioned Innophos for revitalized growth.

With that, I'll now turn the call over to Han to review our Q1 financials and our outlook.

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Thanks, Kim Ann, and hello to everyone joining us today.

Before I discuss our financial results, I want to remind everyone that our adjusted EBITDA financial measure excludes stock-based compensation, currency translation and restructuring expenses. Please refer to our press release and SEC filings for the GAAP to non-GAAP reconciliations.



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As shown on Slide 10, in the first quarter, we met or exceeded the preliminary results ranges that we provided on April 5th with Q1 sales of \$166 million, adjusted EBITDA of \$28 million and adjusted diluted EPS of \$0.59. Sequentially, while sales were flat, our earnings profile also improved due to better mix and an improved cost profile. Q1 EPS was above our stated range due to a discrete tax benefit, which accreted to \$0.04 per share.

Now turning to Slide 11. We delivered year-over-year gross margin and EBITDA margin improvement of 55 basis points and 21 basis points, respectively, despite a 12% decline in sales. This is due to product mix improvement and the positive impact of ongoing cost actions. The adjusted EBITDA bridge demonstrates how our continued focus on lowering input costs and tight cost control delivered \$13 million of savings year-over-year, which mostly offsets the unfavorable \$16 million impact from lower volume and price erosion. Q1 costs included \$1 million of Phase 2 Operational Excellence implementation fees.

Now turning to Slide 12. Sales of \$166 million in the quarter were basically consistent sequentially and 12% down versus the prior year with reductions seen in both the direct and indirect sales channels. The year-over-year variance was driven by 7% unfavorable volume and 5% unfavorable impact from lower average selling prices.

Gross margin of 22% improved year-over-year by 55 basis points due to favorable input cost and better mix.

Moving on to earnings on Slide 13. Net income for Q1 was \$11 million, up \$2 million sequentially but down \$2 million from the first quarter of 2016. Net income as a percent of sales of 7% was down 19 basis points year-over-year with \$1 million of Phase 2 Operational Excellence implementation fees and \$1 million of severance costs, partly offset by a discrete tax benefit that I will touch upon in a moment.

Adjusted EBITDA for the quarter was \$28 million, up \$2 million sequentially, but down \$3 million or 11% from last year. Adjusted EBITDA margin in the quarter was 17%, up 21 basis points versus the year prior.

Moving on to Slide 14. As announced at our Investor Day effective Q1 2017, we transitioned to 3 new reporting segments: Food, Health and Nutrition or FHN, Industrial Specialties or IS and Other. These new reporting segments more accurately reflect the underlying business dynamics and better align with the strategic direction of the company.

Food, Health and Nutrition is a diversified portfolio of vital ingredient solutions that serve an attractive consumer-driven marketplace that is influenced by mega trends like energized aging, health and wellness and clean labels. The FHN segment offers meaningful growth and a strong margin profile.

Industrial Specialties includes phosphate technologies that serve a variety of well-established applications in more mature markets. Our IS business is cash generative, which is very important to us. By executing against our strategy of selectively defending and maintaining our position in IS, we expect to deliver an improved margin profile over time. Underpinning both businesses is our commitment to continuous improvement.

Now moving on to Slide 15. Food, Health and Nutrition sales of \$91 million declined 7% versus Q1 of the prior year with a 4% decline in volumes and a 3% decline in price. The falling decline was primarily seen in high-margin export sales, driven by external factors including currency exchange restrictions in Venezuela and increased import tariffs into China. In addition, sales in India saw a slowdown due to lower-than-anticipated growth. FHN generated adjusted EBITDA margin of 18%, down from 21% in the year ago quarter due to unfavorable mix that I just explained.

Industrial Specialties sales of \$64 million declined 15% with an 8% decline in volume and mix and 7% decline in price, reflecting our proactive pruning of lower-margin business as well as strong price competition in technical-grade products.

IS adjusted EBITDA margin improved year-over-year by 295 basis points to 16% due to mix improvement and strong cost discipline.

Other sales were \$11 million, down 33%. And adjusted EBITDA was \$1 million, in line with the same period of last year.

Now turning to Slide 16. Net interest expense of \$1 million in the first quarter was favorable compared to the same period last year, showing the benefits of our new credit facility.

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Our effective tax rate of 28% for the first quarter was helped by a discrete tax benefit of \$1 million from a change in taxation on stock compensation, which became effective January 1, 2017. Excluding this item, the effective tax rate for the current quarter would have been 33%, which we anticipate to be the normalized rate for the balance of the year.

Capital expenditures of \$9 million in the quarter include approximately 30% for maintenance, 20% for growth-related projects and 50% for the Geismar deep well investment.

We paid \$9 million in dividends during the quarter, which represents a strong payout ratio of 87%.

Finally in the first quarter, net debt of \$159 million was 20% -- 26% lower than the year ago quarter, but up 21% sequentially due to the seasonal working capital build in Q1. Our net debt to adjusted EBITDA ratio increased from 1.1x at the end of 2016 to its current level of 1.3x.

Now turning to Slide 17. Q1 GAAP diluted EPS was \$0.55, down 16% from the same period in 2016. On an adjusted diluted basis, Q1 EPS was \$0.59, above our stated range primarily as a result of the aforementioned discrete tax benefit, which accreted to \$0.04 per share. The combined effect of Phase 2 fees and severance in the quarter accreted to \$0.06 per share.

On a year-over-year basis, EPS was down 11%. The EPS bridge on the right-hand side of the page takes a closer look at the elements that drove the \$0.07 unfavorable variance in adjusted diluted EPS.

Moving to Slide 18. For the first quarter of 2017, cash from operations represented an outflow of \$11 million, an \$8 million unfavorable variance compared to the same period last year. This reflects the impact of a softer adjusted EBITDA performance and a higher seasonal working capital build, partially offset by tax payments that were \$15 million lower than the year ago period.

Free cash flow was an outflow of \$19 million, an \$8 million unfavorable year-over-year variance due to the operating cash flow variance and increased CapEx. The working capital build in the quarter was largely in line with typical seasonality due to items such as funding of pension plan obligations and payments of short-term incentives. The impact on cash performance was more pronounced this year than last year, primarily due to larger restructuring and short-term incentive payments, along with higher inventory in Mexico to optimize purchase prices on key raw materials.

Importantly, when compared to the year ago quarter, working capital was down 18% or \$35 million. Average working capital was down 15% or \$27 million year-over-year. As we move past the seasonally weak quarter 1, we expect working capital to decrease and positive cash generation from operations to return.

Now turning to our outlook on Slide 19. Overall, we consider 2017 to be another year of transition where we will focus on protecting earnings and delivering cash while continuing to build on the strategic pillars and executing against our Vision 2022 Strategic Growth plan. We expect the overall market conditions and competitive landscape for 2017 to be similar to what we experienced in 2016.

We expect full year sales to be down 4%, primarily due to 3 factors: first, the continued pruning of lower-margin, less differentiated products in 2017; second, the impact from reduced sales for lower-margin products that were pruned from our portfolio in 2016 that will affect our comparables, particularly in the first half of the year; and finally, the soft customer demand in packaged food along with price competition from imports in our Industrial Specialties business. We expect to see the favorable impact from our 2016 procurement initiatives to continue throughout 2017. The remaining \$2 million from Phase 1 will hit in the second quarter of 2017.

The benefits of our Phase 2 Operational Excellence initiatives will be reflected later in the year. Specifically, of the \$13 million of savings identified, \$5 million is expected to be generated in the second half of 2017. Full year earnings are expected 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.

In regards to cash flow generation, we forecast 2017 capital expenditures to be in the range of \$45 million to \$50 million. This includes spending of \$14 million at Geismar to construct the deep well injection system.



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As it relates to the second quarter, we anticipate sales comparables to improve sequentially, but still be down approximately 5% year-over-year due primarily to portfolio pruning of lower-margin, less differentiated applications, which did not take full effect until the second half of 2016.

External factors impacting sales into Venezuela and China are expected to continue into the second quarter as well.

Earnings in the second quarter are forecast to be impacted by the remainder of consulting fees for the implementation of Phase 2 of operational excellence, which are estimated to be approximately \$3 million. Input costs and operating costs in Q2 with the notable exception of the aforementioned fees are expected to be in line with Q1.

Adjusted EBITDA is therefore expected to be in that \$27 million to \$28 million range.

We anticipate that a tax rate will return to the more normalized level of approximately 33% beginning in the second quarter.

Adjusted diluted EPS is forecast to be in the range of \$0.51 to \$0.54 per share.

As before, we continue to review opportunities to establish a more fit-for-purpose organization and we remain focused on cash delivery.

With that, I'll turn the call back over to Kim Ann for final remarks.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Thanks, Han. We're very excited for what lies ahead as we focus on executing on our Vision 2022 plan to transform Innophos into a market-oriented growth company with an extended presence in the growing food, health and nutrition segment.

Our top priorities for the year include making continued progress on our 3 strategic pillars. This includes executing against our Operational Excellence initiative to deliver further bottom line savings, commercial excellence blueprint to derive and deliver greater value across our customer base and Strategic Growth Roadmap to position Innophos for revitalized and sustainable growth. In addition, we're committed to further strengthening our business with a focus on generating free cash flow and maintaining a balanced capital allocation strategy and to operate with a relentless focus on pursuing our Vision 2022 target that we established at our Investor Day.

With that, we'll now take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Brett Hundley with The Vertical Group.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

My first question is on FHN, Han, I guess I'll direct it at you. It sounds like these export-related impacts are the majority of the 4% in volume decline. Can you quantify that a little bit more for us?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

I think that's accurate and that's obviously what I spoke to. So that's a takeaway. I mean, those are, and I think I did emphasize, these are higher-margin products into those export territories and that's really representing the lion's share of the volume decline. And therefore also and you will have



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seen this probably in the EBITDA profile of the FHN segment, that's impacted that somewhat adversely to quarter-over-quarter and sequentially actually, yes.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay. So your business outside of exports in FHN, call it, flattish, I guess, can you give us a sense of how that business is trending for you in that segment? Are there any product categories that you guys see that are showing an uptick in business performance?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, Brett, I'll take that. With the current markets that we're serving, I think we've talked about this in the past, particularly in baking, in the meat, poultry and seafood and then in dairy, it's been pretty flat. We've even seen some soft demand. And that's indicative of what you see with the food companies coming out with their own earnings. With that said, we had commented that we're really trying to focus some of our technical and marketing expertise in order to ensure that we can start to see organic growth and it will be particularly in those areas where we're not only bringing our performance benefit, but also more of a nutritional health benefit where we can reduce sodium or where we can add more calcium. So although each one of those products are really low to single digit -- low single-digit part of our overall revenue, we are trying to reallocate our resources on those things and we're seeing those -- a quite of an interest from our customers with those products.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay. And one last question related to FHN. Related to these export impacts, do you pretty much view them all more structural in the sense that they will continue to impact the P&L in coming quarters? Or are there any that you see that are more transitory right now?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, I think we can all say Venezuela is well understood. Unfortunately, we see this in the news constantly. So I think that's more structural. With India where we actually saw a little slowdown of the pharmaceutical -- in the pharmaceutical area, that could pick up again. But I think Venezuela, that's more structural, and in fact, we really factor that into our full year guidance. The China tariffs, that's probably going to become more structural as well. And again, that's reflected in our guidance.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay. And then on your, I guess, the rest of the year outlook, it seems like maybe The Street has the Q2 outlook a bit high as it stands now given the commentary that you've given on EBITDA and we've kind of had the sequencing wrong here through the front half of the year. In order to maybe take a look at the back half of the year and some of the guidance that you've given on cost saves there, should we expect Q3 to start to improve somewhat more markedly? Or do you think that really those cost saves and performance will really start to come in towards the last quarter of the year? Is there any color that you can give us there?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Yes, so Brett, I'll take that. I think -- I'd like to think actually we've been reasonably consistent in making that distinction between the first and the second half in terms of from a comparable perspective. The -- obviously, the first quarter year-over-year was down 12%. We just spoke to the second quarter being approximately 5%. So what you would see, if you do the math, is by the midyear point, it would be -- that would translate to minus 8% approximately, somewhere in that ballpark. And I think actually that's what most of you guys have actually in the numbers, so that's fine. I think if you look ahead to the second half, we see the performance to righten itself because, again, the pruning as we commented took mostly effect in



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the second half of '16. So we see the year-over-year to be pretty breakeven in that sense. So -- and then we'll pick up -- and that's kind of where we net out for full year of 4% down. And I think that's kind of how the numbers work, if that makes sense.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

That's great. And then just...

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

The only thing I would add to that as well just to reiterate so everybody on the call hears this is that in the second half we will start to see the impact of our Phase 2 Operational Excellence.

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Absolutely.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

And you made note of that. And then the other thing that we will continue to look at continuous improvement with our new Senior Vice President of Manufacturing coming onboard starting officially May 1, just yesterday. We will have him also start to look at where else we can think of other areas, particularly in the manufacturing area. So I would say stay tuned for that for the second half.

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Yes, and maybe one additional comment. So that's good because my comments were mostly top line, sales related. Kim Ann made a good clarification as it relates to how it impacts the bottom line. And I think the other thing we need to bear in mind is the comment that I made as it relates to the implementation of the Phase 2 Operational Excellence as it relates to the fees that will be effective in the second quarter. So I want you guys to also kind of be mindful of that. But again, to Kim Ann's point, the savings, and I think a made a comment to the tune of \$5 million, we'll see to accrue in the second half.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay, and then just my last question, Kim Ann. This is not meant to be a critical question, but more just one of understanding and it relates to your M&A pipeline and the confidence that you've both delivered this morning and at your Analyst Day on executing against your Vision 2022. What would you say is the #1 thing kind of keeping Innophos from doing deals right now? Is it more related to the due diligence process in that you have more work to do there? Are you maybe waiting for a target that you want to drop? Or can you give us some insight into kind of what keeps you on the sideline per se right now?



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Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, Brett, it's all about timing and getting the right deal. While growth -- via acquisition is a very important part of our strategy, it's equally as important that we find and acquire the right asset that meets our strategic and financial criteria. So in other words, we're not going to do M&A for the sake of doing M&A, it has to be the right M&A. But we are very -- we're poised to move very quickly. And we've got the right organization in place. And the other thing that I mentioned in our Investor Day, and we've talked about this as well, is we've already done a very critical look at the space out there. And if you recall, Sherry Duff, our CMO and CTO talked about over a year ago -- about a year ago we started with 800 targets and we've now put that through a very, very disciplined filtering criteria process and we have a high priority list that you can count on two hands. So we are very targeted. So really, it's really about the timing right now, Brett.

Operator

The next question is from Francesco Pellegrino with Sidoti & Company.

Francesco Pellegrino - *Sidoti & Company, LLC - Research Analyst*

So I want to touch on -- so first off, I thought there was some great commentary by Han on the international business that you lost and how it was actually higher margin just as we start transitioning to these new reporting segments. It's a little bit more difficult to follow. One of the things that I did want to bring up, just when we start thinking about 2017 as compared to 2016, the elevated spending of \$3 million in consultation fees that are going to hit in the second quarter although we're going to get a net benefit of \$5 million in the second half, is there some sort of range for SG&A that we should be thinking about for the full year?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Are you thinking in terms of percentages of sales? Or are you thinking in terms of dollars?

Francesco Pellegrino - *Sidoti & Company, LLC - Research Analyst*

Dollars because for you to give us a dollar figure, that means that you would have a dollar expectation, I would think.

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Right, right. Now what I said is if you take Q1 and knowing what we've commented on, right, I also said in my commentary that other than the specific impacts of the restructuring and the fees that we commented on, right, we expect the SG&A to be consistent across the quarters. So that should help you to get you to that number pretty easily. Because there's not a lot of noise, I would say, Francesco, other than those two items that I highlighted. It's a pretty consistent story, what we should see for the balance of the year.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

And Francesco, again, just to reiterate. Where you saw the uptick was strictly in support of our Strategic Growth pillar as well as our Operational Excellence pillar.

Francesco Pellegrino - *Sidoti & Company, LLC - Research Analyst*

Okay. Just wanted to bring something up in regards to what you had discussed at the Investor Day. So we had a couple of numbers in regards to what you guys have been guiding for cost structure improvement, I think one was \$35 million in total cost savings from 2016 as a base to 2018.



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And then \$20 million of that, I believe, was from Operational Excellence. I think I just might have missed where we were on a cumulative basis in regards to these savings. Do you have those numbers?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Yes, so if you think about you're referencing the \$35 million total program between what we now call Phase 1 and Phase 2, right? The Phase 1 obviously, that was a \$16 million, \$12 million fully accrued in '16. We said \$4 million in the first half of 2017, \$2 million we did in the first quarter; another \$2 million, the balance of in '16 in the second quarter. So that deals with that aspect. Then you got \$13 million of new identified opportunities, that's Phase 2. Again, we're obviously having -- given that this is a more involved, and I think we made that clear, Phase 2 is more involved. It's in logistics. It takes more of an effort from an implementation perspective. So there's a lot of upfront work that's actually happening as we speak first and second quarter, hence the fees and again those savings will start to improve. So that's the \$13 million, \$5 million in the second half and then the balance in '18. So that's the way to think about that. So that gets you to -- \$16 million and \$13 million gets you to \$29 million by my math. And then the rest round numbers, you have \$5 million left, yes, that is kind of -- that we put on manufacturing excellence and we put that further out in 2018. And again, Kim Ann already made a comment with the new SVP onboard that we are sure that will be an area of focus.

Francesco Pellegrino - *Sidoti & Company, LLC - Research Analyst*

Do any of these remaining cost savings hinge on your ability to do a certain acquisition?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

No, they don't at all, Francesco. So this is really about getting my company fit and even more ready to take on an acquisition. We're ready now, but this really will make sure that the company is operating at its very best.

Francesco Pellegrino - *Sidoti & Company, LLC - Research Analyst*

And just my last question. There's obviously a lot of great things that you guys have outlined in great detail for the company's 2022 vision. But the one thing that really hasn't been addressed, and I think everyone can sort of start making inferences in where it's going to go, is the company's dividend. I think Han pointed out there's a high payout ratio during the quarter. If you guys were to do an acquisition, and I think the types of acquisitions that you're looking to do over the next 5 years might be a little bit pricey, what should we be thinking about in regards to the dividend? Complete elimination or just bringing it down to some sort of modest level?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

As I've stated in the past, my prioritization with regard to capital allocation, first priority is to invest in the growth of this company, hence the reason why we really were so excited to unveil our Vision 2022 and what that will take to get there. Second is continuing with the dividend. We believe that our shareholders see value in that. Third and really, really a low priority would be buybacks. That really would be very opportunistic. So we will continue to look at our capital allocation to ensure that we bring the most value to our shareholders.

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Yes, and Francesco, just to add to that, I think actually during the Q&A during Investor Day, I did address that because somebody asked that very similar question and what we said is I think demand's absolutely spot on in terms of what our sequence of priorities are as it relates to capital allocation policy. The add that I have is -- that we'll obviously have to evaluate and we will always evaluate in the context of the ultimate acquisition or acquisitions that we make and what makes most sense from a shareholder value creation perspective, right?



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Francesco Pellegrino - *Sidoti & Company, LLC - Research Analyst*

Right. Just one other quick question before I let you go. Interest expense in the quarter, I know you guys just recently increased the revolver quite substantially. I would have thought the interest expense on the unused portion of the revolver would have caused your interest expense in the first quarter to be a little bit higher. Didn't really seem to be the case. A little bit of color behind that?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Yes, so the way we negotiated the credit facility, and that's why I emphasized the point, we like to think we did a pretty nice job with it. But in terms of what is causing the lower cost, if that's what you're asking, is actually the step-down in leverage. So the way we negotiated the tiering of the cost structure, if you will, we're now helped by that low leverage point and the cost-competitive structure. So the two combined give us this lower interest expense in the quarter compared to prior quarters.

Francesco Pellegrino - *Sidoti & Company, LLC - Research Analyst*

Nice deal you worked out there.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Thank you.

Operator

The next question is from Curt Siegmeyer with KeyBanc Capital Markets.

Curtis Alan Siegmeyer - *KeyBanc Capital Markets Inc., Research Division - Associate*

Just one quick clarification. Kim Ann, did you say you do expect an impact for the rest of the year or just going forward in general related to the import tariffs and the Venezuela currency issues?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, yes. What -- how -- what our guidance is and what's actually built into our forecast is that impact going -- continuing with Venezuela. I mean, right now, I mean, you see what's going on in the news. I mean, you've got the Venezuelan government taking over GM plants and so forth. It's quite a mess down there. So my guess is as good as yours regarding Venezuela. So we wanted to make sure we were completely transparent about that one.

Curtis Alan Siegmeyer - *KeyBanc Capital Markets Inc., Research Division - Associate*

Got you, okay. And then just kind of thinking about your outlook, and Han sort of touched on this, but given the expectation that pruning should be -- it sounds like in the final innings by third quarter or so.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes.



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Curtis Alan Siegmeyer - *KeyBanc Capital Markets Inc., Research Division - Associate*

And you expect market conditions overall to be kind of similar to last year. So is there any reason by fourth quarter or maybe even third that we shouldn't start to see volume growth across the business?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, you still -- you're exactly right, Curt. Our pruning, by third quarter, we should start to stabilize there. I think what we're starting to see now after that and then also with the market dynamics, we're starting to get, and I've said this to many of you, our new normal, quite frankly. This is what the growth will be. And again, I think we need to continue with that. I think what you'll start to see probably more towards the end of fourth quarter going into early 2018 is some pockets of volume growth, particularly. And I think we haven't stressed this enough, we have put a new head of R&D in place. We've got a new Chief Technology Officer. Many of you met her at our Investor Day. We've hired a new Vice President of Technology under her, 30 years of experience in the industry. So real -- we are really working to build our innovation organic pipeline. And what we're doing is really reallocating the great technology resources we already have to particularly focus on through our new market lens, that Food, Health and Nutrition area, and really taking away from some other areas, which are less profitable and not growing as much. So I think, Curt, you'll really start to see that impact more towards the end of the year. Hopefully, that answers your question.

Curtis Alan Siegmeyer - *KeyBanc Capital Markets Inc., Research Division - Associate*

Yes, it does. Thank you.

Operator

The next question is from Rosemarie Morbelli with Gabelli & Company.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Looking at Venezuela, could you share with us the size of that business? And then looking at what other companies are doing, they are actually exiting the country altogether, whether they are closing their facilities or the facility continues to operate as before, but they are not showing that in the report. It is now discontinued. Do you have -- can you share with us what your plan is in doing there?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Yes, sure, Rosemarie. I'll take that -- is, well first off, I think we should clarify and that is good news for Innophos, is we don't have manufacturing assets on the ground. So for us, we are exporting into the country. Those companies that, indeed, have manufacturing capability on the ground, that's a whole different ballgame, I would say, and I know that firsthand. So we don't have that exposure and that complication. What it is for us is really, as you know, with the current currency exchange systems that they have installed several years back, but is now gone to a very, very difficult situation is that it is difficult to get product into the country, one. Then once it is in the country, to get paid in a currency that is somewhat stable and doesn't see that level of hyperinflation and all that. So that's what everybody's dealing with. Now for us, so no exposure as it relates to assets and all that. It's just really that we cannot get our product into the country with our customer. And again, as Kim Ann said earlier, that's kind of in our health space so it's high-margin business. And that's really where the constraint is, I would say. So that's -- if that helps to clarify your question.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

The other thing I would say, Rosemarie, is that we're predominant -- the sales in Venezuela are predominantly around this one space that we're not. So other impacts of other various parts of our businesses, we will not be exposed to the issue...



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Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

It's very specific.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

It's very, very, very specific to this application and customer.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

And what is the size? Can you share the revenue size? And is there a possibility of selling those high-margin products somewhere else than Venezuela?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Unfortunately, because it is so specific, we really can't comment on the details. But this is a very specific product now used in the Latin American region market. So it's not a product that you would find here in the U.S. or Canada.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Okay. And then if you could talk a little bit about India. I mean, which areas are slowing as I attended an Investor Day yesterday and they see growth in the region, almost everyone is investing there. So could you share what type of business you have going in India and why it is you feel this way?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

It's more in the pharma space and the excipients quite frankly and it's softened, I guess that's really how I would categorize that.

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Yes, yes.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

It was expected that we would have seen a bit more growth and that was also based on voice of the customer as well. And as we stay very close to our customers who are taking this product, they have indicated, and it is rightly so and we see this in our numbers, that it's been a little bit soft for this quarter. We don't expect that to go on forever, but that's what was going on. So it's excipients to be used in pharmaceuticals.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

All right. But with more and more mitigation, let's call it, for lack of a better word on that.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, right.



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Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

There are more and more generic and those are growing in India and they are using excipients in all of those deals. So shouldn't that be a growing market?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, and we are actually -- do sell into the generics. So we're very pleased with that. This was a specific -- 1 or 2 accounts where we're seeing a softness, which we expected this quarter and high profit, quite frankly, profitable. But yes, generics we are absolutely intimately involved with that.

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Yes. And the reason we explained in a way, Rosemarie, is as Kim Ann said, I think what's a little different, we explained it because of this quarter's performance. What we see, unlike Venezuela where we see just a constraint, if you will, just given the whole macroeconomic environment there going forward, with India, we're just explaining based on this quarter, we're not expecting necessarily that as a go-forward trend. So just to make that distinction.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Okay, that is helpful. And lastly, if I may, do you have the segment data for the next 3 quarters, the new segment?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Well, it's not something we typically publicize, yes.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

So you are going to give it to us every quarter as opposed to having a filing and giving us the next 3 quarters as you, as they, well, show up?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

That's right, yes.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

So did I get that right? We are not going to see a filing with all of those numbers? We will have to wait until each quarter to see what it was in 2016 and what it is now?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

You asked about -- okay, Rosemarie, you're asking for last year. Is that -- that's what you're saying?

Unidentified Analyst

Yes, right. So as we build our model, we can actually build it apples to apples.



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Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Okay, fair enough. Yes, we'll work on that and make that available for sure.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, because we've had to restate -- as you all know, because we did the resegmentation, we've had to restate 2016. So no issues, Rosemarie. We misunderstood your question.

Rosemarie Jeanne Morbelli - *G. Research, LLC - Research Analyst*

Oh, well, I wasn't very clear.

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

No, it's okay. So we'll make that available. Yes.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, no problem.

Operator

The next question is from Larry Solow with CJS Securities.

Lawrence Scott Solow - *CJS Securities, Inc. - Research Analyst*

So just to clarify, I think she does want -- we all want the next 3 quarters' numbers, if you have it.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Rosemarie asked first. So what can I tell you, Larry?

Lawrence Scott Solow - *CJS Securities, Inc. - Research Analyst*

I'm totally teasing. Just a couple of more global follow-up questions. On the question about organic growth and you guys -- you talked about decent amount of dollars going into R&D. I thought the number you shared with us at the Analyst Day, I think \$20 million for sales from new products through, I guess, through the 2021 period, whatever; seems a little bit modest are low. I don't know if that -- if you can share a little color on it, but I know you're probably spending I think \$7 million to \$8 million R&D a year, right? So it would seem to me that \$20 million in sales in 5 years is maybe a conservative number, maybe not? I don't know. But any thoughts on that would be great.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Yes, just a couple of different things. I know we've talked about our spending as a percentage of revenue. And many of you have observed it as being low, right? But just a few points. We've been making really important investments in our combined technology and marketing capability by



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bringing in relevant industry experience. And we're really focusing our efforts on applications development versus pure R&D. With that said, that's based on what we know at this point. So we'll refine that because what we're really doing, we're refocusing our current spend on targeted customers in the strategic -- in the strategic food, health and nutrition markets. So if you look at R&D as a percent of total sales, probably not as useful a metric because we're really taking away more from the Industrial Specialties business side, which is more commodity in nature, as we've talked about, where we get really more of the pricing pressures. So I would say that's based on our current knowledge, Larry. But now with what we've been -- with what we will continue to develop in our technology organization, we'll have a better sense for that probably towards the middle of the second half of 2017 that we'll update on our pipeline. What you heard -- when we spoke at our Investor Day, that was really the first time we really talked about that and that's based on our current information to date. But with our new Vice President of Technology who joined about 2 weeks before that Investor Day, he's really digging into that. So each quarter, we'll make sure we update you on that. Because I think that's very important for us as we go forward for our core business.

Lawrence Scott Solow - *CJS Securities, Inc. - Research Analyst*

Okay, great. Thanks for sharing that. Just not to beat a dead horse, but just on the export issue. It seems like the -- obviously, the Venezuela stuff and the higher tariffs in China, that's nothing new. So I guess really the one sort of nuance, and it sounds like it's more transient in nature, is the sales in India, right?

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

India, yes. That's right.

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Yes, yes, exactly. Yes.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Absolutely.

Lawrence Scott Solow - *CJS Securities, Inc. - Research Analyst*

Got it, okay. Just last question, just on -- insider holdings. I think it's -- I know you guys, you have had a significant management turnover. But insider holdings is pretty low, 2%. As we look out over the next couple of years, do you -- should we see that number rising?

Han Kieftenbeld - *Innophos Holdings, Inc. - CFO and SVP*

Well, I think what you're seeing is -- your observation is right as it relates to we have a lot of new management. I think that's an important driver behind the current situation. And I think as time progresses with -- we all have an intent to stick around and make this a great company. You should see that enhanced, I would say.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

So nothing for you to be concerned about.



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Lawrence Scott Solow - *CJS Securities, Inc. - Research Analyst*

Okay, great. Yes, yes, yes, just a comment.

Operator

And we have no further questions at this time. I'd like to turn the call back to Kim Ann Mink for closing remarks.

Kim Ann Mink - *Innophos Holdings, Inc. - Chairman of the Board, CEO and President*

Thanks, Ellen, and thank you all for joining us today. We look forward to keeping you updated on our progress and hope to see many of you at The Vertical Group's Ingredients Conference on May 17 in New York City. Have a great day. Thanks.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. Thank you for participating. You may now disconnect.

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