SENSIENT TECHNOLOGIES CORPORATION

Moderator: Lori Hauser
July 20th, 2018
10:00 a.m. ET

OPERATOR: This is conference # 9465338

Operator: Good morning, everyone, and welcome to the Sensient Technologies Corporation 2018 Second Quarter Conference Call. Today's call is being recorded. At this time, for opening remarks, I would like to turn the call over to Mr. Steve Rolfs. Please go ahead, sir.

Steve Rolfs: Good morning. I'm Steve Rolfs, Senior Vice President and Chief Financial Officer of Sensient Technologies Corporation. I would like to welcome all of you to Sensient's conference call to discuss 2018 second quarter financial results. I'm joined this morning by Paul Manning, Sensient's Chairman, President and Chief Executive Officer.

This morning, we released our 2018 second quarter financial results. A copy of the release is now available on our website at sensient.com. During our call today, we will reference certain non-GAAP financial measures, which we believe provide investors with additional information to evaluate the company's performance and improve the comparability of results between reporting periods.

These non-GAAP financial measures remove the impact of restructuring costs, currency movements, the impact of the 2017 U.S. tax legislation and other items as noted in the company's filings. Non-GAAP financial results should not be considered in isolation from or as a substitute for financial information calculated in accordance with GAAP. A reconciliation of non-GAAP financial measures to the most directly comparable GAAP financial measures is available on the Investor Information section of our website at sensient.com and in our press release. We encourage investors to review these reconciliations in connection with the comments we make this morning.

I would also like to remind everyone that comments made this morning, including responses to your questions, may include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Our statements may be affected by certain factors, including risks and uncertainties, which are discussed in detail in the company's filings with the Securities and Exchange Commission. We urge you to read Sensient's filings for a description of these factors. Please bear these factors in mind when you analyze our comments today.

Now we'll hear from Paul Manning.

Paul Manning: Thanks, Steve. Good morning. Sensient reported earnings per share of $0.92 in the quarter compared to adjusted earnings per share of $0.87 in last year's second quarter. Consolidated revenue was up 6 percent in local currency. We saw a broad-based revenue growth in each of our segments, which was consistent with our expectations and guidance for this quarter.

Color had another strong quarter, reporting both revenue and profit growth. In local currency, revenue grew 7 percent and operating income increased 5 percent, driven by strong demand for cosmetic ingredients and natural food colors.

Cosmetics reported high single-digit revenue and profit growth as we continue to see strong global demand in end markets. We have strong sales and technical resources around the world to help our customers develop unique formulations for their products, and we have a strong innovation pipeline to support future sales growth.

The Food Color businesses performed a very well in the quarter with strong natural color growth in North America and Asia. Natural color sales in North America were up significantly in the second quarter and we have had a number of new wins that will continue to drive growth in the second half of the year.

There's been more activity with natural color conversions over the past 6 to 12 months and our customers -- and for that matter, end customers are demanding that the natural color version of their product has the same vibrant shade as the synthetically colored products.

Sensient will maintain its technical and market leadership position as customers continue to demand natural colors that perform at parity with synthetic colors. On another note, we continue to integrate the GlobeNatural acquisition and this has solidified our supply chain and cost position for several key raw materials.

Flavors & Fragrances Group reported strong revenue growth in the quarter. Our revenue growth was broad-based across a number of product lines and geographies. In total, the group's revenue was up 5.4 percent in local currency and I'm pleased with the progress in most of the groups' businesses.

We had a number of significant wins this quarter with strong revenue growth in the BioNutrients, Fragrances, Natural Ingredients, Latin American Flavors, North America Savory and European Sweet & Beverage flavors in the quarter.

As we gathered in our last call, Flavors & Fragrances' operating income was off in the quarter. The Natural Ingredients business continues to experience higher onion costs due to higher crop costs and lower crop yields, plus pricing pressure due to an unusually high supply in the global market. I estimated that the combined impact of the higher cost and pricing pressure would be about $0.05 in the second quarter, and the impact was slightly higher.

On a positive note, sales volumes for onion were higher than we expected in the quarter. As we previously discussed, we will continue to see a profit headwind here for one more quarter and I expect results to normalize in the fourth quarter.

As I also mentioned during the April call, one of our North American flavor plants is experiencing higher costs and lower volumes related to restructuring. We made good progress on reducing costs and the plant is running well. However, we continue to experience lower volumes. Some of the volume impact is due to the service issues that resulted from restructuring activities. We have also been impacted by ongoing market declines in several key dairy categories with several key dairy customers. We expect to see these lower-volume levels continue to the end of the third quarter with improvements beginning in the fourth quarter.

We had many positive developments within Flavors & Fragrances this quarter, and I believe we can build on these successes. The revenue growth in the second quarter was strong and I expect for the group to deliver mid-single-digit revenue growth for the rest of the year. And consistent with our previous guidance, we expect operating income to be off in the third quarter due to the issues with onion and lower dairy volumes, with growth returning in the fourth quarter.

Overall, the strategic initiatives we have undertaken and the restructuring program have created a solid foundation for growth and businesses that had previously been uncompetitive and undifferentiated. I remain confident in the long-term potential for Flavors & Fragrances.

Asia Pacific delivered solid results in the second quarter with revenue increasing 4 percent and operating income growing by 19 percent in local currency. The profit growth in Asia Pacific was also broad-based with particularly strong growth in Thailand, China, New Zealand, Australia and India.

We recently announced the acquisition of Mazza Innovation, a global leader in botanical extraction technology. As I've noted in the past, we have been particularly interested in acquiring businesses with umbrella technologies, meaning, technologies that would have broad applications across both flavor and color businesses. We believe that this acquisition is exactly that type of technology platform.

Mazza has developed a revolutionary extraction technology that only uses water compared to current extraction methods that require chemical solvents. This acquisition allows us to conduct extractions from natural plant sources using environmentally friendly and sustainable extraction methods.

Mazza's technology is still in the early stages of commercialization, but we are very excited about the potential applications for our businesses. We think that it'll allow us to develop cost-effective, clean label products for food applications in both flavors and colors, in addition to cosmetics and nutraceutical applications.

We believe this extraction capability will be very attractive to our customers as they continue to work to develop the clean label, sustainable products that their customers demand. This acquisition will be dilutive to 2018 EPS by approximately $0.02, but we believe will be a very significant long-term addition to Sensient.

My performance expectations for each of the groups have not changed from what I communicated last quarter. For the year, I expect Color to deliver mid-single-digit revenue growth and high single-digit profit growth in local currency. Color is very much on track to meet these expectations. Asia Pacific is on track to meet my local currency growth expectations of mid- to high-single-digit revenue and profit growth for the year. We had nice revenue growth in Flavors & Fragrances in the second quarter and I expect mid-single-digit local currency revenue growth in both the third and fourth quarters. While I expect Flavors & Fragrances' operating income to be down in the third quarter, year-over-year profit growth will resume in the fourth quarter.

Since the end of April, the U.S. dollar has strengthened significantly and this adds a headwind that we did not have during our last call. The stronger dollar reduced the favorable impact of currency translation in the second quarter, and we will have a headwind to EPS in the second half.

Based on today's rates, the impact of currency on EPS will be about $0.10 lower than we expected just a few months ago. In light of the revised currency outlook and the impact to the Mazza acquisition, I'm adjusting our EPS guidance for the year. I now expect EPS to be between $3.60 and $3.70 for 2018. Our previous guidance had been $3.70 to $3.80.

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

Steve Rolfs: Thank you, Paul. Sensient's revenue was $363 million in the quarter compared to $338.5 million in last year's second quarter, representing a 7.3 percent increase. Operating income was $52.2 million in the quarter compared to $44.4 million in the comparable period last year. The 2017 operating income results include restructuring and other costs of $7.9 million in the quarter. And excluding the restructuring and other costs, adjusted operating income was $52.3 million in last year's second quarter.

Foreign currency translation increased both revenue and operating income by approximately 1 percent in the quarter. Diluted earnings per share was $0.92 in the quarter compared to $0.69 in the comparable period last year. Restructuring and other costs reduced last year's second quarter earnings per share by $0.17. Adjusted diluted earnings per share were $0.87 in the second quarter of 2017. Foreign currency translation increased EPS by $0.01 in the quarter.

For the first 6 months of 2018, revenue was $719.5 million compared to $679.9 million in the first half of 2017. Operating income was $107.9 million in the first half of this year compared to $68.4 million in the first 6 months of 2017. The 2017 operating income results include restructuring and other costs of $39.2 million in the first half of last year. Excluding the restructuring and other costs, adjusted operating income was $107.6 million in the first 6 months of 2017.

Foreign currency translation increased both revenue and operating income by approximately 3 percent year-to-date. Diluted earnings per share was $1.81 in the first half of 2018 compared to $0.99 in the comparable period last year. Restructuring and other costs reduced last year's diluted EPS result by $0.70 for the first 6 months and adjusted diluted earnings per share were $1.69 in the first half of 2017. Foreign currency translation increased EPS by approximately $0.05 in the first 6 months of this year.

On the last call, I referenced that our tax rate for the year may be a few points lower as a result of certain planning opportunities. We executed on those opportunities in the quarter, which had an impact of approximately 8 percent on the second quarter tax rate. We are continuing to wait for additional guidance on last year's tax law changes, which may impact the estimated charges that we took at the end of 2017. This guidance may result in an additional tax benefit later this year, which is not included in our current EPS guidance. Absent any further adjustments to those calculations, we expect our full year tax rate to be in the low 20 percent range.

I also discussed our cash flow presentation last quarter, which reflects new accounting guidance related to certain cash receipts for collections on securitized accounts receivable. I will attempt to explain the new presentation and normalize it relative to our historical cash flow statements. As reported, cash flow from operations for the first half of 2018 was a use of cash of $28.2 million compared to $800,000 of cash provided by operations in the first half of last year.

Cash receipts on sold receivables, which are now reported as cash flows from investing activities under the new accounting rules were 91.9 -- $91.1 million in the first half of this year compared to $59.3 million in the first half of last year. The sum of the cash flow from operations and the cash receipts on sold receivables was $62.9 million for the first half of the year compared to $60.1 million for the first half of last year.

In summary, the cash generated to fund capital expenditures, dividends, acquisitions and debt repayment was up in both the second quarter and the first 6 months of the year. We amended our securitized accounts receivable agreement at the end of June and under the terms of the new arrangement, the securitized accounts receivable and the related long-term debt are now reported on our balance sheet.

The change in this agreement increased both the accounts receivable and the long-term debt balances by $60 million as of June 30. We made this change to make the presentation of our cash flows and borrowing position easier to understand. The new arrangement continues to deliver favorable borrowing costs, and it will normalize our cash flow reporting on a prospective basis beginning next quarter.

Capital expenditures were approximately $12.9 million in the quarter and $24 million year-to-date. We expect capital expenditures to be between $50 million and $60 million for the full year. Debt-to-adjusted EBITDA is 2.8, and barring any additional opportunistic acquisition or share repurchase opportunities, I would expect that our leverage will trend toward 2.5x debt-to-EBITDA. We did not repurchase any shares in the second quarter and we will continue to take a balanced, prudent and long-term approach to deploying our capital.

Thank you very much for your time this morning. We'll now open the call for questions.

Operator: Today’s question and answer question will be conducted electronically. If you would like to ask a question, please signal us by pressing star one. We will take as many questions as time permits. Once again, if you would like to ask a question, please signal us by pressing star one. Our first question comes from the line of Brett Hundley from the Vertical Group.

Brett Hundley: I apologize for the background noise. I'm on a train, but I'm going to ask my questions and then go on to mute. My first question is related to your Sweet Flavors portfolio. If I remove dairy, can you talk about what the growth looks like for that product set and what levers you might have to pull if the dairy side of the business remains challenging no longer than expected? So that's my first question. My second question, I wanted to revisit the work that you guys have been doing to narrow the cost performance gap between naturals and synthetics on the Color side. It's great to hear about demand going up, but I'd be curious what impact that might have to margins, too, as you see more and more demand for naturals? And then just my last question is related to soy. I think that soy is a bigger COG for you guys, if I'm not mistaken. What type of potential benefit could this be going forward and do you have that incorporated into your guidance?

Paul Manning: OK. Brett. Let me take those in the order you gave them. So sweet flavors, so our sweet flavors business fundamentally developed as a dairy flavors business. A few years ago, as we've talked about on this call and a lot of our one on ones, we made a very concerted effort and we continue to make a very concerted effort to diversify that business into other categories such as bakery and confectionery. In some cases, we had some presence in those segments. But in other cases, we did not.

So a lot of our effort in dairy, we sort of recognize some of these declines that could grip the dairy industry, particularly in North America, and so we really made a concerted effort there. A lot of where our wins are coming today are coming from bakery and confectionery-type projects. We're able to profile a lot of our sugar reduction platform. We're able to provide integrated products that also include color. For many customers, this is a very compelling aspect to development because they either lack some of the technical resources of a larger player, or they simply -- and/or they want to move very, very quickly.

And so having a supplier like us who can provide color and flavor, which tend to be among the more challenging ingredients to formulate given their high intensity, in particular, in these types of applications, it's proven to be a pretty good approach that we've taken there. So our work will continue on that front. There are definitely, just to go back to dairy in general, there are definitely signs of improvement. You'd see in some of the trailing data the last 12 months, ice cream has actually been up as a category, which is a nice sign. But then you'd also see that yogurt has been down, in fact, 7 percent to 8 percent in the U.S. market.

Now some brands are up, some are down. But in general, the category is down and then there are customers and products in that category that are significantly different from that average. So the program will continue to be dairy is a good business, in general, the market can grow over time. They're just -- we're kind of in a cycle right now, we're in a bit of a trough. But we're certainly not going to abandon dairy and there are definitely applications where we can begin to introduce more sugar reduction, more natural ingredients to that particular category, which I think we will be helpful. But the bigger play there is how do we continue to diversify into these other very interesting, and in some cases, particularly the bakery case, fast-growing segments.

On your second question, you had a question about how is Sensient closing this cost to performance gap in natural colors. And yes, it's a very -- it's, in some cases, it is -- we've been very, very effective in terms of expanding our shade range, colors that can be suitable for different applications. So part of the gap here is just based on technology. Can you get the shade? Can you get the shade to be as richly colored as a synthetic shade because as I mentioned in my prepared comments, customers in the North America -- in the Americas and most of Asia are not going to accept a natural solution that looks anything less than a synthetic solution.

And there is this talk about somehow natural color needs to look differently or if it's more whitewash and water washed, it will somehow communicate naturalness. Well, not in the eyes of the consumer. When the natural color does not match the synthetic color, the customer doesn't buy their product because more often than not, the customer thinks the flavor has changed. So color is totally linked to flavor perceptions in the minds of the consumer.

So to go back to your question, how do you close this cost to performance gap, technology is a big part of that. The supply chain is another big part of that. Our acquisition of GlobeNatural was done very much with this concept in mind. How do we get more vertical on some of the key raw materials? Not all of them, but some of them that can lend itself to better economics surrounding supply -- surrounding natural colors, but also -- certainly, there's elements of availability, too, that also factor in there.

But I think the other piece here is, there's a real distinction between products that are synthetically colored and they're going to be naturally colored and then new-to-the-world products. And new-to-the-world products are converting or they're being introduced on the market at a rate of 80 percent with natural colors. The balance of the market that has not converted or is not using natural colors is faced with this question of how do I convert and how do I make these economics work. I think that is a challenge for some customers, but it's certainly one that, again, going back to these 3 points, technology and supply chain being a big part of that, that is very much in the last 8 or 9 years, those 2 factors have gone a considerable way towards narrowing this gap between performance and cost.

To your point about margins, I think the best way to explain this on natural colors is, yes, on a -- if you've a synthetic red, you want a natural red, in general, it takes more natural red to achieve that synthetic red, which translates to more volume, maybe that's at a lower gross margin. But on the EBIT margin, you should see a relatively fixed SG&A across that sale, which is to say, it should be EBIT margin neutral. But perhaps, it could be gross margin dilutive in certain cases. And then your last question, Brett, I'm not sure I totally caught it. I think it was about soy. I think Steve will take that one.

Steve Rolfs: So if the question was about soy, so the price of soy has come down recently. My understanding is it's now, for the products we buy, close to where it was last year. So that will represent some benefit where we use that in some of our savory ingredients, but keep in mind we use a lot of different raw materials. And really in flavors, there's nothing greater than 4 percent, so soy would be under 4 percent. And there are other items that -- there are always things going up and down, so I would consider that benefit to be in our outlook and guidance for the rest of the year.

Operator: Our next question comes from the line of Curt Siegmeyer from the KeyBanc Capital.

Curtis Siegmeyer: Paul, when you referred to the service issues impacting volumes in Flavors, obviously, that's nothing new this quarter. But volumes were up in the quarter, and so I was wondering if you could just talk a little bit about that impact that, that may have had on volumes. And then on the margin contraction kind of similar, if you could give us a better view of some of the restructuring progress that you guys have made. It might be helpful if you could quantify sort of what the onion impact was this quarter on margins as it relates to that?

Paul Manning: Yes. So the first piece about service issues, yes, so certainly the service issues affected volume at that particular business. But overall, we were able to overcome that as a group with some of the other businesses I highlighted where there is very good volume growth. A lot of that generated from new wins. So a lot reason for optimism because as we lap these service issues in

Q3, that particular business we anticipate would become also additive to the cost, which is to say we should have a nice supporting business there for continued revenue growth.

So I think the positive here is despite that headwind, we overcame that across the portfolio, across the businesses and had very nice revenue growth in the flavors which, obviously, is a real bright spot because I think it's a testament to the end of the restructuring and our ability to grow this business, absent that significant distraction. And I think -- so I think it was a good, a very good outcome for that group. And I think that it would suggest that the future looks quite good between Flavors, Colors in Asia Pacific as I think we've got good momentum.

I think the wins that I see are quite good. We've got a very aggressive group of managers and sales people out there, and they want to win. And they're not order takers, they focus on getting into accounts, new accounts, B and C accounts. Sometimes you got to hustle up business and sometimes it's about service levels and sometimes it's about technology. And perhaps in other cases, it's about all three. But this is really what we're focusing on and what we've got the businesses lined up to do.

With respect to your second question on margin contraction, yes, I mean, onion was a really big chunk of that on the margin front. So I think we have that headwind playing out in the EBIT margin. Obviously, the dairy business we're talking about as well is also a chunk of that. So I think this, I think as we get into Q3, we have the impact again, not unlike Q2 and Q1. But come Q4, when we lap these factors, I would expect a return to nice growth on the EBIT margin of the Flavor Group.

Curtis Siegmeyer: OK. That was actually my follow-up question. So the confidence that you have in 4Q returning to growth in terms of OI for Flavors, the biggest factor is just lapping some of these headwinds and some of the wins that you have that give you confidence in that outlook?

Paul Manning: Yes. Absolutely. That, plus revenue growth. And between culling in FX and restructuring, we haven't really been talking a lot about revenue growth in the

Flavor Group in sometime, so this is a real high positive for that group. And I think that when you take that and you take the lapping of these other factors, that makes for what I would anticipate to be a quite nice quarter in the fourth quarter for Flavors. And then again, that momentum builds as we go into 2019. So yes, when I say, hey, I'm optimistic about the future, it's not a pipe dream. It's based on wins. It's based on the management in place. It's based on the elimination of this restructuring, and I think it's going to follow a lot of the success that you've seen in Colors and what you're seeing now in Asia Pacific.

Operator: The next question comes from the line of Fintan Ryan from Berenberg.

Fintan Ryan: So firstly, just -- I guess, following on from the last question. Are you still confident of achieving, like we've seen several quarters of declining margins within the Flavors & Fragrances business, would you still be confident of getting back to the 20 percent target margin from that business in time? And secondly, in terms of the working capital developments in the -- during the quarter or in the first half, I know you explained the slight different presentation of the working capital on the securitization.

But I think, and if I'm not wrong, I think back at the Q1 call, you did mention at that stage that working capital outflows that you saw in the first quarter, you expected to, if anything, to unwind to the back-end of the year. What are your thoughts that overall working capital movements for the rest of the year, please. And then, finally, just -- I guess, a more broader -- a high-level question.

So in the last few months you've seen a lot of M&A enhancing the space, and specifically as you've done with Naturex and IFF acquiring Frutarom, which would seem to me at least to be trying to sort of muffle in on the areas where I sense it is operating and particularly, with regards to the natural colors in food and beverage. Could you give us some of your, I guess, high-level thoughts on what this means for the industry as a whole? And like do you think that it might -- could this be a negative for Sensient's growth outlook in the midterm having to compete with the giants of the flavor and fragrance industry?

Paul Manning: OK. So first question, are we confident? Am I confident in 20 percent? The answer is yes. What we're seeing right now are, to some degree, some exogenous factors and in other cases, onetime self-inflicted problems. But the margin decline does not have anything to do with the portfolio or the markets that we're operating in or anything unusual with respect to a market pricing dynamic or a raw material dynamic. Yes, there's always price pressure in various parts of the market. That's nothing new.

Maybe there's a little bit more in 2018 than there has been in the last few years, but I wouldn't tell you anything outrageous and nothing fundamentally has changed about the market. So I think this is a matter of lapping these factors, and I think I would be very, very confident to tell you that you'd see a nice resumption of the EBIT growth in Q4 and as we get into 2019. So a lot of that -- the 20 percent is driven by good technologies, operating a lean operation, lean from an SG&A standpoint as well, and I think we've got of those components in place, and so now it's a matter of continued execution -- continued execution on selling flavors.

With respect to your second question, working capital, so I'll let Steve talk about that one. Steve loves talking about working capital. But I'll say this, we -- what we said in the beginning of the year and what we've said even towards the end of last year is that we anticipated that inventory would peak in the first part of 2018. Some of that facts -- some of that had to do with I wanted to improve our service levels in some of our plants, so I intentionally had them build and hold more inventory in a very controlled and thoughtful manner.

So don't get concerned about what I just said there. We're not over building and stockpiling things. But there is definitely, as we work through those service issues as we have and many of those plants are operating far better than they did even before restructuring, I would anticipate that those levels will continue to come down in the future. SNI is always a big inventory component. It's always a big factor in driving the working capital and so we've taken steps in that business as well to unwind some of the inventory and liquidate some of that stock, and perhaps even avoid some of the raw material positions that we took.

But I'll let Steve come back to that one in a second, but let me just get to your M&A one real quick. I think that we can all say that the food industry, M&A moves in cycles, and clearly, we're in a cycle right now where folks are buying some companies. What does it mean to the industry? Well, what time will tell. I mean, certainly, one of those acquisition suggest that the future of the market is extracts. Another one of those acquisitions suggested that the future of this market is flavors.

Now for most folks on the phone, that doesn't necessarily -- those aren't terribly different concepts, but for those in the business and those in the industry and the technical areas, those are significantly different products. An extract is generally considered to be more sustainable, more natural than perhaps a natural flavor would be, and has some very positive connotations for product labeling. And so time will tell which of those moves -- well, time will tell the outcome of those particular moves.

I think for the industry, this is still a very, very large industry with a lot of new companies, a lot of startup companies. There's more B and C companies out there than any company get their arms around, and they're growing daily. So I think there's a lot of opportunities for Sensient. I think there's a lot of opportunities for a lot of folks in the marketplace. And every particular company has an area where they're very good and with customers that they're very successful with.

We have our customers that we are quite successful with in our approach, but we've been working on this notion of integrating flavors and colors for some time. We think there's a high level of interest in many of our customers and I think that's going to continue for us. So I think we're going to keep riding and roping here. I think we've got an approach and we've got a strategy. The competition always changes and we're always watching that. But we think we've got very solid products and very solid people, and we think we can compete very strongly there.

Steve Rolfs: And on the -- so just following up on the working capital. So Paul covered the build, which we said peaked, and I certainly would agree with that. Since the beginning of the year in terms of days, we've seen inventory come down about

22 days and it's also coming down in terms of the dollar value on the balance sheet. Receivables, obviously, we have some build of receivables just with the strong sales. But in terms of -- the days are fairly constant to a year ago, so as we go through the year and we monetize that that should be a positive for cash flow. So I continue to expect benefits in the second half of the year and also the tax benefit that we generated this quarter will have some real tax flow -- cash flow benefits in the second half of the year as well.

Operator: Our next question comes from the line of Christopher Perrella from Bloomberg Intelligence.

Christopher Perrella: A question on Colors. With the robust sales group -- sales growth in Colors this year, I would have figured greater margin expansion. How much are the recent acquisitions and integration costs weighing on margins this year?

Paul Manning: I would -- not much. I think that the Globe acquisition it was about, let's just say, $8 million to $10 million in revenue when we brought that in, so not terribly dilutive there. And then with respect to Mazza, we just -- we closed on that one about a week or 2 ago.

I mentioned that will be about $0.02 dilutive to the corporation in the course of the remainder of the year. So I would tell you that the gross margins that we can achieve in that business should be right around the average of what we can achieve in the Color Group, in general. So not much today, maybe a touch, maybe it's 50 basis points on gross margin. But I think as you get into 2019, we have more time to sell those products and integrate those businesses, I think it'll be right -- consistent to where that margin profile is for Color.

Christopher Perrella: Great. And then in terms of the stronger dollar and the FX exposure, could you just remind me what the largest FX portion, is it Europe, is it over in Asia?

Steve Rolfs: So for us, the big currencies would be euro, peso, pound and there could be a couple of Asian currencies as well, but those are the big ones.

Operator: Your next question comes from the line of Mike Sison from KeyBanc.

Mike Sison: I missed a little bit of your -- beginning of your call, but when I think about flavors sales growth, a good portion of that was volume. Did you address that? Is that the bulk of the sales growth ex foreign currency?

Paul Manning: Well, we talked about it a little bit. But for you, Mike, that's a every -- we'll take it -- I think, where you're going on that one, I think it's just sort of the breakdown between price and volume. And as I'm looking at it overall, it's an overall volume, was a bigger impact than price. I think price has been pretty nominal this year, in general, probably across the corporation. So the growth that we're getting is fundamentally volume driven. And you could -- I think it's safe for me to say that, that would be across each of the 3 groups.

Mike Sison: That's great. And then when you think about turning the corner and volume growth for the segment, you feel pretty good that you'll continue to see that momentum in the second half of the year. And if so, what are the areas you think will continue to drive that growth?

Paul Manning: So I think we're going to continue to see the nice growth, top line, where I continue to guide on Color and Flavor, mid-single-digit top line growth. So you can infer from my answer to your last question that, that would be principally volume driven. Asia Pacific would be mid- to high single-digit top line growth. And there, again, I think volume will be a good chunk of that piece as well. So I think it bodes well for the second half of the year to see good top line growth in the business and I'm inclined to say that we should be in very good position. Well, we haven't given 2019 guidance specifically.

I think that, that mid-single-digit top line growth should be a good benchmark for us to be able to achieve overall as a corporation, but even that, within each one of these businesses. Now to the other part of your question about what businesses, I mean, certainly natural colors had a really good quarter. We had very nice growth, in particular in North America, natural colors had outstanding growth. Good growth in Asia. Cosmetics continues to be a good driver of revenue and volume.

But you're seeing, and we're seeing also, very good growth coming out of the Flavors Group in our Natural Ingredients business, in our BioNutrients, Fragrances and then certainly within our Flavor businesses as well. North America Savory had good growth and we also see good growth in Latin America. So pretty broad-based overall and that's very, very exciting to see because it's a -- I think it's a testament that things are looking pretty good and we've got some good momentum and it's not just one pocket or one piece of the company driving it.

Mike Sison: Right. Paul, that's great. And then given that the volume growth has really turned a corner here for Flavors, I know you still have some -- you will have a headwind in foreign currency and raw materials a little bit of an issue, but what do you think needs to happen to get sort of the operating EBIT growth in line with the good sales growth in that business over the next couple of quarters?

Paul Manning: What I need is it to be October 1, 2018. In other words I need a lap, the Q3 headwind in there because I think, ultimately, for mid-single-digit top line growth, that should translate very nicely to mid- to high single-digit OP growth, which will be very nice to the EBIT margin. So I would anticipate -- fully expect that Q4, you'd see that relationship return to the Flavor Group.

Mike Sison: OK. Great. And then, I guess, last question, your balance sheet is still in really good shape. Multiples are definitely high. We've seen one of the other bigger players has done recently, pretty big multiple there. But what do you see in the M&A market and where do you see the opportunities to maybe continue to build upon your growth via acquisition?

Paul Manning: We like these umbrellas or what we call -- or you may call it platform technologies. So companies like Mazza are very consistent with what we're looking for. They are businesses that, once we buy them, we feel like we can make use of our rather vast sales network and we can make use of these technologies in a lot of different parts of the organization. So the Mazza one is going to be able to -- that's going to be -- help us to sell nutraceutical products within our pharma colors and excipients business.

It's going to allow us to sell cosmetic active ingredients for hair, for face. It's going to allow us to sell and perhaps, better extract natural colors and do so in a solvent-free manner. And I don't want to -- I think the solvent-free piece, I can't tell you how important that is to a significant portion of this market. If you can move away from chemical solvents or alcohol as a solvent, that is a big point of difference in your extracts versus say, somebody else's. And so not only for natural colors is that true, but also extract as an alternative to a natural flavor providing -- using this technology to achieve it is a very strong and compelling method.

So these types of acquisitions are right what we're looking for. I think we can get them for a fair price and I think they're technologies that have a lot of play within our organization. So to some degree, there are a lot of these types of companies out there and it's just a matter of picking the right one and finding the ones where you can bring the technology as far as possible for your organization. And I think Mazza is exactly that type of company, and I'm pretty excited that we got it.

Operator: Our next question comes from the line of Garo Norian from Palisade Capital.

Garo Norian: Help me kind of a little -- a bigger picture here. For the full year of 2018 versus full year 2017, understanding the adjustments that have to be made for 2017, on a local currency basis, can you help me just with EBIT, is it -- how does it compare year-over-year? And I'm trying to kind of get to, as much as possible, a like-for-like and then after that kind of understand the impact of the onion stuff on EBIT.

Paul Manning: Yes. So if you take the guidance and you start there, the $3.60 to $3.70 versus just over $3.40 for the end of last year, EBIT will certainly have to be in the mid-single digit growth range to achieve that type of level. I think that certainly, depending on what happens with taxes, as we noted in the call, tax -- that may be a benefit. If it is, that that could be additive to the range. But right now, it's hard to project how that would come out. But that's, obviously, below the EBIT line. I think the specifics on the onion piece of thing.

Onion is a significant impact here. It's a significant headwind to EBIT. But some of that starts, as I said, we lapped that in Q3, so we get relief in Q4. And as you noted, a lot of those crops are still pulling out of the ground in late Q4 and early Q1, so it's hard to get a total read on those. So that would be -- it's a little bit more difficult to see what the uplift would be in Q4 from onion specifically. But yes, I think, overall, to answer your question, EBIT, to make the math work, would need to be about in that mid-single digit range for this all to come together.

Garo Norian: Got it. And that's kind of talking in local currency?

Paul Manning: That's right.

Garo Norian: Got it. Got it. And then separately, just going back in a certain direction on M&A. Have you guys gone through, I mean, some of these deals have been significant. Have you gone through a robust process internally to really evaluate Sensient's and its position and who, maybe of the bigger players, if there was a combination would make the most sense or make no sense or how do you guys kind of gone through an evaluation of kind of moving the chess pieces on the board in big scale M&A?

Paul Manning: Yes. Well, I guess, I'd say this. My mission is to earn the highest return to shareholders. And so on a daily business, what does that mean? That means, you look at sales, you watch sales, are we executing on NPD, are we executing on supply chain, the things that we need to do. So I'm focused on the strategy of the business and how do we grow this business organically. How do we make acquisitions here and there, to add to that. And I guess that's the way I think about the business. We want to maximize returns and there's a lot of different ways that, that can be done. But we're always looking at the market, we're always looking at opportunities and -- yes, I guess, that's all I have to say about that.

Garo Norian: Yes. And then just one last one. I was curious on the progress being made towards new leadership for Flavors.

Paul Manning: Yes. Progress is good. In the interim, they're stuck with me and they'll have to work through that. But no, I think we got some great general managers down there. We've got some great folks on our staff. We've got great folks in the business and they're very motivated to be successful. They got a little chip on their shoulder, which I like because I have a chip on my shoulder, and I think it's a good combination. So we're looking at a lot of folks in and outside the industry and we're considering all our avenues.

But I would anticipate that we're, obviously, going to name somebody here in the future. And I think I want to make sure they're the right person and they're a good fit to our strategy and the culture that we've built here, which is a lot about empowering folks to make decisions and really driving for results and doing so in a very sustainable fashion. So those people aren't necessarily so easy to find. And I think that we're going to continue to consider a number of candidates and we'll let you know when -- Garo, you'll be the first guy to know. Well, actually, you won't. Everybody will be the first guy to know, technically.

Operator: Our last question is from the line of Davis Paddock from Invesco Advisers.

Davis Paddock: Just to follow up on the inventory question. You mentioned that you very largely needed to increase inventory last year as you're going through the plant consolidation. Do you anticipate getting back to inventory, returning to level either on a day's inventory or percentage of sales to 2016 levels? Is that where we should be expected to go back to? And if so, sort of what -- over what time period it will take to get back there?

Paul Manning: Yes. Well, I think there is certainly an opportunity to take a number of days out of this inventory. We think some of the bigger opportunities lie within flavors right now because we, let's just say, kind of built inventory for the service reasons I described before. So I think we're going to -- you're going to see some -- particularly, sales continue to look good. You're going to continue to see inventory kind of coming out of the system. Plants run well. They've been consolidated. They run better and better, and that's going to help.

We're always going to have a little bit of the "we run a crop-based business, too". And so that's a business where, in some cases, if you don't have the inventory, you're in big trouble because there are no easy substitutes for that. Now the flip side of that is when you're the guy who does have inventory, there's a lot of nice opportunities for you there, too. So that's a little bit of a balancing act and I think, right now, we're a bit heavy there. But as Steve mentioned, and he'll give you a few more details, I think that's one of the areas that we really targeted for bringing down the inventory levels.

Steve Rolfs: Yes. So I think as we get into next year, we've optimized more of the plants. There is opportunity there. It just was not the focus over the last 6 or 12 months as we're coming out of restructuring. And you referenced 2016 inventory levels, and I don't have the numbers in front of me, but I would just go back to what Paul said about that Natural Ingredients business. So that business, outside of anything we're doing, can cause some fluctuation year-to-year and we did have a couple of lean years on certain inventories like garlic, and I think that might have been in the '16 and '17 year. So that might be a little bit of a limit on our ability to get back down to that low level, but we definitely would be able to make improvement form where we are today.

Davis Paddock: OK. That's helpful. And then moving to the onions that you mentioned in Q4, to start improving, is that more on just a comparable basis? It's not getting worse compared -- I think, it started last year in Q4? Or is there something fundamentally changing in the market that are bringing the onion cost down back to sort of more normalized levels?

Paul Manning: Well, the onion cost is more of a factor of our business. And as much as some of the yields were not where they needed to be because we grew less crop overall, you're obviously not running as much volume through that particular part of the plant so there's accounting overhang there. But no, I wouldn't tell you that anything is fundamentally changed in the onion market from a cost standpoint. Recognize that we grow this product and garlic, ditto, in a lot of different areas. It's not just in one area.

So it's a pretty diversified track of spots. And -- but so, yes, as we get into Q4, and in fact even as we're here in Q3, early reads are we're cautiously optimistic, but it looks like things could be returning to a better situation on onion from a yield standpoint. But again, we're taking that out of these fields for the next several months and processing it for the next several months, so things may change there. But right now, things are looking better than they did earlier and that's a real positive.

Davis Paddock: Great. And then just the last question, you mentioned that customers are increasingly requesting kind of an integration of your color and flavors capabilities. Could you give a little bit more color on what they're requesting and how you're trying to serve those requests?

Paul Manning: Yes. I'll give you some color and flavor on what they're requesting. Yes, and I think a lot of it is just about speed. And some of the folks we deal with, they want to launch products in like 4 or 5 months, not 2 or 3 years. And I think that, that in and of itself, requires very, very quick action from suppliers. That's point number one. Point number two, not necessarily every customer has the same technical resources. And so to that end, if you can provide some of those technical resources to customers, that can be a very compelling point-of-sale difference for you versus, say, somebody else.

But I think the third piece is that these products, particularly in their natural iterations, are very complex to work with you. I mean the reason we make money, and part of the reason we're successful, is that this is an applications-driven business. These applications are not traditionally taught in food science programs. Not every customer has, say, flavorist or color scientist on staff. In fact, I would say the majority of customers and potential customers do not, so there's a lot of value that we can add in of these transactions.

And so as you look at opportunities to sell natural colors with natural flavors or natural colors of extracts, there's a lot of complications built into that. The inherent variability of crop-based raw materials is a significant development challenge. But that's what we see as a real point of difference in our business, is the ability to make that a more seamless project and process for our customers.

Operator: We have reached the end of the question-and-answer session. Please contact the company with any additional questions. At this time, I will turn the conference call back to the company for closing remarks.

Paul Manning: OK. Thank you very much for your time this morning. That will conclude our call.

Operator: This concludes today's call. You may now disconnect.

END