SENSIENT TECHNOLOGIES CORP
Form 10-Q
November 06, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10 Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: September 30, 2014

OR

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

For the transition period from to

Commission file number: 1 7626

SENSIENT TECHNOLOGIES CORPORATION
(Exact name of registrant as specified in its charter)

Wisconsin	39 0561070
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

777 East Wisconsin Avenue, Milwaukee, Wisconsin 53202-5304
(Address of principal executive offices)

Registrant's telephone number, including area code: (414) 271 6755

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

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

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

Smaller reporting company o

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

Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 31, 2014
Common Stock, par value $0.10 per share	48,156,931

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SENSIENT TECHNOLOGIES CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS
(In thousands except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	$364,504	$370,457	$1,105,002	$1,112,006
Cost of products sold	243,003	250,645	729,597	752,891
Selling and administrative expenses	85,407	70,685	280,981	224,231
Operating income	36,094	49,127	94,424	134,884
Interest expense	4,016	4,048	11,866	12,317
Earnings before income taxes	32,078	45,079	82,558	122,567
Income taxes	9,414	13,315	27,116	36,558
Earnings from continuing operations	22,664	31,764	55,442	86,009
Loss from discontinued operations, net of tax	(1,359)	(239)	(7,151)	(763)
Net earnings	$21,305	$31,525	$48,291	$85,246
Weighted average number of shares outstanding:				
Basic	47,902	49,761	48,799	49,741
Diluted	48,230	49,946	49,080	49,910
Earnings per common share:				
Basic:				
Continuing operations	$0.47	$0.64	$1.14	$1.73
Discontinued operations	(0.03)	-	(0.15)	(0.02)
Earnings per common share	$0.44	$0.63	$0.99	$1.71
Diluted:				
Continuing operations	$0.47	$0.64	$1.13	$1.72
Discontinued operations	(0.03)	-	(0.15)	(0.02)
Earnings per common share	$0.44	$0.63	$0.98	$1.71
Dividends declared per common share	$0.25	$0.23	$0.73	$0.68

See accompanying notes to consolidated condensed financial statements.

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SENSIENT TECHNOLOGIES CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Comprehensive (Loss) Income	$(35,509)	$58,773	$(3,299)	$86,816

See accompanying notes to consolidated condensed financial statements.

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SENSIENT TECHNOLOGIES CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS
(In thousands)

ASSETS	September 30, 2014 (Unaudited)	December 31, 2013
CURRENT ASSETS:		
Cash and cash equivalents	$25,789	$19,836
Trade accounts receivable, net	243,894	233,751
Inventories	475,011	474,452
Prepaid expenses and other current assets	74,729	61,786
Assets held for sale	581	-
TOTAL CURRENT ASSETS	820,004	789,825
OTHER ASSETS	70,870	47,786
INTANGIBLE ASSETS, NET	9,122	10,546
GOODWILL	437,515	457,269
PROPERTY, PLANT AND EQUIPMENT:		
Land	42,423	56,343
Buildings	292,333	374,388
Machinery and equipment	712,828	751,267
Construction in progress	67,532	55,236
	1,115,116	1,237,234
Less accumulated depreciation	(625,396)	(671,926)
	489,720	565,308
TOTAL ASSETS	$1,827,231	$1,870,734
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade accounts payable	$97,128	$99,117
Accrued salaries, wages and withholdings from employees	30,427	32,669
Other accrued expenses	79,380	78,579
Income taxes	3,471	5,478
Short-term borrowings	18,953	7,050
TOTAL CURRENT LIABILITIES	229,359	222,893
OTHER LIABILITIES	34,580	28,495
ACCRUED EMPLOYEE AND RETIREE BENEFITS	21,382	28,538

LONG TERM DEBT	441,610	348,124
SHAREHOLDERS' EQUITY:		
Common stock	5,396	5,396
Additional paid-in capital	109,269	105,119
Earnings reinvested in the business	1,230,304	1,217,874
Treasury stock, at cost	(199,081)	(91,707)
Accumulated other comprehensive (loss) income	(45,588)	6,002
TOTAL SHAREHOLDERS' EQUITY	1,100,300	1,242,684
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,827,231	$1,870,734

See accompanying notes to consolidated condensed financial statements.

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SENSIENT TECHNOLOGIES CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net earnings	$48,291	$85,246
Adjustments to arrive at net cash provided by operating activities:		
Depreciation and amortization	39,461	39,051
Share-based compensation	4,035	1,963
Loss on assets	66,553	357
Deferred income taxes	(8,562)	(1,100)
Changes in operating assets and liabilities	(22,669)	(7,748)
Net cash provided by operating activities	127,109	117,769
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(46,726)	(77,247)
Proceeds from sale of assets	926	5,931
Other investing activity	(685)	(165)
Net cash used in investing activities	(46,485)	(71,481)
Cash flows from financing activities:		
Proceeds from additional borrowings	191,060	80,574
Debt payments	(115,636)	(82,365)
Purchase of treasury stock	(108,753)	-
Dividends paid	(35,861)	(34,016)
Proceeds from options exercised and other equity transactions	576	513
Net cash used in financing activities	(68,614)	(35,294)
Effect of exchange rate changes on cash and cash equivalents	(6,057)	(1,801)
Net increase in cash and cash equivalents	5,953	9,193
Cash and cash equivalents at beginning of period	19,836	15,062
Cash and cash equivalents at end of period	$25,789	$24,255

See accompanying notes to consolidated condensed financial statements.

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SENSIENT TECHNOLOGIES CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. Accounting Policies

In the opinion of Sensient Technologies Corporation (the "Company"), the accompanying unaudited consolidated condensed financial statements contain all adjustments (consisting of only normal recurring adjustments) which are necessary to present fairly the financial position of the Company as of September 30, 2014, and December 31, 2013, the results of operations and comprehensive income for the three and nine months ended September 30, 2014 and 2013, and cash flows for the nine months ended September 30, 2014 and 2013. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Expenses are charged to operations in the period incurred. However, for interim reporting purposes, certain expenses are charged to operations based on a proportionate share of estimated annual amounts rather than as they are actually incurred. In interim periods, depreciation expense is estimated using actual depreciation on fixed assets that have been placed in service at the beginning of the year, combined with an estimate of depreciation expense on expected current year additions.

On January 1, 2014, the Company adopted Accounting Standards Update (ASU) No. 2013-11, Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, which requires companies to change the balance sheet presentation of certain unrecognized tax benefits and deferred tax assets. The adoption of this ASU had no material impact on the Company's balance sheet presentation, financial condition or results of operations.

On April 10, 2014, the FASB issued ASU No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which amends the definition of a discontinued operation in Accounting Standards Codification ("ASC") 205-20 and requires companies to provide additional disclosures for disposal transactions. Under the revised standard, a discontinued operation represents a strategic shift that has or will have a major impact on an entity's operations or financial results. ASU 2014-08 is required to be applied prospectively to all disposals that occur in annual periods beginning on or after December 15, 2014, with early adoption permitted. The Company will prospectively apply the guidance to applicable transactions beginning in 2015.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. The requirements of the new standard are effective for interim and annual periods beginning after December 15, 2016 with early adoption not permitted. We are currently evaluating the expected impact of this new standard.

Refer to the notes in the Company's annual consolidated financial statements for the year ended December 31, 2013, for additional details of the Company's financial condition and a description of the Company's accounting policies, which have been continued without change.

2. Fair Value

ASC 820, Fair Value Measurements and Disclosures, defines fair value for financial assets and liabilities, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. As of September 30, 2014, and December 31, 2013, the Company's assets and liabilities subject to this standard are forward exchange contracts and investments in a money market fund and municipal investments. The fair value of the forward exchange contracts based on current pricing obtained for comparable derivative products (Level 2 inputs) was negligible and an asset of $0.2 million as of September 30, 2014 and December 31, 2013, respectively. The fair value of the investments based on September 30, 2014, and December 31, 2013, market quotes (Level 1 inputs) was an asset of $2.0 million and $19.8 million, respectively, and is reported in Other Assets in the Consolidated Condensed Balance Sheets.

The carrying values of the Company's cash and cash equivalents, trade accounts receivable, accounts payable, accrued expenses and short-term borrowings approximated fair values as of September 30, 2014. The fair value of the Company's long-term debt, including current maturities, is estimated using discounted cash flows based on the Company's current incremental borrowing rates for similar types of borrowing arrangements (Level 2 inputs). The carrying value of the long-term debt at September 30, 2014, was $441.6 million. The fair value of the long-term debt at September 30, 2014, was $452.3 million.

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3. Debt

On October 24, 2014, the Company entered into a $450 million credit facility, consisting of a $350 million revolver and a $100 million term loan. The revolver will mature on October 24, 2019. Interest rates on borrowings under the revolver are at LIBOR plus a margin based on the Company's leverage ratio. Currently, when fully drawn, the interest rate is at LIBOR plus 1.375% under the new agreement. The term loan bears interest at LIBOR plus 1.375% and matures on October 24, 2019. The credit facility will be used to repay maturing debt and for general corporate purposes.

4. Segment Information

Operating results by segment for the periods and at the dates presented are as follows:

(In thousands)	Flavors & Fragrances	Color	Corporate & Other	Consolidated
Three months ended September 30, 2014:				
Revenue from external customers	$ 206,474	$ 121,856	$ 36,174	$ 364,504
Intersegment revenue	9,028	5,986	27	15,041
Total revenue	$ 215,502	$ 127,842	$ 36,201	$ 379,545
Operating income (loss)	$ 30,169	$ 29,100	$ (23,175)	$ 36,094
Interest expense	-	-	4,016	4,016
Earnings (loss) before income taxes	$ 30,169	$ 29,100	$ (27,191)	$ 32,078
Three months ended September 30, 2013:				
Revenue from external customers	$ 216,076	$ 118,209	$ 36,172	$ 370,457
Intersegment revenue	8,926	5,848	20	14,794
Total revenue	$ 225,002	$ 124,057	$ 36,192	$ 385,251
Operating income (loss)	$ 31,205	$ 27,902	$ (9,980)	$ 49,127
Interest expense	-	-	4,048	4,048
Earnings (loss) before income taxes	$ 31,205	$ 27,902	$ (14,028)	$ 45,079

(In thousands)	Flavors & Fragrances	Color	Corporate & Other	Consolidated
Nine months ended September 30, 2014:				
Revenue from external customers	$ 618,555	$ 376,050	$ 110,397	$ 1,105,002
Intersegment revenue	26,518	16,356	138	43,012
Total revenue	$ 645,073	$ 392,406	$ 110,535	$ 1,148,014
Operating income (loss)	$ 93,662	$ 89,960	$ (89,198)	$ 94,424
Interest expense	-	-	11,866	11,866
Earnings (loss) before income taxes	$ 93,662	$ 89,960	$ (101,064)	$ 82,558
Nine months ended September 30, 2013:				
Revenue from external customers	$ 641,387	$ 361,966	$ 108,653	$ 1,112,006
Intersegment revenue	26,082	16,904	68	43,054
Total revenue	$ 667,469	$ 378,870	$ 108,721	$ 1,155,060
Operating income (loss)	$ 91,595	$ 83,758	$ (40,469)	$ 134,884

Interest expense	-	-	12,317	12,317
Earnings (loss) before income taxes	$ 91,595	$ 83,758	$ (52,786)	$ 122,567

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Beginning in the first quarter of 2014, the results of operations for the Company’s fragrances businesses in Asia Pacific and China, previously reported in the Corporate & Other segment, are reported in the Flavors & Fragrances segment, and the results of operations for the Company’s pharmaceutical flavors business, previously reported in the Flavors & Fragrances segment, are reported in the Color segment with the pharmaceutical colors business. Results for 2013 have been restated to reflect these changes.

During the quarter ended September 30, 2014, one of the business units in the Color segment met the criteria to be presented as a discontinued operation and is classified accordingly in the Company’s Consolidated Condensed Statement of Earnings for all reported periods. See Note 12 Discontinued Operations for additional information. The Company evaluates performance based on operating income of the respective segments before restructuring and other costs, interest expense and income taxes. The 2014 and 2013 restructuring and other costs related to continuing operations are reported in the Corporate & Other segment.

5. Inventories

At September 30, 2014, and December 31, 2013, inventories included finished and in-process products totaling $333.4 million and $317.1 million, respectively, and raw materials and supplies of $141.6 million and $157.4 million, respectively.

6. Retirement Plans

The Company’s components of annual benefit cost for the defined benefit plans for the periods presented are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2014	2013	2014	2013
Service cost	$610	$752	$1,877	$2,265
Interest cost	502	599	1,704	1,803
Expected return on plan assets	(478)	(362)	(1,432)	(1,089)
Amortization of prior service cost	43	43	129	129
Amortization of actuarial (gain) loss	(14)	798	(331)	2,397
Settlement expense	289	-	289	-
Curtailment gain	-	-	(115)	-
Total defined benefit expense	$952	$1,830	$2,121	$5,505

7. Shareholders’ Equity

During the nine months ended September 30, 2014, the Company repurchased 2 million shares of its common stock for an aggregate price of $108.8 million. The Company did not repurchase any shares during the three months ended September 30, 2014.

8. Derivative Instruments and Hedging Activity

The Company may use forward exchange contracts and foreign currency denominated debt to manage its exposure to foreign exchange risk by reducing the effect of fluctuating foreign currencies on short-term foreign currency denominated intercompany transactions, non-functional currency raw material purchases, non-functional currency sales and other known foreign currency exposures. These forward exchange contracts have maturities of less than twelve months. The Company’s primary hedging activities and their accounting treatment are summarized below:

Forward exchange contracts – The forward exchange contracts that have been designated as hedges are accounted for as cash flow hedges. The Company had $24.7 million and $29.6 million of forward exchange contracts, designated as hedges, outstanding as of September 30, 2014, and December 31, 2013, respectively. Due to the short-term nature of these contracts, the results of these transactions are not material to the financial statements. In addition, the Company utilizes forward exchange contracts that are not designated as cash flow hedges and the results of these transactions are not material to the financial statements.

Net investment hedges – The Company has certain debt denominated in Euros and Swiss Francs. These debt instruments have been designated as partial hedges of the Company’s Euro and Swiss Franc net asset positions. Changes in the fair value of this debt attributable to changes in the spot foreign exchange rate are recorded in foreign currency translation in other comprehensive income (“OCI”). As of September 30, 2014, and December 31, 2013, the total value of the Company’s Euro and Swiss Franc debt was $101.5 million and $96.5 million, respectively. For the three and nine months ended September 30, 2014, the impact of foreign exchange rates on these debt instruments decreased debt by $8.3 million and $8.5 million, respectively, and has been recorded as foreign currency translation in OCI.

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9. Income Taxes

The effective income tax rates for the quarters ended September 30, 2014 and 2013, were 29.3% and 29.5%, respectively. For the nine-month periods ended September 30, 2014 and 2013, the effective income tax rates were 32.8% and 29.8%, respectively. The effective tax rates in both 2014 and 2013 were impacted by restructuring activities and changes in estimates associated with the finalization of prior year foreign and domestic tax items, including the reversal of valuation allowances related to the impact of restructuring activities on tax loss and credit carryovers.

10. Accumulated Other Comprehensive Income

The following tables summarize the changes in Accumulated Other Comprehensive Income (OCI) during the three- and nine-month periods ended September 30, 2014:

Three Months Ended September 30, 2014

(In thousands)	Cash Flow Hedges (a)	Pension Items (a)	Foreign Currency Items	Total
Balance as of June 30, 2014	$ 341	$ (6,890)	$ 17,775	$ 11,226
Other comprehensive income (loss) before reclassifications	207	-	(57,020)	(56,813)
Amounts reclassified from OCI	(28)	27	-	(1)
Balance as of September 30, 2014	$ 520	$ (6,863)	$ (39,245)	$ (45,588)

Nine Months Ended September 30, 2014

(In thousands)	Cash Flow Hedges (a)	Pension Items (a)	Foreign Currency Items	Total
Balance as of December 31, 2013	$ (99)	$ (6,768)	$ 12,869	$ 6,002
Other comprehensive income (loss) before reclassifications	957	-	(52,114)	(51,157)
Amounts reclassified from OCI	(338)	(95)	-	(433)
Balance as of September 30, 2014	$ 520	$ (6,863)	$ (39,245)	$ (45,588)

(a) Cash Flow Hedges and Pension Items are net of tax.

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The following tables summarize the pension items reclassified out of OCI and into the Statement of Earnings during the three- and nine-month periods ended September 30, 2014 and 2013:

	Three Months Ended September 30,	
(In thousands)	2014	2013
Amortization of pension expense included in selling and administrative expense:		
Prior service cost	$43	$43
Actuarial (gain) loss	(14)	798
Total before income taxes	29	841
Income tax benefit	(2)	(315)
Total net of tax	$27	$526

	Nine Months Ended September 30,	
(In thousands)	2014	2013
Amortization of pension expense included in selling and administrative expense:		
Prior service cost	$129	$129
Actuarial (gain) loss	(331)	2,397
Total before income taxes	(202)	2,526
Income tax expense (benefit)	107	(945)
Total net of tax	$(95)	$1,581

11. Restructuring

The Company incurred restructuring costs in both continuing and discontinued operations. The discussion in this note relates to the combination of both continuing and discontinued operations unless otherwise noted. Restructuring costs related to discontinued operations are recorded in discontinued operations within the Company's Consolidated Condensed Statements of Earnings and are discussed in Note 12 Discontinued Operations in more detail.

In March of this year, the Company announced the 2014 Restructuring Plan related to eliminating underperforming operations, consolidating manufacturing facilities and improving efficiencies within the Company. The Company anticipates that the 2014 Restructuring Plan will impact several facilities and will generate cost savings estimated to be approximately $30 million per year, with incremental savings expected to be achieved over the next few years and the full benefit expected to be achieved after 2016. The Company also anticipates that the 2014 Restructuring Plan will include a reduction in headcount by approximately 300 employees, primarily direct and indirect manufacturing labor, and pre-tax charges of approximately $120 million to $130 million. In connection with the 2014 Restructuring Plan, less than 50 employees were terminated as of September 30, 2014 and limited savings were recognized by September 30, 2014.

The Company determined that certain long-lived assets, including land, buildings and certain pieces of equipment associated with the identified underperforming operations were impaired. As a result, the Company has reduced the carrying amounts of these assets to approximately $34.9 million, their aggregate respective fair values, which were determined based on independent market valuations for these assets.

For the three and nine months ended September 30, 2014, the Company recorded restructuring and other costs of $23.1 million and $88.8 million, respectively. The Company determined that this was the appropriate amount of costs to record in each period in accordance with GAAP and based on an internal review of the affected facilities and consultation with legal and other advisors. Included within the restructuring and other costs, the Company incurred $3.2 million for the nine months ended September 30, 2014, related to the 2014 proxy contest. The 2014 proxy contest costs recorded for the three months ended September 30, 2014, was not material.

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The Company evaluates performance based on operating income of each segment before restructuring costs. The restructuring and other costs related to continuing operations are recorded in the Corporate & Other segment. The following table summarizes the restructuring and other costs by segment and discontinued operations for the three-and nine-month periods ended September 30, 2014 and 2013:

	Three Months Ended September 30,	
(In thousands)	2014	2013
Flavors & Fragrances	$20,064	$4,167
Color	-	1,497
Corporate & Other	968	922
Total Continuing Operations	$21,032	$6,586
Discontinued Operations	2,071	-
Total Restructuring	$23,103	$6,586

	Nine Months Ended September 30,	
(In thousands)	2014	2013
Flavors & Fragrances	$74,115	$18,657
Color	-	5,807
Corporate & Other	4,672	1,537
Total Continuing Operations	$78,787	$26,001
Discontinued Operations	10,017	-
Total Restructuring	$88,804	$26,001

Details of the restructuring and other costs recorded during the three and nine month periods ended September 30, 2014 are as follows:

(In thousands)	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Employee separation	$ 1,033	$ 14,611
Long-lived asset impairment	18,210	66,082
Intangibles impairment	-	1,049
Write-down of inventory	2,671	2,671
Gain on asset sales	-	(602)
Other costs [1]	1,189	4,993
Total	$ 23,103	$ 88,804

(1) Other costs include decommissioning costs, professional services, personnel moving costs, other related costs and 2014 proxy contest costs.

The Company expects to incur approximately $12 million to $17 million of additional restructuring costs by the end of December 2014 and $20 million to $25 million of additional restructuring costs by the end of 2016, consisting primarily of employee separations, asset impairments, and other restructuring related costs. These estimates relate to both continuing operations and discontinued operations.

For the three- and nine-month periods ended September 30, 2013, the Company recorded restructuring costs of $6.6 million ($4.4 million after-tax) and $26.0 million ($18.5 million after-tax), respectively