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IPHS - Q4 2016 Innophos Holdings Inc Earnings Call

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## FEBRUARY 22, 2017 / 2:00PM, IPHS - Q4 2016 Innophos Holdings Inc Earnings Call

### CORPORATE PARTICIPANTS

**Mark Feuerbach** *Innophos Holdings, Inc. - VP, IR*

**Kim Ann Mink** *Innophos Holdings, Inc. - President & CEO*

**Han Kieftenbeld** *Innophos Holdings, Inc - CFO*

### CONFERENCE CALL PARTICIPANTS

**Larry Solow** *CJS Securities - Analyst*

**Brett Hundley** *Vertical Group - Analyst*

**Francesco Pellegrino** *Sidoti & Company - Analyst*

**Curt Siegmeyer** *KeyBanc Capital Markets - Analyst*

**Chris Shaw** *Monness Crespi Hardt - Analyst*

### PRESENTATION

#### Operator

Welcome to the Fourth Quarter 2016 Innophos earnings conference call. My name is Ellen, and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Please note that this conference is being recorded.

I'll now turn the call over to Mark Feuerbach. Mr. Feuerbach, you may begin.

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#### Mark Feuerbach - *Innophos Holdings, Inc. - VP, IR*

Good morning and thank you for joining us today for Innophos' fourth quarter and full year 2016 results conference call. Joining me on the call today are Kim Ann Mink, President and Chief Executive Officer and Chairman of the Board; and Han Kieftenbeld, Chief Financial Officer.

During the course of this call, management may make or reiterate forward-looking statements made in our February 21st 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 February 22, 2017 and the presentation for this call can be found on our website at [www.innophos.com](http://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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Before turning the call over to Dr. Kim Ann Mink, CEO of Innophos, we would like to announce that on March 15th, Innophos will host an Investor Day in New York City with our extended management team. At the event we will be presenting the company's long-term strategic growth plan. Anyone that is interested in attending should send an email to [iphs@investorelations.com](mailto:iphs@investorelations.com).

With that you can now turn to slide four. Kim Ann?

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### **Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Thanks Mark. And good morning, everyone and thank you for joining us today. 2016 was a meaningful and transformative year for Innophos. We strengthened the foundation of our business, delivered significant bottom line improvement and laid the groundwork for strategic growth. We ended the year with a strong fourth quarter by focusing on cost reduction, productivity improvements and efficient working capital we once again delivered EBITDA growth, solid earnings and very strong cash generation. All this by continued market headwinds in our core phosphate market. This solid performance during the past year was the result of a collective commitment by the Innophos management team to relentlessly control what we could through decisive, swift and aggressive management of cost and cash delivery, all in the face of a very dynamic business environment.

It is also a true testament to the performance driven culture that we've cultivated at Innophos. Throughout the organization teams are embracing our transformation, delivering results and displaying a commitment to excellence, transparency and accountability. Han will cover the quarterly and full year financials in more detail in a few moments. But first I'd like to recap some key strategic accomplishments in 2016 and provide an update on the progress we've made against our three strategic pillars.

Moving to Slide 5, in 2016 we remained laser focused on creating a solid foundation by making significant changes to the organization and bringing into the company required new skill sets, new ideas and external best practices. We were very intentional about talent acquisition as it provided the basis for taking the business to the next level. And driving us to act based on where we are going and not where we've been. That is why you see a refreshed executive team with the depth and breadth of experience upon which we can leverage to effectively execute the initiative around our strategic pillars. This team has a proven track record in executing best-in-class operational and commercial practices.

In addition, as a management team, we have deep industry knowledge and experience in all stages of the mergers and acquisitions process. From systematically evaluating prospects to the critical integration process. This will be extremely important and apparent as we execute against our growth strategy.

As shown on slide six, to better align our structure with strategic goals and processes, we also had made important organizational changes. First, the supply chain purchasing and customer service function of the nutrition business have joined the broader corporate supply chain and purchasing organization. This move allows us to more effectively leverage best-in-class work processes across all business units. Increased operational efficiency and respond more quickly to changing market conditions. Further, the sales, marketing and technology functions for the nutrition business now report to Sherry Duff, Senior Vice President and Chief Marketing and Technology Officer. This ensures a sustained focus on growth through market leadership, innovation and customer responsiveness. Additionally, we also adjusted the reporting structure of our Specialty Phosphate commercial organization. With the Head of Global Sales now reporting directly to me. This is already proven to be a very important change that is providing us with better visibility into our markets and customers.

Now let's move to an update on our three strategic pillars which continue to be the driving force behind the continued improvement in our financial performance as well as the construction of the roadmap for our strategic direction. As shown on slide seven, in 2016, we made remarkable progress in getting the business fit by executing against our initiatives under the operational excellence pillar, where we drove operational efficiency through investment and improvement in our supply chain and purchasing processes. We launched the operational excellence effort in the first quarter of 2016 and since then have delivered several notable achievements. In April, we brought on Amy Hartzell as VP, Supply Chain and Purchasing to lead the development and implementation of a fully integrated, end-to-end global supply chain and operational improvement program that builds a leaner, faster process while also increasing profit. The ability to optimally integrate all areas of the supply chain are key to meeting customer needs, delivering shareholder value and allowing decision makers the visibility to identify concerns early on and respond promptly.



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With a no excuse mentality Amy went right to work focusing her new organization on raw material sourcing, cost optimization and inventory management. Through these efforts we achieved a \$44 million or 26% reduction in inventory for 2016 versus 2015. And identified our procurement savings pipeline of \$15 million to \$18 million from both direct and indirect spend. This is \$3 million above the range that we have previously identified and more than \$8 million above the range we estimated at the start of the year. \$12 million of these procurement savings were realized in the 2016 P&L and the balance is expected to be realized in 2017.

We are very, very proud of our team's ability to effectively execute on the first phase of the operational excellence initiative. The cost reductions and efficiencies achieved impacted every aspect of our business. As Innophos continues to improve upon our foundation, we are moving to the second phase of operational initiatives where we are implementing a strategic purchasing process, focused on logistics, packaging and MRO parts and labor. These efforts are expected to yield even further bottom line savings. We're also examining supplier terms and further advancements to our planning process in order to deliver additional reductions in working capital. We will be providing further granularity around these initiative at Innophos' upcoming Investor Day on March 15.

Our ongoing journey around operational excellence is driven by continuous improvement mindset; approaching business in this manner will keep us ahead of our competitors, improve our focus and allow us to seize opportunities for growth.

Now moving on to commercial excellence on slide eight. Our goal with this pillar is to maximize our value selling, drive top line improvement and effectively manage our margin by identifying, understanding and meeting the complex and ever changing needs of our customer base. We've now completed a customer segmentation to establish a better and more meaningful alignment of our product and service offerings with customers' needs and preferences. The driving factors in this process were profitability, market served and growth. Further, based on this segmentation we completed a revised customer engagement strategy which we expect to be fully operational in Q2. This engagement strategy allocates resources and expectations to drive the organization to serve customers appropriately. We believe these efforts will help to accelerate top line growth by getting us closer to key accounts while also delivering bottom line benefit through increased efficiency.

Further, we are focused on commercial realignment through the reorganization of the specialty phosphates sales force away from the generalist model that has historically been in place and toward a more market centric model centered on our food, health and industrial specialties market. This new market orientated structure is expected to be in place by the end of Q1. We're currently in the process of filling key leadership positions to support this realigned organization and we look forward to updating you on the impact of this initiative.

Now let's turn to slide nine to discuss the final pillar, strategic growth. Last quarter, we indicated that we would have our strategic growth plan completed by the end of 2016. We accomplished that objective and now have a clear and fully articulated strategic growth roadmap in place that our Board has supported and executives has brought in. In developing this plan, we took a methodical, fact based approach that leveraged a very deep set of internal and external expertise. We are confident in the trajectory that this roadmap sets us on in realizing our vision, of transforming Innophos into a market oriented growth company that provides a broad set of value added and innovative technology based ingredient solutions for the food, health and nutrition market.

I look forward to providing you further details on this growth strategy at our March 15 Investor Day. With that I'll now turn the call over to Han to review the quarter and the year in more detail. Han?

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### **Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

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, restructuring expenses and costs related to the fourth quarter 2016 refinancing of our credit facility. Please refer to our press release and SEC filings for the GAAP to non-GAAP reconciliations.

Now on slide ten. We are proud of our performance in the fourth quarter which closed out a strong year. As a result of our ongoing focus on cost actions and working capital reduction, we delivered growth across several key operational metrics despite a decline in top line. This included very strong net income and adjusted EBITDA growth and exceptional cash delivery.



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Turning to slide 11, let's start with earnings for the full year. We delivered net income of \$48 million, up 82% year-over-year on a GAAP basis and 9% on an adjusted basis. Adjusted EBITDA for 2016 was \$122 million, or 17% of sales, which represents a year-over-year margin improvement of 180 basis points. As shown on this EBITDA bridge, the favorable \$44 million impact from cost actions were instrumental in protecting earnings and offsetting the unfavorable \$40 million margin impact from lower volume and price erosion.

Now turning to slide 12. I will provide context for our sales revenue and gross margin performance. Sales of \$168 million in the quarter were down 2% versus the prior year. The reduction seen in both the direct and indirect sales channels. The year-over-year variance was driven by 3% favorable volume and mix and 5% unfavorable impact from lower average selling prices. On a full year basis, sales were \$725 million, down 8% compared to 2015 of which 5% can be attributed to adverse volume and mix and 3% to unfavorable average selling prices. This reflects our proactive efforts to improve sales of lower margin less differentiated products, the continued soft demand in end markets and price competition from overseas imports particularly seen in technical applications.

Gross margin of 20% improved year-over-year by 519 basis points due to favorable input costs and continued manufacturing discipline along with mix improvement. The procurement savings pipeline from both direct and indirect spend continue to have a positive effect this quarter.

Moving on to earnings on slide 13 starting with the fourth quarter. Net income for Q4 was \$9 million, up \$14 million from the fourth quarter of 2015. Adjusted EBITDA for the quarter was \$26 million, a 17% increase from last year. Adjusted EBITDA margin in the quarter was 16%, up 249 basis points versus the year prior. The favorable effect from \$7 million of lower input cost, \$3 million of lower manufacturing cost and \$1 million of reduced SG&A offset the unfavorable impact from lower sales volume and mix of \$1 million, and lower selling prices of \$8 million. Favorable foreign exchange effects on our fixed cost added another \$2 million improvement in adjusted EBITDA year-over-year.

Moving on to slide 14 to review our performance by segment. Specialty Phosphates sales of \$156 million declined 6% versus Q4 of the prior year. With US, Canada adds minus 9% and Mexico showing a 5% increase. The shortfall in Specialty Phosphate sales was mostly driven by a 4% decline in volume for lower margin less differentiated applications. GTSP and Other sales were more than doubled the same quarter last year as favorable sales volumes were partly offset by the effect of low market prices due to weak fertilizer market conditions in destination markets across Latin and South America.

Moving on to adjusted EBITDA by segment for the quarter. The Specialty Phosphates business generated adjusted EBITDA of \$27 million, up 20% year-over-year. Specialty Phosphates adjusted EBITDA margin improved year-over-year by 365 basis points to 17% of sales due to mix improvement and strong cost discipline. GTSP and Others generated flat adjusted EBITDA in line with the same period of last year. This reflects the early effect of GTSP tolling agreement that we put into place in December.

Now turning to slide 15. Net interest expense was \$2 million in the fourth quarter and \$8 million for the full year in line with expectations. Our effective tax rate was 31% for the fourth quarter and 32% for the full year which was at the low end of our expected range. A very good result given that most of our business is in North America. Capital expenditures were \$11 million in the quarter and \$37 million for the year, which was around the high end of our expected range. 65% of the full year capital expenditures was from maintenance and 35% was for growth related projects. We paid \$9 million in dividends during the quarter and \$37 million in total for the year, which represents a strong payout ratio of 79%. And finally in the fourth quarter we reduced net debt to \$132 million, a 21% sequential decrease enabled by reductions in working capital. Our net debt to adjusted EBITDA ratio decreased 35% year-over-year from 1.7x to 1.1x.

Now turning to slide 16. Q4 GAAP diluted EPS was \$0.47 and adjusted diluted EPS for the fourth quarter was \$0.52, up 294% and 62% respectively from the same period in 2015. On a full year basis, diluted EPS was \$2.44 and adjusted diluted EPS was \$2.55, representing an 89% and 12% increase respectively from the prior year. The EPS Bridge on the right hand side of the page takes a closer look at the elements that drove the \$0.20 favorable variance in adjusted diluted EPS in Q4 and \$0.28 favorable variance for the full financial year. On a quarterly basis, operational items in aggregate were up \$0.17 per share versus the same period in the prior year driven by \$0.56 per share favorable impact of cost savings. On a full year basis, operational items in aggregate were up \$0.19 per share this year versus the year prior due to the same principal drivers as mentioned for the quarter.



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Moving to slide 17, I'll review our cash performance which was once again very strong. For the fourth quarter of 2016 cash generated from operations was \$57 million, a 149% increase from the same period in the prior year. Free cash flow was \$46 million, the highest quarter of the year and more than tripled the same period of 2015. Free cash flow was driven by strong adjusted EBITDA delivery along with working capital reductions that enabled net debt to decrease \$35 million sequentially. Working capital improvement was principally due to inventory reductions consistent with our operational excellence agenda.

With our solid balance sheet and our ability to generate free cash flow on a recurring basis, we remain committed to maximizing shareholder value through a balanced capital allocation strategy. This includes executing on our near to mid-term priorities of investing in strategic growth and continuing to support our dividend program.

Now turning to our outlook on slide 18. Overall we consider 2017 to be another year of transition with a focus on protecting earnings and delivering cash while continuing to build on the strategic pillars and executing against our 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 into 2% to 4% range, primarily due to three factors. First, to continue pruning of lower margin less differentiated products. Second, the impact from reduced sales for lower margin products that were pruned from our old portfolio in 2016 that will impact our comparables particularly in the first half of the year. And finally, the impact from soft customer demand in package food and price competition from imports.

We expect to see the favorable impact of reduced costs from our 2016 procurement initiatives to continue through 2017 with an approximate \$4 million of benefit from these efforts to be realized in the first half. And the impact of our Phase 2 operational excellence initiative to be reflected later in the year. The cumulative impact of cost savings actions is expected to largely offset ongoing pricing pressures. As a result, 2017 earnings as a percent of sales are expected to be consistent with 2016.

As it relates to cash flow generation, we forecast 2017 capital expenditure to be in the range of \$45 million to \$50 million reflecting increased spending at Geismar to construct a Deep Well Injection System that we recently communicated. As before, we continue to review opportunities to establish a more fitful purpose organization and we remained focused on cash delivery.

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

Kim Ann Mink

Thanks, Han. At the heart of Innophos today is a company wide commitment to transparency, excellence and execution. This is demonstrated by the progress that we made against all of our 2016 objectives that I outlined at the start of the year. And I am so very proud of our achievements and of our organization. As we look forward, we're very excited for what lies ahead for Innophos as we focus on executing on our vision of transforming into a market oriented growth company. Where as 2016 was largely focused on getting our house in order, 2017 is all about execution. With that in mind our top priorities for the year are to execute against our operational excellence initiatives and deliver further bottom line saving, our commercial excellence blueprint and our strategic growth roadmap. In addition, we will continue to focus on generating free cash flow and remain committed to a balanced capital allocation strategy.

Although we expect 2017 to be a year of transition, we believe we are positioned to deliver ongoing shareholder value as we focused on these priorities and fire on all strategic and operational cylinders.

With that we'll now take your questions. Allen?

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question is from Larry Solow with CJS Securities.



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**Larry Solow** - *CJS Securities - Analyst*

Hi, good morning.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Hi, Larry.

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**Larry Solow** - *CJS Securities - Analyst*

Hi, Kim. Congratulation to Kim Ann on your recent appointment to Chairman of Board as well.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Thank you, Larry.

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**Larry Solow** - *CJS Securities - Analyst*

You are welcome. So just a couple of questions just on volume trends. It looks like a little bit improvement this quarter in your outlook. It sounds like, although you didn't give specific volume numbers, there is not much price impact maybe a little bit on those numbers but it sounds like at least in your core markets things are at least stabilizing and most of the drop is now more discretionary or you're walking away from pruning some lower market business and some stuff in the less and more commoditized market. So is that fair to say?

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Yes. We had mentioned overall from a revenue standpoint we are expecting 2% to 4% revenue decline. So pricing environment we said will be similar to last year so this implies that we will see better volume comparable than in 2016 which really reflects the benefits of our commercial excellence initiatives this year.

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**Larry Solow** - *CJS Securities - Analyst*

I know that the backdrop clearly is remains challenging. Are you seeing any areas of growth within your specific product lines or things that have improved?

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Yes. As I had mentioned previously in our phosphate business in most of the markets, at best, we are going to see GDP growth. So I think everything that we are trying to do is to really shore up to get that business fit and shore up our position as a leader in North America. So I think you'll see -- you'll expect some of the same competitive pressures that we've been seeing and that I have been talking to you all about for the last year.

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**Larry Solow** - *CJS Securities - Analyst*

Okay. And just lastly and the question for Han. You guys obviously done a good job in cost cutting and it sounds like in terms of maybe going forward maybe there is -- as you go into your second phase maybe there is a significant amount more but just in terms of near term you had some nice margin improvement this year, you were able to more than offset the sales drop. As we look out to 2017, your number it sort of seems like



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you are sort of plateauing your margin improvement at least in the time being is that sort of what you are implying here or maybe there is upside to that?

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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Well, I think a couple dynamics, Larry. One is -- and I think I made a comment just moment ago when we spoke to the slides, which was around the pressures in the market, so the pricing pressure we will continue to see heading into 2017, that was one of the comments. Again, we are working hard to offset that like we have successfully done in 2016 with a number of initiatives. So that's where the offsets come in.

So from an overall margin perspective and whether you talk about gross margin or EBITDA margin, we expect to see a very similar profile in 2017 compared to 2016. Now remember, in 2016 we made some very important strides and improvements, right, by any comparison, call it a wider peer group in specialty chemicals and or even in the ingredient space, these are very respectable margins and we expect those to be maintained heading into or going through 2017.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

The only thing I would add to that, Larry, and at our Investor Day, coming up in March, we are going to expand in more detail on our phase two operational excellence initiatives, around timing and savings expectations. So stay tuned for that. We'll have more to say.

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**Larry Solow** - *CJS Securities - Analyst*

Great. I look forward to it and thanks for taking my questions.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Thank you.

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**Operator**

The next question is from Brett Hundley with Vertical Group.

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**Brett Hundley** - *Vertical Group - Analyst*

Hey, good morning, everyone.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Hi, Brett. How are you?

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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Hey, Brett. Good morning.

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**Brett Hundley** - Vertical Group - Analyst

I am good, thank you. Kim Ann congratulation to you and your team for everything you've done in 2016 especially in the back half of the year.

**Kim Ann Mink** - Innophos Holdings, Inc. - President & CEO

Thank you.

**Brett Hundley** - Vertical Group - Analyst

With that said, so first of all I just had a quick question for you guys on Mexico volumes during the quarter. The performance was definitely better than we had been expecting and I am curious if there is anything in there related to inventory stocking just given testiness along the border there and maybe yourselves or customers loading up ahead of any changes to NAFTA and if that is the case should we expect another bump in volumes during Q1?

**Kim Ann Mink** - Innophos Holdings, Inc. - President & CEO

Han, can you take that?

**Han Kieftenbeld** - Innophos Holdings, Inc - CFO

Yes, I can. Obviously, it's kind of top of mind, Brett, and I think across the spectrum everybody in business (is) kind of thinking about it. But as we -- it's also a big unknown right. So we are all speculating in terms of what might happen and how it may impact. You know the results of the business as well as what kind of proactive actions might be taken. What we are seeing right now is nothing proactive if you will because people don't know yet what they are dealing with. Be it border taxes or what have you, I think everybody is kind of doing their back of the envelop calculations in terms of what it might mean with a little information that's out there. But we haven't seen, so to your question, we haven't seen any activity yet on the part of our customers to increase their inventory holdings in preparation for anything. So right now, the way we look at the quarter and the first half is not to assume any kind of uptick as a result -- direct result of that.

**Kim Ann Mink** - Innophos Holdings, Inc. - President & CEO

And I guess I'd only add on top of that is clearly this is something we've continued to monitor as

**Han Kieftenbeld** - Innophos Holdings, Inc - CFO

Absolutely.

**Kim Ann Mink** - Innophos Holdings, Inc. - President & CEO

-- does many of the folks in our industry.

**Brett Hundley** - Vertical Group - Analyst

That's interesting to hear, so maybe some improvement sequentially potentially for that business. Maybe can you remind us, in the investment community here, the mix of your business in Mexico? I want to say that about half of it actually stays in country and the remainder comes either up to the US or broadly across Latin America. Am I correct in saying that?



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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

No. It's less than that. So it's a bigger piece that doesn't stay in Mexico, let me put it that way, because it is, to your point, it's going up to the United States that's one piece. And there is an important piece also that goes into other parts of South and Latin America. So it is the minority piece that stays in Mexico, the majority is being exported either into the United States or down south.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Just to remind you Brett the way he have been segmenting our business historically that the sales that you see associated with Mexico is associated with the products being sourced from Mexico. That's the historical segmentation.

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**Brett Hundley** - *Vertical Group - Analyst*

Okay. I appreciate that color. And then on your 2017 earnings outlook we had expected little bit of growth nothing material just given the overall environment. But we had expected some growth related to incremental cost savings and then also your GTSP business kind of flattening out for you relative to recent losses. And clearly it sounds like the market environment is going to be a little bit softer than we had been anticipating. So I just wanted to ask you two questions related to that.

Number one, it sounds like calling may continue for longer than we had anticipated. I am curious how your calling efforts are pacing relative to timetables and magnitude that you had originally set out and then secondly, the commentary that I have seen from other public players further upstream has at least suggested to me that maybe the environment could taper off a little bit and potentially get a little bit better from a pricing standpoint mostly related to product coming out of Asia. And so it doesn't sound like that's the case from where you sit and I just wanted to get an update from what you are seeing across the marketplace and why you expect pricing to continue to decline in 2017?

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Yes, Brett. Good question. Yes, with regard to pricing pressure, we said the market remains competitive with the strength of the US dollar against the euro. Chinese competition is still out there more so, as I think we've discussed with technical grade phosphates, so looking out to 2017 we expect those pricing pressures will continue as we saw in 2016 at about that same level of competition. And this is consistent with what are you going to see across the market whether it continues to be limited volume growth and downward pricing pressure.

I think I mentioned when Larry asked the question about the volume decline, volume is going to be pretty flat year-over-year. That notwithstanding during our March 15 Investor Day, we will have more to say about what we are going to do in our operational excellence and commercial excellence initiative. As we did in 2016 to really try to offset some of those headwinds. So you'll have more granularity regarding timing and amount of savings, if you will, in a couple of weeks.

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**Brett Hundley** - *Vertical Group - Analyst*

That's great. And just one more for me, I'll leave the floor. Kim Ann I know you've been running 100 miles per hour here and you've accomplished a lot. I know that portfolio diversification is important for you and I wanted to revisit the M&A strategy and filter -- I'm curious if you've been frustrated at all that a deal hasn't come along for you by any optionality that's out there and just curious if you can remind us the sweet spot of deal size that you are looking at. Thank you for taking my questions.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Oh no. Again, we'll have more to say in our March 15 day but we continue to evaluate opportunities that are going to extend our presence in the growing food, health and nutrition market adjacencies. I am not frustrated. It's all about timing; it's about getting the right deal. Again, we'll talk more about the specific M&A criteria, we'll give you a lot more granular details around our strategic roadmap including the M&A criteria and target market in a couple of weeks.

But we continue to be very active in this aspect of our growth strategy because as I commented in the past, our phosphates business, I'm proud of our heritage, but that business will not grow -- it will grow, at best, GDP growth. So we believe we have now identified the key sub segment within the food, health and nutrition on where that growth is and we are very surgically looking at acquisitions right now to help us grow on those areas where I think we'll be uniquely qualified to take that forward. So again, take two put off more for the March 15 Investor Day but I think you will be pleased about what we will be discussing.

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**Operator**

The next question is from Francesco Pellegrino with Sidoti.

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**Francesco Pellegrino** - *Sidoti & Company - Analyst*

Good morning, guys.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Hi, Francesco. How are you?

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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Hey, good morning.

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**Francesco Pellegrino** - *Sidoti & Company - Analyst*

Pretty good. And just echo Larry congrats you on the board appointment.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Thank you.

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**Francesco Pellegrino** - *Sidoti & Company - Analyst*

I want to hit on so first off just looking at specialty phosphates US and Canada, the pricing seems to be holding up really nicely as you guys continue calling the high volume low margin business. But I guess maybe just to touch on Brett's point. And Brett focuses a little bit more on volume. What exactly are we seeing on the pricing end for specialty phosphates Mexico segment?

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Han, can you take that?



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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Sure. So you asked specifically about specialty phosphates in Mexico right?

**Francesco Pellegrino** - *Sidoti & Company - Analyst*

Yes. And the pricing dynamics we've seen there.

**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Yes. So what you've seen obviously and you've seen it probably in the attachment to the press release that the Mexico piece has been quite important to us in 2016 from an overall earnings delivery perspective. What we are seeing there from a pricing perspective is given the nature of the products coming out of our operations there which are more technical in nature compared to the food and pharma grade out in the US facilities, is also that it is more prone to some of the pricing influences that are in the commodity markets namely the fertilizer markets right.

So as we reported I think we commented but equally we reported on it through the press releases and what you have is that those markets are quite depressed currently. They are at a seven year low and we've navigated through that pretty well but that is an impact that the Mexico business, if you will, the segment is more exposed to than our US, Canada segment. And that's probably the most important factor I would comment. Other than that, our business managers over there have done really well navigating through it as I've said and maintaining both volume and actually pricing at a pretty good level. But that's an external dynamic that definitely we are working with.

**Francesco Pellegrino** - *Sidoti & Company - Analyst*

So it's more of a byproduct of the product midshift essentially?

**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Yes. An influence by some of those commodity end markets, yes.

**Francesco Pellegrino** - *Sidoti & Company - Analyst*

GTSP pricing and I know you have the new tolling agreement that you announced on the last conference call, I would have thought just pricing would have held up a little bit better when I look at just where the fertilizer markets are. Could you just maybe talk about why pricing was as weak as it was? I mean in the segment, I am possibly thinking that margins might even be lower for the tolling agreement than I had initially anticipated just given how steep of a decline pricing was during the quarter.

**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Well, during the quarter GTSP and Others sales were more than double same quarter last year

**Francesco Pellegrino** - *Sidoti & Company - Analyst*

But that was a byproduct of volume right?



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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Yes. At favorable sales lines

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**Francesco Pellegrino** - *Sidoti & Company - Analyst*

Right.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

-- but were probably offset by the effects of low market prices due to weak fertilizer market conditions in the destination market across Latin and South America. So we saw very, very low market prices.

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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

I think, Francesco, the way we look at it is, we are actually overall pretty pleased where the year netted out. If you look at some of the comments -- I didn't speak to it in much detail but you take your eye back to slide 14, you actually see that overall for the year we netted out with GTSP zero adjusted EBITDA number and so, that's exactly kind of what we set out to do. You are, now particularly with the new agreement in place, we are pleased that and that's kind of -- and I think Brett you asked the question about it too, but that's kind of obviously setting the pace for 2017 -- so that kind of zero impact level.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Because if you recall, earlier in 2016, we saw an EBITDA loss of \$2 million as we had in second quarter 2016 followed by a positive EBITDA of \$2 million in third quarter 2016 so that's a \$4 million swing from one quarter to the next. So again, that GTSP contract will really dampen that earnings volatility which is exactly what we want it to do.

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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Yes. And then lastly maybe Francesco just to round out the point is, probably the year-over-year comps is particularly that kind of informed your question. If you look at it actually sequentially and you look at it Q2, Q3 and Q4, our pricing in the segment GTSP for Mexico -- very similar, very similar, very consistent. So we've seen it for three quarters in a row but, yes, the prior year was stronger but then again the markets came off in 2016.

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**Francesco Pellegrino** - *Sidoti & Company - Analyst*

You guys wouldn't happen to have handy specialty ingredients including technical grade pricing volume mix dynamics, would you? Just because if there are any issues I just wanted to maybe discuss them now.

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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Yes. Why don't you go ahead and ask your specific question. We'll see whether we can answer it.

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**Francesco Pellegrino** - *Sidoti & Company - Analyst*

I was just wondering if you had the data points available. The specialty ingredients what the change in price was for the quarter as well as the volume mix and then those numbers as well for food and technical grade PPA? Because you sort of just break it out geographically.

**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Yes. We set it out; I am not sure if that is what you are referring too. We set out in the appendix of the press release too but price for the quarter for total specialty phosphates was a negative 2% and volume and margin was negative 3.5% for the total of 5.5%.

**Francesco Pellegrino** - *Sidoti & Company - Analyst*

I am talking about the food and technical grade PPA and then the specialty ingredients because I think there is a couple of different ways that you do report it and the way that it's reported in the press release is just more of a geographical look at it. And I was just hoping to look at maybe the consolidated business overall, we get touch basis on that offline.

**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Yes. Why don't we do that? We have that stuff sure at our finger tips but we can talk about it as follow up.

**Francesco Pellegrino** - *Sidoti & Company - Analyst*

And then my last question for you is I guess as we start calling a lot more of the commodity part, commodity portion of the business just in regards to volume, we are getting more towards a business that has more differentiated end market products that they are selling but at the end of the day the R&D spend just seems really, really low when you look at the peer group. Maybe Kim Ann could you just elaborate a little bit with how important internal R&D is going to be? I know you just increased the revolver, I know you are going to talking a lot about M&A

**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Yes.

**Francesco Pellegrino** - *Sidoti & Company - Analyst*

But just what do you in house with the R&D opportunities maybe for productivity.

**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Yes, no, good question, Francesco. I said this in the past, the company has done an excellent job in building a team of what I believe are best in class scientists who understand ingredient formulations and where we have fallen short, somewhat short is really in commercializing this expertise. That's where we are laser focused on today. How can we better use market intelligence and strategic marketing to identify the right growth opportunities and be more meaningful to our customers?

And when I talk about R&D, it's probably more application development versus pure R&D. So we are really looking at this point in time on how we can reallocate time on the right things. But, a good point, there is a strong possibility that we would get R&D benefits coming from inorganic opportunities. So I'm balancing that initiative and that effort of looking at inorganic opportunities while at the same time trying to really reallocate the resources in a proper way. But I do believe that innovation will be part of our growth going forward. And that I am willing and ready when the timing is right to increase the R&D investment.



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**Francesco Pellegrino** - *Sidoti & Company - Analyst*

Okay, perfect. Thank you so much.

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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Thank you.

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**Operator**

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

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**Curt Siegmeyer** - *KeyBanc Capital Markets - Analyst*

Hey, good morning, guys. Congrats on another nice quarter.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Hi, Curt.

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Thanks. How are you?

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**Curt Siegmeyer** - *KeyBanc Capital Markets - Analyst*

Pretty good. Just one question on margins. As I look at Mexico compared to US and Canada, margins are just a few years back in 2012, 2013 timeframe were pretty close. Net gap has seemingly steadily grown over the years. Is there any reason structurally why US and Canada can't close that gap over time and I guess if the answer is "no" what would need to happen for that to occur?

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**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Han, do you want to comment on that?

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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Yes. Depends a little bit or could from what you are looking at from a margin perspective. If I look at variable margin it's been pretty consistent and yes Mexico is stronger than the United States but not by a mile, if you will. And again, in both instances, what I would say for US and Canada the margin delivery has been quite consistent, and I am talking variable margin. If you look at Mexico, per se, that has improved over the last 12 months because it is more vertically integrated and has benefited from a number of more directly I would say from a number of the procurement initiatives also particularly as it relates to sourcing of certain raw materials. So that's where you see that uptick and that improvement in margin year-over-year in particularly happening for that reason. So it's a bit of a difference I would say in the supply chain model, if you will.



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**Curt Siegmeyer** - KeyBanc Capital Markets - Analyst

So there is a structural sort of reason for it.

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**Kim Ann Mink** - Innophos Holdings, Inc. - President & CEO

Yes.

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**Han Kieftenbeld** - Innophos Holdings, Inc - CFO

Right.

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**Curt Siegmeyer** - KeyBanc Capital Markets - Analyst

Okay. Make sense. And then just another one on free cash flow. You guys had a really nice quarter in terms of cash generation, good inventory and just overall working capital management, so just kind of curious on any thoughts you have on the free cash flow outlook going into next year and if you are -- how you kind of manage working capital has changed that we should maybe expect better cash generation going forward?

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**Kim Ann Mink** - Innophos Holdings, Inc. - President & CEO

Curt, there are really two factors that are going to drive our cash performance. The first is working capital. And as you know that really helped us in 2016. Now although working capital reductions continued to be an important part of our agenda, we expect to see continued improvements. We don't expect to see the same step changes we did in 2016 because that was a lot of the low hanging fruit. The other factor is CapEx, and as we commented we are expecting to see our CapEx go up due to the Geismar Deep Well Injection System, that incremental \$4 million in support of that system. So while we continue to look at this as a very important part of our profile, is our free cash flow; it won't be as high as 2016 but extremely strong, we believe, in 2017.

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**Operator**

The next question is from Chris Shaw from Monness, Crespi, Hardt.

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**Chris Shaw** - Monness Crespi Hardt - Analyst

Hi, good morning. How are you guys doing?

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**Kim Ann Mink** - Innophos Holdings, Inc. - President & CEO

Hi, Chris. How are you?

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**Han Kieftenbeld** - Innophos Holdings, Inc - CFO

Good morning.

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**Chris Shaw** - *Monness Crespi Hardt - Analyst*

Good, good. Thanks. I just clarify I think you said volumes in 2017 would be flat and I am just trying to - then does that mean that 2% to 4% decline in sales is all going to come from the lower prices or was that a comment about volumes, core volumes and not just stuff that you recall.

**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Yes. I had, I did say Chris, right, the 2% to 4% revenue decline and that is due on a couple of different things. We got competition continuing to persist there. But since the pricing environment is going to be similar to last year that implies we will see better volume comparable than in 2016. And again I believe that really reflects our initiative in commercial excellence.

**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Yes. The additional comment I would make, so I think that's absolutely accurate. So it's mostly a price impact that you factored in. The other thing is one of phasing during the year and I made one of those comments around volume and pruning that took place particularly as the year progressed. So we see, from a comp perspective, more of a year-over-year kind of un-favorability if you want to use that word in the first half and then things will righted itself in the second half. But the comment that Kim Ann made for the full year is on target.

**Chris Shaw** - *Monness Crespi Hardt - Analyst*

So net of that first half impact, volume impact from pruning, you would think that volume would be up in 2017 otherwise?

**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

No. The other way around right? So they would be down on a comp basis versus 2016 and then as the year progresses with the actions we are taking you would see a bit of an uptick year-over-year. So for the full year it should be close enough to zero and then with the largest impact on a full year basis within that 2% to 4% range being from price.

**Chris Shaw** - *Monness Crespi Hardt - Analyst*

Okay. Thanks. And can you talk about what is the outlook for raw cost, sulphur cost I mean I am not sure where they are trending right now or are they relatively flat or is there going to be some benefit for 2017?

**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Yes, they are relatively flat, that's really what we are going to see for this year, Chris.

**Chris Shaw** - *Monness Crespi Hardt - Analyst*

Okay. And then from the announcement from a month ago the Geismar plant, do you have, I guess just want I'm trying to get at, do you have a guidance for CapEx for the year? I think that was going to increase the CapEx for 2017 right?



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**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Yes, exactly. So one of the comments I made, so if you look at our typical capital which is mid -30s right? That is not changing in 2017. I called out a range in the upper 40s up to \$50 million during the call just a moment ago. That is because of around \$40 million that's linked to Geismar facility, the Deep Well Injection System. And so, that's a 2017 event so that's kind of a one off aspect.

**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Right. And if you recall in our press release we had said that the capital expenditure for the system was \$16 million. We had spent \$2 million of preliminary engineering and equipment investment from 2016, \$14 million really carrying over into 2017 and that is consistent with our expectation and that we had actually reflected in our guidance for 2016.

**Han Kieftenbeld** - *Innophos Holdings, Inc - CFO*

Right.

**Chris Shaw** - *Monness Crespi Hardt - Analyst*

Okay, great. That's all I have. Thank you.

**Operator**

We have no further questions at this time. I would like to turn the call back to Kim Ann Mink for closing remarks.

**Kim Ann Mink** - *Innophos Holdings, Inc. - President & CEO*

Thank you, Allen. And thank you everybody for joining us today. We look forward to seeing many of you at our March 15 Investor Day in New York City where we will introduce our strategic roadmap for growth and expand upon our longer-term expectations for Innophos. As Mark indicated at the start of the call, any investors or analysts that are interested in attending should please send an email to [iphs@investorrelations.com](mailto:iphs@investorrelations.com). Thanks everyone for joining us today.

**Operator**

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

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