

## INNOPHOS 2Q15 RESULTS CONFERENCE CALL

### EDITED TRANSCRIPT

CALL HELD JULY 28, 2015

#### CORPORATE PARTICIPANTS

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

**Randy Gress** *Innophos Holdings, Inc. - Chairman, CEO, President and Director*

**Robert Harrer** *Innophos Holdings, Inc. - VP and CFO*

#### CONFERENCE CALL PARTICIPANTS

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

**Christopher Butler** *Sidoti & Company - Analyst*

**Bruce Zessar** *Advisory Research - Analyst*

**Chris Shaw** *Monness, Crespi, Hardt & Co. - Analyst*

#### PRESENTATION

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##### Operator

Good morning, ladies and gentlemen, and welcome to the Innophos second quarter 2015 results conference call. My name is Vanessa, and I am your operator for today. (Operator Instructions). Please note that this conference is being recorded.

And I would now like to turn the presentation over to your host for today's call, Mr. Mark Feuerbach, Vice President, Investor Relations. Sir, you may begin.

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

Good morning, and thank you for joining us today for Innophos's second quarter 2015 results conference call. Joining me on the call today are Randy Gress, Chief Executive Officer; and Robert Harrer, Chief Financial Officer. Randy will start with comments on our second quarter results and provide updates on our progress in executing our strategic initiatives. Robert will then provide details on our financial results and further comments on our outlook for the remainder of 2015. Randy will then conclude with some final remarks before we open up the call to your questions.

During the course of this call, management may make or reiterate forward-looking statements made in our July 27 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.

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 July 28. 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.

Now I would like to turn the call over to Randy Gress, CEO of Innophos. Randy?

***Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director***

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Thanks, Mark, and good morning, everyone. In the second quarter, as expected, we continued to experience the unfavorable market conditions that we encountered over the past two quarters. Soft specialty horticulture, firefighting, and processed foods market demand, competitive pricing pressures, and a strong US dollar continued to challenge our business. While we saw some stability in our financial performance on a sequential basis, not much changed regarding the overall business drivers, leading to many of the same year-over-year comparative results that we recorded in the first quarter.

Despite these challenges, we generated significant cash flow during the quarter, which we used to increase returns to our shareholders. We paid \$10 million in dividends and repurchased over 973,000 shares for \$52 million, returning a total of \$62 million to shareholders during the second quarter alone. This brings our first-half 2015 returns of cash to shareholders to a total of \$106 million, including \$86 million of share buybacks, representing nearly 70% of our announced \$125 million program for 2015.

Regarding business performance, we delivered total Company net sales of \$217 million in the second quarter, down 1% or \$2 million from the same period last year. Diluted earnings per share of \$0.65 were up 18% sequentially due to translation expense in the first quarter of 2015, but down 30% compared to the \$0.93 recorded in the prior-year period.

On the Specialty Phosphates side, year-over-year revenues were down 3% or \$6 million due primarily to 2% lower selling prices, as the strong US dollar continues to foster increased competitive pricing pressures. Volumes were also down 1% for the quarter compared to last year on softer market conditions, particularly in the specialty horticulture and firefighting markets. Our total Specialty Phosphate operating income was \$11 million below the prior-year period on lower selling prices and higher cost. Specialty Phosphates operating income margins of 11% were down by 520 basis points compared to the second quarter of 2014. Specialty Phosphates margins are expected to improve from this level in the second half of the year as a result of price increases implemented late in the second quarter.

US and Canada Specialty Phosphates operating income margins were 9%, down 450 basis points year-over-year due to lower selling prices, higher raw material cost from a contract that reset on January 1, and higher manufacturing costs. Mexico continues to perform well, providing greater efficiency and flexibility, supporting our North American network and strengthening our product mix in Latin America. Mexico PPA sales volumes were up 41% for the second quarter as we continue to build on our strong performance last year. Mexico Specialty Phosphates operating income margins remained strong at 17%, but were down 840 basis points from an extremely high second quarter 2014, when Mexico achieved price increases ahead of cost increases.

Export sales overall were down 5% year-over-year, primarily due to order patterns for Europe, Middle East, and Africa; and lingering effects on sales in Asia from the US West Coast ports, which returned to normal operations during the quarter.

As we stated last quarter, underlying demand throughout most of the markets we serve continues to be soft, a condition which we now believe will persist throughout 2015. Thus, the soft market conditions will likely offset any successes we will achieve on the new products and a second-half recovery in geographic expansion, which we believe will result in a flat comparison for 2015 against 2014. That said, we are reaffirming our guidance for our full-year operating income margin to be in the range of 12% to 13%.

We continue to see excellent results for our INNOVALT® product line, which again posted very strong sales. Volumes were up 28% year-over-year for the second quarter, and the government seems to be making some progress on extending the Highway Trust Fund. We remain confident in the long-term market potential of our INNOVALT product line.

Cal-Rise®, our low-sodium baking product, also showed excellent volume growth in the quarter, up 34% year-over-year. NutraTab™, our new excipient blend which was launched last fall, is showing early promise with many contacts made and commercial orders already on the books. We continue to look for ways to expand our product portfolio with innovative technologies and offerings.

I would also like to add that our Taicang, China, business continues to show traction with second quarter 2015 sales from the operation more than two and a half times the prior-year quarter.

I will now turn it over to Robert for additional detail on financial results in the quarter and on our 2015 outlook.

Robert?

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**Robert Harrer - Innophos Holdings, Inc. - VP and CFO**

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Thanks, Randy. Net sales of \$217 million for the second quarter of 2015 consisted of \$192 million from Specialty Phosphate and \$25 million from GTSP and Other. This represents a 1% or \$2 million decrease year-over-year.

Diluted earnings per share for the second quarter of 2015 were \$0.65, up slightly on a sequential basis, when adjusting the first quarter 2015 for translation expense and exchange effects in taxes.

US and Canada Specialty Phosphate recorded second quarter sales of \$148 million, down 6% from the prior-year period due to 2% lower prices and 4% lower volumes. Soft demand in firefighting markets and reduced sales to specialty horticulture markets, due to low demand and import pricing, accounted for the entire volume decline.

Mexico Specialty Phosphate second quarter sales of \$44 million were up 7% year-over-year on 10% higher volumes but 3% lower selling prices. The decrease in selling prices in Mexico is a result of significant price increases implemented in the second quarter 2014, which have since declined somewhat. Operations at our Coatzacoalcos plant continue to run well, as illustrated by these strong margins which have averaged 17% for the last six quarters.

Total Specialty Phosphate generated \$21 million of operating income for the second quarter, down \$11 million versus the prior year. Overall, operating income margin in Specialty Phosphate was 11% for the second quarter, down 520 basis points from the prior-year period.

US and Canada operating income of \$13 million was down \$8 million from prior-year period as a result of 2% lower selling prices, \$2 million of higher raw material costs, and higher manufacturing costs. Operating income margin was 9%, down 450 basis points compared to the same period in 2014.

Operating income for Mexico Specialty Phosphate was \$7 million, down \$3 million from the same period last year, but flat sequentially. Operating income margin remained strong at 17% for the second quarter, but was down 840 basis points from an extremely high second quarter 2014, when Mexico achieved price increases ahead of cost increases.

Our effective tax rate for the second quarter was 31%, below our expected range, primarily due to an increased proportion of taxable income in lower tax rate jurisdictions. We expect an effective tax rate in the range of 32% to 34% for 2015.

Depreciation and amortization was \$11 million for the quarter, up \$2 million compared to the year-ago period. Capital expenditures were \$8 million in the second quarter, with approximately 70% spent on maintenance, and the remaining 30% for strategic growth initiatives. The majority of the strategic growth investments were focused on improving capability and capacity at our Coatzacoalcos, Mexico, facility. Our expectations for 2015 capital expenditures remain in the range of \$30 million to \$35 million.

Net debt increased just \$16 million in the second quarter to \$164 million, while we repurchased roughly 973,000 shares for \$52 million aided by \$29 million of decreased working capital, which more than reversed the \$21 million increase of working capital in the first quarter. With our solid balance sheet and our ability to generate free cash flow on a recurring basis, we remain committed to returning capital to shareholders and maximizing shareholder value.

We continue to expect Specialty Phosphates volume to be flat for full-year 2015, with soft market demand expected to offset success on new products and any second-half recovery in geographic expansion. Full-year operating income margin expectation is in the 12% to 13% range, as we expect improved margins in the second half of the year from second quarter 2015 levels due to higher selling prices.

Fertilizer market prices showed a slightly declining trend during the second quarter 2015, and are currently 5% to 10% below prior year levels. Market phosphate rock prices were flat sequentially, and are expected to remain stable for the third quarter. Sulfur market prices decreased approximately 10% sequentially in the second quarter 2015 and are expected to remain relatively stable in the third quarter.

GTSP and other recorded breakeven operating income for the second quarter 2015, in line with expectations. Given the current market conditions, we expect operating results to be near breakeven again in the third quarter 2015.

Now back to you, Randy.

**Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director**

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Thanks, Robert. It is now apparent that the headwinds we experienced in the first half of the year due to softness in end markets, and those caused by the strengthening of the US dollar, will likely persist throughout the second half of the year as well. We have implemented price increases in Specialty Phosphate, which should increase margins from our second quarter level and keep us in the 12% to 13% expected range for 2015.

Given the 2015 margin compression that we are experiencing, we are currently evaluating several initiatives to improve the overall operating efficiency of the organization, targeting to at least cover the 100 basis points cost component of the margin compression. These initiatives may require various one-time costs, such as capital spending and separation costs. The various initiatives being reviewed include production unit consolidations and various staff reduction initiatives. We intend to conclude the evaluation of these initiatives and seek Board approval by the end of the third quarter 2015.

These actions, in addition to several others, have been designed to overcome the challenges we are facing. Other initiatives include focusing on quality and maintaining superior service levels, focusing on additional operating efficiencies, building on successes of recent product launches; and lastly, looking at a number of ways to reduce GTSP

earnings volatility, including structuring the GTSP production as a toll manufacturing operation for a phosphate rock supplier or a fertilizer customer; diversifying the co-product options to include other solid fertilizers as well as specific phosphoric acid grades; and distributing the product through additional channels besides our own marketing.

Despite these challenges we are facing in the business, our focus remains on maximizing value for our shareholders by actions that lead to direct returns to them, such as through our quarterly dividends and our expanded share repurchases program. In that regard, we are well on our way to delivering on our announced \$125 million in share repurchases during 2015.

Thank you for listening. We will now take your questions. Operator?

## QUESTION AND ANSWER

### Operator

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(Operator Instructions). Larry Solow, CJS Securities.

### Larry Solow - CJS Securities - Analyst

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Was wondering just your thoughts on your price increases. And have you already implemented them, or is that an ongoing process? And what is your confidence level, then, on that being able to stick?

### Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director

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Yes, Larry. As we ended the second quarter, we announced in the latter part of the second quarter there, the increases here in the US/Canada. And we're having success in a number of areas with the increases. And that's what gives us the confidence of doing the 12% to 13% margin with the improvement from the second quarter at 11%. And it is still a competitive environment there. We still face some of the headwinds of the strong US dollar, but expect to have that success for the latter part of the year.

### Larry Solow - CJS Securities - Analyst

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Okay. And then in terms of some of these potential initiatives to offset some of the margin pressure, and I think you said it. Hopefully at least a minimum of cost cutting that offsets 100 basis points -- that will improve margins back at least 100 bps. Is this the low bar, or might there be significantly potentially more than that?

It seems like the weakness in sales is perhaps not a short-term phenomenon. Or maybe this week it's short term, but perhaps your longer-term outlook and assessment may need to come down a little bit in terms of it being a 3% to 5% grower. Are there are potentially more cost cuts on the horizon?

And then the second question to that is any thoughts on the -- I know you had mentioned last quarter in the GTSP segment, perhaps tolling that or some other type of setup for that. That would be great if you could give us an update on that. Thanks.

### Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director

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Yes, sure, Larry. Thanks. For the cost restructuring, I think it's important to point out that, at an SG&A level, we already run fairly lean; and benchmark well with, I think, the industry at 9.3% of sales there. So, that combined with I think we have a pretty complex network of plants and are fairly well integrated.

So as we look at the opportunities here for restructuring, I do believe that with that 100 bps that we're targeting, at least, I have confidence that we can achieve that. I think we are completing some of the evaluation and looking at

where those opportunities are to further optimize some of the efforts we've made on the manufacturing side. And then also what we can do on the overall overhead side of things to optimize and improve things.

I think we will continue to focus on what we can do there with the overall continuous improvement efforts that we have within manufacturing, within quality, within improvement in the supply chain, as well, on top of this base restructuring program.

If I can jump to your second question on GTSP, sure, we're having confidential discussions on the tolling arrangement. Too early to talk about anything there. But we have made improvements just in our overall GTSP operation, and driving some of the improvements in quality so that we can sell to different geographies and through different channels. And have also made some sales of some alternative products, as well, primarily in the acid area.

And I think some of that will take some time, but continue to make some continuous improvements to stabilize that area. But I think it important to point out that with the expected breakeven here in the third quarter, as well as what we achieved just slightly roughly breakeven, slight 2%, I guess operating income in the second quarter.

**Larry Solow - CJS Securities - Analyst**

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Okay. Great, thanks.

**Operator**

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Christopher Butler, Sidoti & Company.

**Christopher Butler - Sidoti & Company - Analyst**

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Could you talk about how things have progressed since the last conference call? Your pricing -- is that down sequentially? It's stable? And then in your talking about the demand environment, competitive environment has that gotten more challenging in the last three months than you had expected?

**Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director**

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Yes, overall, the pricing from first quarter to second quarter has basically been flat. And it's at the end of the second quarter is when we implemented the price increases, which we expect to see the improvement in pricing.

I think from a competitive environment, it feels relatively stable. But I think on the international side of things, and for the exports, we see some increased challenges based on I think the relative strength of the dollar. And that continues.

**Christopher Butler - Sidoti & Company - Analyst**

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And I know with the -- on the last conference call you talked about the strength of the dollar actually hurting foreign competitors a little bit as far as raw materials. Is that something that becomes a bit of a delayed benefit for you, that

they work through some of their inventory and then they start to face some of the same challenges that you are facing? Or how does that play out?

**Randy Gress - *Innophos Holdings, Inc. - Chairman, CEO, President and Director***

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Well, as we look at -- let's take, as an example, a European producer. A lot of their raw material costs are generally, globally, on a dollar basis. And I think the one we saw in raw materials from fourth quarter into the first half of the year, you saw MGA prices go up \$40; and then for the second half, a \$5 increase is what has been announced for MGA prices.

So those costs are in dollars. And then I think on local cost, they are certainly going to be in their local currency, but a smaller portion of their overall cost structure.

**Christopher Butler - *Sidoti & Company - Analyst***

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And just finally, could you talk about use of cash? You've been repurchasing shares at a greater pace than what I was looking for. Is that expected to continue? And what does that say about your acquisition pipeline?

**Randy Gress - *Innophos Holdings, Inc. - Chairman, CEO, President and Director***

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Yes, I'm going to ask Robert to address that, please.

**Robert Harrer - *Innophos Holdings, Inc. - VP and CFO***

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Yes, as you said, we saw in the second quarter, due to the lower share price, opportunities to use our flexibility with our open market transactions. And that yielded a significantly higher amount of share repurchases. We will continue throughout the third and the fourth quarter to monitor the situation. And if we deem it to be beneficial, we will increase our purchases on an ad hoc basis. So yes, you're right; we continue to use the flexibility in the program for the remainder of the year.

**Randy Gress - *Innophos Holdings, Inc. - Chairman, CEO, President and Director***

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And then on the acquisition pipeline, we continue to look for those acquisitions that are a good fit strategically, and we get the right return on. And that will impact -- any success in that area would impact what we do with the overall capital allocation plans going forward.

**Christopher Butler - *Sidoti & Company - Analyst***

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Thank you for your time.

## **Operator**

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Bruce Zessar, Advisory Research.

### **Bruce Zessar - Advisory Research - Analyst**

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I just had a question on phosphates. Are you seeing any pushback from your customers that they are not healthy, organic, or eco-friendly? Is there any pushback to want to substitute away from phosphates, particularly with your processed food customers?

### **Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director**

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Bruce, for the processed food customers, I think you do see some of the trends there of the clean label and going natural. And that has received a lot of press. But just let me say up front that phosphates in foods are safe, and the safety of phosphates is well-established as a food science. And to deliver some of the functionality that a number of our customers have to deliver, they would need phosphates for that group of products.

I think you could see some of the growth we've had in some of our unique products, and also some of the nutritional value that some of the phosphates provide. But certainly the processed foods industry receiving some headwinds, and some of the pressures they're under would impact some of the overall demand that we see in phosphates.

### **Bruce Zessar - Advisory Research - Analyst**

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But then separately, I guess the third part of my question had to do with eco-friendly. And there are sometimes environmental concerns raised about phosphorous mining and whatnot. And I'm wondering whether that is bleeding into any of the discussion with your customers on the use of phosphates.

### **Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director**

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Where the phosphates have had more of an ecological impact, at least from a market political basis, has been more as it relates to the STPP area, and -- phosphates and detergents, automatic dish wash, or home laundry detergents. And that has certainly played out its course in North America, or at least in the US and Canada and a number of other geographies around the world.

Phosphates are still used within the detergency and home laundry detergents in Mexico and some parts of Latin America. But a major soaper has announced reformulation there, but there are still pockets of use there. And that's where you can see our STPP has showed a little bit of additional decline here year-over-year in the quarter. I think we're down 5% for the phosphates. But it's roughly 9% of our total revenue stream there.

So it's more limited to the detergent side as opposed to any kind of ecological on the other markets.

And then I think, you know, you talk about some of the manufacturing and producing; I think there's more of an issue with a phosphates as it relates to the fertilizers and runoff and livestock runoff, as opposed to -- for the industrial phosphates business and what we produce.

**Bruce Zessar - Advisory Research - Analyst**

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Okay, thank you. Thanks for your time.

**Operator**

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Chris Shaw, Monness, Crespi.

**Chris Shaw - Monness, Crespi, Hardt & Co. - Analyst**

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I had a question about the price increases. I guess you said you enacted them at the end of this quarter, second quarter. You've had a little time to see maybe if they've been successful or not. And I remember -- I thought, in the first quarter call, you were -- it seemed like you characterized the environment as not being very conducive to price increases. So have you seen acceptance so far, and are you fairly optimistic?

**Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director**

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Yes, Chris, we have seen some acceptance. Certainly the price pressure we saw year-over-year is there. I think the competitive environment is still there. And I think in the less differentiated products, you are going to see more of a competitive pressure than in the more specialized products; and what will have, I expect, more success in the specialized products than the less specialized products. There is some competition, including from imports.

**Chris Shaw - Monness, Crespi, Hardt & Co. - Analyst**

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Okay. And then I don't think you really touched on it. But just curious the -- in the whole area of business that mineral additives that you were piecing together through the different acquisitions -- Kelatron, Triarco, what was it, AMT I think -- how big is that? Is that a separate business? Or how big is it total, and how's it doing? I guess a general answer to that; I haven't seen an update in a while.

**Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director**

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Yes. For those businesses, you're right. We pieced together a few businesses on the mineral side of the micronutrients and minerals, and that has shown some strength, I think, year-over-year. Where we saw some softness is more in the botanical and enzyme business that we had bought, and trying to get some synergies between the two.

But we did -- you may recall there was the US Attorney General -- or New York Attorney General there that had some negative press and putting some pressures on some of the suppliers -- or producers of those downstream products, and for the market and what's on the label. And thinking that over time here there may be some opportunity for us because of the quality levels that we provide. So that area had suffered. As far as total revenues, I think we've shared we're north of the \$50 million range for those acquisitions.

**Chris Shaw - Monness, Crespi, Hardt & Co. - Analyst**

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Is that big enough to start breaking out at some point into its own little segment?

**Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director**

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It's one of those areas where we're going to just continue to incrementally try to grow that business, both with new products as well as geographically within that business, and try to focus and get some growth there. And again, I think we seem to have more success, at least now, on the mineral side of things.

**Chris Shaw - Monness, Crespi, Hardt & Co. - Analyst**

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Thank you.

**Operator**

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And thank you. We have no further questions.

I will now turn the call over to Mr. Randy Gress for closing remarks.

**Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President and Director**

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Well, I'd like to thank everyone for joining us today, and we certainly appreciate your interest in Innophos. And we also look forward to speaking to you in October, when we report our third quarter 2015 results. Thank you and have a good day.

**Operator**

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And thank you, ladies and gentlemen. This concludes today's conference. We thank you for participating. You may now disconnect.