

INNOPHOS 1Q13 RESULTS CONFERENCE CALL

EDITED TRANSCRIPT

CALL HELD April 30, 2013

PARTICIPANTS

Corporate Participants

Mark Feuerbach – Vice President, Investor Relations, Treasury, Financial Planning & Analysis

Randolph Gress – Chairman, President & Chief Executive Officer

Neil Salmon – Chief Financial Officer & Vice President

Conference Call Participants

Larry Solow *CJS Securities - Analyst*

Peter Cozzone *KeyBanc Capital Markets - Analyst*

Edward Yang *Oppenheimer & Co. - Analyst*

Christopher Butler *Sidoti & Company - Analyst*

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

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MANAGEMENT DISCUSSION SECTION

Operator

Welcome to Q1 2013 Innophos earnings conference call. My name is Adrienne and I'll 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. Mark Feuerbach, you may begin.

Mark Feuerbach - Innophos Holdings, Inc., VP - Treasury, Financial Planning & Analysis

Good morning and thank you for joining us today for Innophos's first quarter 2013 results. Joining me on the call today are Randy Gress, Chief Executive Officer and Neil Salmon, Chief Financial Officer. Randy will open with comments on our first quarter performance and progress in executing our strategic initiatives. Neil will then summarize our financial results in more detail and provide a look ahead to the 2013 second quarter, after which Randy will conclude with some final remarks before opening the call up to your questions.

During the course of this call, management may make or reiterate forward-looking statements made in our April 29th 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 risk and other factors as set forth in the forward-looking statements' section and in Item 1A, Risk Factors, in our Annual Reports 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 our press release and via a webcast available on the Company website. In addition, please note that the date of this

conference call is April 30, 2013. Any forward-looking statements we may make today are based on assumptions that we believe as 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

Thanks, Mark, and good morning, everyone. Our results this quarter were not in line with our long-term objectives and reflected lower demand for some of our higher margin products and operational disruptions at our primary Mexico facility. Despite these challenges, I remain confident that we are making good progress with our strategic growth initiatives. We benefited from strong performance within our nutrition businesses and continued success of our innovative, low-sodium product line, as well as record export sales from our US and Canada facilities, including strong results in Asia-Pacific, which is particularly satisfying given the investments we have made in this region.

While we are encouraged by these developments, we were not able to fully offset pockets of softness in certain higher margin market segments during the quarter, and our Mexican Specialty Phosphates also fell significantly short of our earlier expectations on continued variation in production rates and operating efficiency. As a result, we delivered net sales of \$214 million in the first quarter, a 6% decline from last year. Adjusted diluted earnings per share were \$0.60 compared to the \$0.90 recorded in the prior year period, after giving effect to the disclosed adjustments for each quarter.

Let me give a bit more detail on the progress we are making in our growth strategy. In North America, overall sales for US and Canada Specialty Phosphates were up 7%, primarily due the benefit of our recent acquisitions in the nutrition space. These acquisitions positioned us well within the highly attractive bioactive mineral ingredient space, and we are encouraged by their performance and our integration efforts, which are proceeding according to plan.

We are beginning to realize the full potential of these businesses on an individual basis and are now shifting our focus on capturing the synergies inherent in their combination with each other and our specialty phosphate business. Kelatron, AMT Labs, and Triarco Industries are highly complementary to each other, and I continue to believe we have a strong platform for future growth in this attractive market segment. Combined, these businesses are expected to generate annual revenues in excess of \$50 million with EBITDA margins in line with our more differentiated Specialty Ingredients business. Going forward, we believe they are well positioned to achieve high single digit growth rates in spite of the challenging economic environment.

Another important growth initiative for us is developing innovative product lines that fit well with broader consumer trends and address specific customer needs. A great example of that are our CAL-RISE® products, which reduce the sodium content in baked goods, while maintaining the same taste profile and functionality. Market acceptance of this product has been gaining traction and we are delivering good growth, with sales more than doubling in the quarter. We remain focused on developing other products that reduce sodium in processed foods, as well as increased nutritional content and other mineral fortification in a variety of foods and beverages.

We also achieved record level of export sales out of our US and Canada based business with year-over-year volumes up over 10%. This remains a critical source of future growth and one that we continue to pursue in select attractive markets. Our record performance was primarily derived from success in Europe and Asia-Pacific. In Europe, we benefited from market share gains in both industrial and food markets, consistent with our strategy in this region, to focus on those segments where we have a clear differentiation in the European market. In Asia-Pacific, we are encouraged by our performance for the quarter and the traction we are building following the increased customer facing resources we put in place at the end of last year.

Having recently attended our opening ceremony at Taicang, China facility in late March, I witnessed firsthand significant interest in Innophos and our products. The event was attended by over 100 customer representatives from China and Asia-Pacific and the initial feedback has been very positive. I'm also pleased to announce that we have recently been granted our food additives manufacturing license in China, which is a major milestone for the Company and positions us well for continued growth in the region. As we look ahead, I feel we now have a very strong platform in China to enable us to capture the immediate opportunities in front of us, while enhancing our presence in this important region.

Notwithstanding our progress in executing our growth initiatives, our results for the quarter were adversely affected by a shift in mix driven by temporary softness in certain high margin market segments. For example, our industrial asphalt

business was affected by prolonged cold weather conditions during the early part of 2013, which led to many infrastructure projects being deferred into the second quarter. Our asphalt business is a good example of where even though first quarter results were below our expectations, we feel increasingly positive on the growth prospects for the business.

In the last 12 months or so, four states have approved the use of polyphosphoric acid in asphalt modifications and trials or discussions are underway in a further eight states. We are also close to completing some exciting innovative projects that will improve the performance and ease of use of our product range under a wide range of application conditions.

Looking now at exports, although we recorded a strong quarter for export sales from the US and Canada to Latin America, we experienced a significant decline in sales to Venezuela as economic instability in that country severely disrupted local supply chains. Sales to a number of other higher margin market segments including excipients and other niche industrial applications were unusually soft at the end of the quarter. Having said that, we view the shift in mix as temporary. The order book for the beginning of the second quarter is positive and would suggest a more typical profitability mix going forward.

Our results in the quarter were also affected by problems in our operation in Mexico. As you know, over the past few years we've been executing our long-term strategy to make Coatzacoalcos a world-class facility by increasing its food grade capacity and quality, while enhancing its flexibility to handle multiple raw materials sources. Although we continue to make good progress in transforming this facility, we experienced some unexpected failures largely from equipment we had already identified for replacement, but where the failures occurred much earlier than we had anticipated. As a result of the unplanned down time, we experienced reduced production volumes, lower efficiencies, and higher maintenance expenses as we put in place short-term work arounds to supplement the longer-term upgrade plan that continues to be implemented.

We have made good progress addressing these issues and have implemented several upgrades to our process equipment and infrastructure in Q1 with more scheduled for Q2. We have also seen clear evidence of improving trends since the second half of March and expect this to continue during the second quarter. As a result, we expect significant improvements in cost efficiency with a much-reduced risk of being affected by unplanned downtime. There's more to do beyond the second quarter and our long-term plan extends into next year, as we continue to evolve our facility to meet the needs of more differentiated markets.

Finally, revenues were lower in our co-product GTSP. However, this was entirely a consequence of the usual quarter-to-quarter variation in this product line that results from the timing of individual shipments. Profitability in GTSP continued near breakeven as expected with phosphate fertilizer market prices experiencing their typical seasonal declines in the first quarter. I'll now turn it over to Neil for some more detail on the financial results in the quarter. Neil?

Neil Salmon - Innophos Holdings, Inc - CFO

Thanks Randy. Net sales of \$214 million for the first quarter of 2013 consisted of \$190 million from Specialty Phosphates and \$24 million from GTSP and other. This represents a 6% decline or \$14 million compared with the first quarter of 2012. Specialty Phosphates revenue was 1% lower compared to prior year period. Our recent acquisitions contributed a 5% revenue gain. Excluding acquisitions, US and Canada sales were similar to the year ago period with the decline arising in Mexico where volumes were lower for the reasons Randy outlined and prices also decline moderately primarily on the less differentiated products such as the detergent grade products.

We generated \$18 million of operating income, down \$20 million for the first quarter of 2012. Before I get into the underlying business drivers experienced in the quarter, let me cover in more detail the unusual items, which we called out in our press release. Firstly, I am pleased to say, we've now finalized our longstanding disputes with the Mexican National Water Commission or CNA over the amount of water rates dating back to 2005. Early in the second quarter, we made a final payment of all outstanding amounts of just \$3.3 million after tax, and with certainty on the final payment, we were able to record a gain of \$5.4 million after tax in our first quarter accounts.

We also continue to work on reducing our water rates going forward, but there is no concrete progress to be announced on that front today. The gain on our water duties provision was more than offset by a series of items that elevated cost of goods sold by \$9.2 million in the quarter composed of the following:

- \$3.8 million with the additional cost incurred in the quarter from the Mexico manufacturing issues Randy described, including operating inefficiencies and higher than normal maintenance cost, but not taking account of the lost sales, which also resulted. \$2.9 million affected the Mexico's Specialty Phosphate P&L and \$0.9 million affected GTSP and other.
- \$2.3 million was for an out-of-period adjustments related to a long-term supply agreement, where we realized our established accounting practice did not match correctly with the exact contract terms on inventory title transfer.
- \$1.3 million arose following a revision we made based on more accurate information to our capitalization policies for manufacturing variances.
- \$1.1 million related to a short-term increase in the cost of the key raw material that we believe resulted from demurrage incurred by our supplier.
- We also incurred \$0.7 million for acquisition accounting expenses, primarily arising from the amortization of the inventory fair value adjustments on the Triarco acquisition.

Finally, let me remind you that the first quarter 2012 benefited from a delay in the realization of market raw material inflation in our cost of goods sold. We called this out at the time and our cost to goods sold caught up to market beginning with the second quarter 2012. The net benefit to the first quarter 2012 was \$6 million with the US and Canada business advantaged in that quarter by \$8 million and the Mexico business moderately disadvantaged by \$2 million.

I will now return to comments on our underlying business performance, excluding both the last year and current period items I have just described. Total Specialty Phosphates operating income during the first quarter, excluding the items mentioned, was down \$8 million from the first quarter 2012. Operating income for the US and Canada, excluding the items mentioned, was \$3 million lower than the first quarter 2012 with this primarily a consequence of the mixed effects Randy described. Operating income for Mexico Specialty Phosphate, excluding the cost arising from higher maintenance and operating inefficiencies, were \$3 million lower than the same period last year, as a result of lower sales arising from these production restrictions, partially offset by lower depreciation.

GTSP and other operating income continued near the breakeven level as expected. Our effective tax rate for the first quarter of 2013 was 28.2%, primarily due to the gains related to the Mexican water rate provision being recorded as a discreet item for income tax provision purposes, which had a 300 basis point effect on the rates. Going forward we anticipate an effective rate in the 32% to 34% range.

Depreciation and amortization was \$9 million for the quarter, \$1 million lower than a year ago. For the full year we expect depreciation and amortization to be \$7 million less than in 2012 with approximately \$4.5 million benefiting Specialty Phosphates. This has resulted from asset values created at the formation of the company in 2004 reaching the end of their depreciation lives, partly offset by the amortization of the intangibles associated with recent acquisitions. Capital expenditures were \$7 million in the first quarter of 2013 with a lower spend rate primarily due to some expenditures that were accelerated into the fourth quarter of 2012. We continue to expect 2013 capital expenditures to remain in the \$40 million to \$45 million range.

Importantly, cash flow improved significantly on the first quarter of 2012 driven by working capital improvements and we reduced our net debt by \$21 million to \$128 million. Our strong balance sheet allows us to continue to maximize value for our shareholders by investing in our business and future growth, while also paying an attractive \$0.35 per share quarterly dividend. Our investment priorities continue to focus on supporting our future growth, capacity enhancements for US, Canada, and Mexico Specialty Ingredient facilities and upgrading our Mexico purified phosphoric acid facility.

Looking ahead, we continue to expect only modest market growth in 2013. However, we believe that the progress we are making in our growth strategy will still enable us to achieve growth in Specialty Phosphates for the second half within our 4% to 6% long-term target range. For the second quarter, the improvement seen towards the end of the first quarter in Mexico, which is continued through early April, gives us confidence the impact to production restrictions will be significantly reduced.

However, there may be some residual effects in the second quarter as we continue to implement our long-term equipment upgrade program. And so while we anticipate good sequential sales improvement, volumes for the second quarter for

Mexico's Specialty Phosphates are likely to be moderately below the year ago level. We are targeting continued improvement in US and Canada volumes and expect this to offset the Mexico decline in comparison to the second quarter last year. We do not expect any major change in raw material purchase prices or underlying selling prices through the second quarter of 2013, and so year-over-year selling price variances should be similar to the first quarter.

With regards to operating income margins, with a more typical US and Canada business mix, and improved Mexico production performance, Specialty Phosphates' operating income margins are expected to improve significantly in the second quarter on a sequential basis and reach our original full year goal of 15% by the third quarter. GTSP is expected to continue near breakeven through the second quarter, with pricing so far only showing modest improvement on the lows of the first quarter. Now back to you, Randy.

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

Thanks, Neil. Our performance for the first quarter reflected good progress against our strategic priorities under challenging market conditions. In spite of modest market growth in 2013, we still expect to grow Specialty Phosphates within our long-term target range for the next three quarters. Thus far, April appears better from both the volume and mix perspective in the US, with conditions also improving in Mexico.

Looking ahead, our priorities for 2013 are focused on getting our performance back on track for the remainder of the year, continuing to execute our growth initiatives, and completing the transformation of our facility in Mexico.

Finally, we will continue to take the necessary steps to ensure that we are maximizing shareholder value by leveraging our strong cash flow and balance sheet both to support growth and improve cash returns to shareholders. Our track record is established against these objectives, and with the strong balance sheet and ample liquidity, we are well-positioned to continue delivering against our goals in 2013.

Thank you for listening, and we will now take your questions. Operator?

QUESTION AND ANSWER

Operator

(Operator Instructions) And we have Larry Solow from CJS Securities. Please go ahead.

Larry Solow - CJS Securities - Analyst

I know this question comes up, so just to avoid redundancy a little bit, but in terms of your confidence, we've spoken a lot about the growth drivers in the business. In the mix shift, is it just looking at your order book going forward that kind of gives you confidence that this was a temporary thing? Did the order -- did you get any indication from your customers what happened and what gives you sort of confidence that we're going to come back?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Certainly the order book gives us some good confidence in what we've seen in April. I think what we saw in the first quarter, we did see some softness in demand in some of the higher margin markets and we do attribute some of that to some very tight inventory controls from some of our customers, although that's really difficult to specifically identify. But on top of all of that, I think also with our increased focus and efforts with working with customers and identifying both on an account by account, product by product basis where those opportunities are to continue to improve and we do expect to continue to have success in that area. I think on top of that, it's also what we've had planned for the new product success as well as our continued growth in the export markets.

Larry Solow - CJS Securities - Analyst

Okay. And you just specifically, you mentioned sort of some things like some geographical weakness and then you specifically talked about the asphalt product. Can you tell -- are there other products, I mean have you like the CAL-RISE®, it sounded like that did pretty well, other higher margin specific products that didn't do so well as you source the product across or within those regions you have talked about?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Yes. The CAL-RISE® did well. As we talked about asphalt, we had certainly some softness and delays from the tough winter that we talked about. We mentioned excipients. I think in the excipient area, we had some slowness in the first quarter or below the expected market growth there. A couple of the other areas, in the frozen seafood a little bit less than the expected growth, in the 2% to 3% range there. And a market area like processed cheese I think actually showed some decline in that business. But I think on a geographic basis, we did have some softness that we identified there in Venezuela. However, we do have some plans working with our partner there to recover some of that at the end of the second quarter.

Larry Solow - CJS Securities - Analyst

Okay, just last question, just switching on the manufacturing side, clearly you guys had some -- several sort of unexpected increase (inaudible) and shutdowns and what have you. Is it possible that just part of that is just the cost of the business and what gives you confidence that we won't sort of see these continual sort of recurring, non-recurring type items as have plagued you three or four quarters in the last six or something?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

We definitely invested in both improving the flexibility, capability, and as especially capacity on the food side and we are talking about our Coatzacoalcos operation here. The downtimes really were driven by some of the premature failure or earlier than expected failures of some of the equipment, and that's primarily in the merchant grade acid area of the plant. But what gives me confidence is we have made a number of repairs within the area and replaced some of the equipment and we are continuing to accelerate our longer-term plan here, replacement of other equipment, some being completed here in the second quarter. And I think with the improvement and some of the results we have seen already, I do have confidence that we are doing the right things and making the right progress in those areas.

Operator

And we have Peter Cozzone from KeyBanc Capital Markets.

Peter Cozzone - KeyBanc Capital Markets - Analyst

Randy, your outlook for 4% to 6% organic growth in specialty business in the second half, does that assume any improvement in the rate of underlying market growth from the flattish market seen in the first half? It seems that has been a harder goal to hit over the past three quarters given some of the production disruptions. I am just trying to gauge if there are other factors that might contribute to that acceleration in the back half.

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Peter, I am expecting some recovery within that base business, but I think also what I had mentioned before with some of the implementation we have had of some increased focus with customers and still getting some good improvement within our growth product areas as well as the export business. So it's all those added on top of the each other really giving me the confidence of that 4% to 6%. And then on top of that I just want to mention also the 5% that we are expecting from the nutrition business as well.

Peter Cozzone - KeyBanc Capital Markets - Analyst

And then not to be too repetitive, but just looking for some more color on the disruptions from Mexico, maybe when did you first begin to see the impact during the quarter? Did you have any kind of plant maintenance or investments that you had already factored in and then with these new equipment and the upgrades is there still bit of a learning curve as those start to get ramped up in the operation there?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

For the improvements we've made, as I mentioned before, a number of them were in the MGA or the merchant grade acid or green acid area. Some of the major pieces of equipment, I mean not to get too granular in some of the information, but in areas of equipment like the evaporator and in centrifuges we've made some replacements and repairs there. Again, some accelerated repairs of the plant going forward and at the end of the quarter, we saw some improvement and continue to see some improvement today.

I think what we have planned, we are going to continue to focus on those areas and drive the improvement, so I still have some good confidence that plants are going to deliver. I think a couple of other steps we've taken include, we've increased some of the technical resources within the plant, specifically in this area, as well as brought in some outside consulting support to help us improve and address some of the reliability issues we face, and again making, I think, some good progress there.

Peter Cozzone - KeyBanc Capital Markets - Analyst

And then lastly, on the raw material front I believe the annual contract reset in 2Q here, can you talk about the expected impact on profitability there? It seems to have finally been coming down a bit in 2013 year-over-year and would you expect any of that to flow through GTSP as well?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Yes, I am going to ask Neil to address that. Neil?

Neil Salmon - Innophos Holdings, Inc - CFO

Sure. The annual contract that you are referring to only affects the US business. There, yes I think we said last quarter that we do expect a modest improvement into the second quarter and that's reflecting Q4 market prices, that contract reset based on Q4 market prices, but not a material affect overall for the rest of the year.

Peter Cozzone - KeyBanc Capital Markets - Analyst

But on the non-fixed business, you should still see some benefit is rock falls further here in 2013?

Neil Salmon - Innophos Holdings, Inc - CFO

Yes, I mean there's not really any sign of that currently, but yes if we were to see a further set down in market raw material prices that would be of some benefit, though delayed as you know, because of the contract terms we have and the cost of goods sold, and at the moment our view is that the raw material prices are very steady.

Operator

We have Edward Yang from Oppenheimer online with a question. Please go ahead.

Edward Yang - Oppenheimer & Co. - Analyst

Randy, just circling back to the equipment failures in Mexico, I was never under the impression that Coatzacoalcos was particularly an old facility, and in fact I thought Rhodia had over spent on that facility. So some of these issues and operating issues that you are experiencing there, what's driving that? You mentioned some of the plant upgrades you've done there. Have you had any personnel changes? Are you experiencing any difficulties processing to different grades of rock? What's changing that business?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

I think the challenges have been with some with the reliability primarily for the MGA area. As far as the age of the plant, it does go back a few decades, quite a few decades and what we've done is continued to invest in the operations, continued to improve things. I think what we've also done is we have these periodic plant outages within the operation, primarily in the sulfuric and MGA areas, and we try to both drive improvement within the operation as well as invest in areas that we try to predict where there may be some failures.

I think both increasing the capability, complexity as well as the mix of rocks certainly increases the challenges there. But overall, I think it was just more premature failures in some of the equipment. I think as far as people and resources, don't really have any changes. We've added some new people to the operation and I think refocused some of the tighter controls and capabilities necessary for us to be successful going forward.

Edward Yang - Oppenheimer & Co. - Analyst

Okay, I just wanted to clarify because it is -- what you are trying to do is somewhat novel in that I don't think your other competitors have that level of complexity of feedstock and you think the different grades of rock, you don't think that's a driver some of these issues?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

I think it makes the ability or the need to control the operation more stringent, but in putting more rigor into things, I think we will be proving some of the success in this area.

Edward Yang - Oppenheimer & Co. - Analyst

Okay. And the drop in the prices in Mexico, how is that broken out between some of the pricing pressure you saw on the commodity grade products and the step down that you mentioned in that long-term customer contract?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

The drop in price in Mexico was primarily with our less differentiated products there, with the STPP, as well as the detergent grade asset portion of the market. And then we did have a reset more in line with our material cost going into this year.

Edward Yang - Oppenheimer & Co. - Analyst

Are you expecting any additional long term contracts to reset down?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Not really.

Edward Yang - Oppenheimer & Co. - Analyst

Okay.

Neil Salmon - Innophos Holdings, Inc - CFO

Generally I would say, we're seeing good price trends on the more differentiated products in Mexico and continue to look for price increase opportunities as we go forward. So in some very specific situations in the first quarter.

Edward Yang - Oppenheimer & Co. - Analyst

Okay. And just finally, it's clear that your free cash flow and your dividend has been supporting your stock and been a source of strength during this period of earnings volatility, and given the recurring nature of your business I would expect this to continue unless you were to have some sort of step change in your CapEx spend. And along that vein, do you expect any major changes there in terms of your level of capital spending versus the \$40 million to \$45 million you are targeting? That is up substantially from levels that you were spending in the '07 - '09 timeframe. But going forward, are there any potential surprises down the road? For example you are evaluating these phosphate sand concessions. Is there any possibility that that CapEx level will change significantly from here?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Neil?

Neil Salmon - Innophos Holdings, Inc - CFO

So I think the \$40 million to \$45 numbers has been a good reflection of the plans that we have and that we're continuing to work through and of that portion of the amount -- you'll also remember that previously we said our sort of maintenance level, the required to maintain current operations is around \$20 million to \$25 million. So we are spending roughly double that level and a significant piece of that investment is related to this long-term upgrade plan that Randy referred to at Coatzacoalcos. So that's specific to the next two to three years and not indicative of the step change increase in the maintenance CapEx.

With regard to the phosphate sands development, we continue to explore those on a quarter-by-quarter basis looking at each step in the project as we go, before committing to the next step. It certainly indicates that full development of those deposits to a mining resource would take significant investment, but we have consistently said and it remains our position that we would most likely do that in partnership with someone else and certainly not necessarily carry the full financing burden on our balance sheet. But in any case, any decision on that is not going to be taken for another year plus until we have more detailed information on exactly what we have there in terms of the size and the quality of the deposit.

Operator

And we have Chris Butler from Sidoti & Co. online with a question. Please go ahead.

Christopher Butler - Sidoti & Company - Analyst

Just circling back again to Mexico, I know that previously you had stated that the repairs and the replacements were going to start to come to an end here for the second quarter and then your reliability issues should go away as we look to the second half of this year. And while you are still saying that, this morning you've also indicated that there's more to come, more improvement. Would that be additional replacement, additional repair? Could you kind of jive those two ideas together?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Yes, the additional plans that we have underway are accelerating some of our long term replacement plans and which will make further improvement in reliability, but I believe we've already made a number of changes and improvements and I think it's indicative of some of the performance thus far, that we've improved our reliability and performance here.

Christopher Butler - Sidoti & Company - Analyst

And looking at pricing you had mentioned that out of Mexico in some of the pricing difficulties was on the STPP side, but if we look at the different product lines it's the specialty ingredients that have posted the largest price decline. Could you talk to that a little bit for us?

Neil Salmon - Innophos Holdings, Inc - CFO

Well, that was where we had a contract formula based correction in the quarter Chris. It isn't indicative of any shift in pricing dynamics within that product range. If anything, as I mentioned, we continue to pursue incremental increased opportunities where we've not fully completed the price increase actions that we began last year.

Christopher Butler - Sidoti & Company - Analyst

And looking at the fertilizer business, GTSP and other, you know we are moving into the spring season where you tend to get better demand. When do we start to see this business start to

revert back to norms for you? Obviously, it's not the second quarter, but as we look into the second half of the year as we get away from spring planting, is it still in the cards or do we now have to start thinking about next year?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

That's tough for us to predict Chris. I think so far the spring planting season has been delayed particularly in the US where first of all cold weather and I understand heavy rain is delaying some of the normal farming calendar. So we've not seen a significant improvement in phosphate fertilizer prices as we did this time last year or as is typical. But the fundamentals remain positive I think for phosphate fertilizer use and certainly that's how the makers continue to discuss this space. We continue to be of the view that this current compression between market raw material prices and market finished fertilizer prices is not sustainable to the long term and certainly we are seeing the number of industry analysts make similar references. The non-integrated part of the fertilizer market is faster in supply and demand and margins are compressed for anyone who doesn't have their own source of the raw materials, if your major market is the phosphate fertilizers. So we continue to expect that either pricing improves or raw materials have to give some so that there is some positive margin restored in the fertilizer step of the value chain. Difficult, though, to predict in which quarter that occurs.

Christopher Butler - Sidoti & Company - Analyst

And just finally, with the raw material lag benefit from the first quarter last year, did you have the minimal benefit in the second quarter as well?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Yes, it was all through by the second quarter. So no effect in the second quarter last year.

Christopher Butler - Sidoti & Company - Analyst

Okay, so no effect on the second quarter at all?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Yes.

Operator

And we have Chris Shaw from Monness. Please go ahead.

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

I guess more questions on Mexico. What was the volume impact there, was it all in the non-specialty stuff? Was there any impact to the specialty products?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

The focus with any impacts on the volume, we tried to optimize our mix as best we could. So most of the impact was in the non-specialty side.

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

The volume that you lost, is it that's just pushed out to 2Q or is that just lost permanently to a competitor?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

It's more where we would expect to return to prior levels that we had before, not necessarily building up any expected sales there.

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

Okay and then what's exactly the impact in the US-Canada business from the Mexican issues? Was it purely a raw material cost pass-through issue? Or was there none? I might have read it wrong.

Neil Salmon - Innophos Holdings, Inc - CFO

There was a moderate impact of cost pass through but not significant and really the effect was contained within the Mexico segment. I'd add to Randy's last comment that it has delayed our plans that remained in place to commercialize the new food ingredient capability out of Mexico. So we're later than we thought we would be in really getting the sales growth on those products. But we are still very confident that market demand is there and that customers are looking for us to be a strong player out of the Mexico facility in that space. And we still anticipate those plans coming through as we achieve the services reliability and production levels from Coatzacoalcos.

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

And then the issues from 1Q in Mexico, was there any relationship at all to the maintenance that you took in the third quarter or is it just totally unrelated?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

That's more unrelated I think specifically to any of the impacts here. What we did in the third quarter was more of a scheduled, planned outage where we were continuing to deal with some of the regular expected improvements.

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

And if you are pulling forward some of your long term projects there in Mexico to do them now, does that impact your CapEx in 2014 or some other out year at all? Or it's not big enough?

Neil Salmon - Innophos Holdings, Inc - CFO

I mean these are not typically big cost items within the plant here. These are the sort of bits and pieces in between the major pieces of equipment and so the challenge is more the time you need to make the repairs. Also, some of these pieces of equipment have long lead times or need to be made to order. So those are more the issues in working through the upgrade plan. They're not by themselves major capital cost items. But obviously, clearly, they are very important to the overall efficient operation of the plant.

Operator

We have Elie Mishaan from Corsair Capital on line with a question. Please go ahead.

Elie Mishaan - Corsair Capital Management - Analyst

I wanted to ask you a little bit about capital allocation, sort of piggy backing on Yang's question a few moments ago and actually recommend reading his commentary, his very good commentary. I think he gets it. So in terms of the dividend, it seems like (inaudible) there's a lot of room there. You guys sort of a normalized basis long term should be generating \$4 to \$5 in free cash flow

annually. Maybe it's on the lower end of that this year. So the question is how did you guys come to the dividend level that you are right now?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

I think we have been clear identifying where our priorities for the cash were, firstly to support the growth of the business and then secondly to return value to the shareholders. I think as we define this dividend level we've said that we were going to continue at a minimum to grow dividends with earnings. However, the board certainly hasn't ruled out increasing the payout ratio in the future.

Elie Mishaan - Corsair Capital Management - Analyst

I guess in the context of how much debt you guys have paid down in the last few years, obviously this quarter may not have been the best from an operational perspective. You generated a lot of cash and you continue to pay down the debt. You have less than one times net debt-to-EBITDA. So this business can probably handle a lot more than that.

So I'm just curious and I think Neil mentioned the resource deposit that you I guess will discuss a year plus from now. But there's not -- it doesn't seem like your balance sheet would be holding you back from doing other growth maybe tuck-in acquisitions, or if it's the resource, whatever it is. It seems like there's a lot of bandwidth there and you're generating a lot more cash than I guess the dividend. And if you are -- take in the CapEx as well, there's still obviously a lot more there.

So in terms of sort of the outlook for the next couple of years, has there been any discussion in terms of the payout ratio or is that something that's just on the table and it will be discussed at a future date? Or is there sort of a real sort of real commitment to growing the dividend?

Neil Salmon - Innophos Holdings, Inc - CFO

Yes, I think we've certainly communicated in the past and continued to do so, that we expect the dividend to improve. I think this obviously is a Board matter, but the Board, it's something that the Board keeps under constant review I would say. And as Randy mentioned, has certainly not ruled out a higher payout ratio. So I share your analysis of some of the practice there and we certainly view our dividend payment as an important part of the overall value proposition here to shareholders. So it will remain under active review. I think we've done or we've made several increases over the last two years, including one only a couple of quarters ago. So that's by no means the end of the story as far as we are concerned in using the dividend as an avenue for value generation.

Elie Mishaan - Corsair Capital Management - Analyst

Great. And just one other thing I would just add would be that other than the very good shape your balance sheet is in, if the company were to increase its dividend significantly, it seems like the company would be able to if wanted to even double the dividend you're paying right now and your stock would trade at, take a yield, your stock would be a lot higher than it is today, significantly higher. We could be talking about a stock in the 80s and if you wanted to grow that would be a great currency to grow. So it's not just balance sheet and it's not just cash that you are generating that you can use to grow. If you chose, you could have a stock significantly higher and I think people would be lining up to invest in Innophos given the long-term story that you guys have.

I think people would line up to invest in and buy stock in the 80s for use of proceeds deal if it this was mine. I think the resource, or if it was some other growth project that you guys were looking for. I think you have a lot of options there and a higher stock price always increases the options. So thank you and looking forward to the next quarter.

Neil Salmon - Innophos Holdings, Inc - CFO

Thank you, Elie. We certainly appreciate your confidence in the business.

Operator

And we have Jonathan Bloom from Fiduciary Management.

Jonathan Bloom - Fiduciary Management - Analyst

A quick question. When you go back to your Investor Day presentation in November of 2011, you presented kind of a long-term outlook for Specialty Phosphates. You highlighted 4% to 6% volume, 7% to 8% operating profit growth. Since then, obviously sales and margins have been well short of those expectations. I guess my question is, is this still your long-term expectation for the company, albeit starting at a lower base, and if so, what's it going to take for you guys to get back on that track?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Jon, I think still we have those kind of expectations. I think what we're expecting for the latter part of this year to recover to that 4% to 6% volume growth level and I think corresponding with the improvement in the business expect to target the higher percentage in the overall performance I think. We're continuing to invest I think in those growth initiatives where again I think support with the export business at the 1% to 2%, as well as the new product side of things, 1% to 2% that we identified within the investor presentation. We still believe that on top of what we had hoped with the growth in the base business to deliver for our business. So I think those are still consistent with the targets. Our expectations are still consistent with the targets identified and we hope to achieve this.

Jonathan Bloom - Fiduciary Management - Analyst

And I guess as a follow-up, when you look at that presentation, I think your 2015 estimates would have been implied kind of an 18.5% operating margin in that business. And so, which was up a few 100 basis points from where you were at that time and obviously well ahead of where we are today. What are the drivers that you still see in this business and opportunities to drive that margin improvement over time?

Neil Salmon - Innophos Holdings, Inc - CFO

Yes, I think part of the reason that market is -- over the last couple of quarters have been below where we expected them to be, have been firstly a less volume leverage and volume leverage is an important driver of the business, and then specifically to an extent last quarter, but more pronounced this quarter has been a very disadvantageous business mix, which we have discussed already and we feel is temporary, not reflecting any fundamental shifts in the business.

So with normalizing those factors and getting Mexico back to where it should be and can be in reliability terms, what gives us the confidence that we can get Specialty Phosphates to what we think is its current underlying level of around 15%. Moving forward from there, I think it's the same drivers that we talked about in the past. So generally our growth is beneficial to margins both from the volume leverage it creates, plus also the fact that we are very targeted within our growth strategy of those products and markets where we feel we have a differentiated position.

We continue to invest in or have plans within that \$40 million to \$45 million CapEx program for productivity investments and which would further improve the cost differentiation of the business. And then we remain in a business where customers put a lot of value on product differentiation,

on innovation, on technical service and we think that's supportive to price being an element that will also assist margins over the long-term

So nothing in our recent performance gives us cause for concern on what are the fundamentals we think that will continue to drive success going forward. I would add that one of the major reasons that we're short of the -- the major reason that we're short of the 4% to 6% target since our Investor Day has been market growth. So we said if based on what is the generally accepted estimate of growth in our industry of 2% to 3%, we should benefit from that and then benefit from an additional 2% to 3% of strategic growth initiatives.

And what we have seen since then is market demand flat or moderately down in some segments, but we still see continued good success with our own strategic growth initiatives. So we feel we are making progress in the areas that we can control and our goal is to get to the 4% to 6% for the second half of this year will likely have less support from market growth than we anticipated. So we are really stretching our plans and a lot of work, as Randy mentioned, going on very detailed and customer by product plans to get up to our targeted growth rate, even with less help from market growth than we had originally anticipated.

Jonathan Bloom - *Fiduciary Management - Analyst*

And then lastly I wondered if you could give just a little bit more detail on the revision of the inventory accounting, the demurrage of the raw material purchases and the out of period adjustment beyond the basic comments you have made? If there is any additional detail you might be able to provide?

Neil Salmon - *Innophos Holdings, Inc - CFO*

There's not a lot of additional detail I can provide. It's just, I can put it in context a little bit. We are now 18 months into our new ERP operating environment and that's allowed us to really look at some of the basic procedures that we've had in place for some time. And I think the increased visibility we are getting in terms of variances within the business and also the more integrated nature of the system has uncovered some areas in which we felt improvements to our procedures were appropriate. This period item is on a contract that we had for a long time and we realized our established accounting practice did not correctly reflect when title was passing on the material.

So it's an adjustment we had to make, but a non-cash item and one that its origin goes back to some period in time. So the others were -- I mean the demurrage was a specific one quarter thing we believe. We don't expect it should recur. So I think that's the additional color I can give you, but just wanted to put it into the context of our new ERP system as well.

Operator

And we have Rick D'Auteuil from Columbia Management online with a question. Please go ahead.

Rick D'Auteuil - *Columbia Management Investment Advisors - Analyst*

A lot of my questions have been answered. Just a couple of things, one the detergent side of the business, is that a permanent change? And I guess what's left on volumes there? That was primarily to my recollection into Latin America. Are volumes also declining there?

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

So for the detergent business some of that was a shift in the business, but what we expect going forward is just some continued gradual decline from any type of ongoing reformulation. And you are right, Rick, it is a much lower percentage of the total group.

Neil Salmon - Innophos Holdings, Inc - CFO

Mark, do you have the first quarter number? I would expect it it's around the 10%.

Mark Feuerbach - Innophos Holdings, Inc - VP, Treasury, Financial Planning & Analysis

Yes, around 10% of the overall --

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

But pricing, is that permanently impaired? Or was that a temporary price?

Neil Salmon - Innophos Holdings, Inc - CFO

I mean I think there pricing is likely to continue at similar levels. This is the product line in which there really isn't that much differentiation in the product line between alternative suppliers. So very different to the more specialty ingredients, and so typically we do see that product follow market trends more generally and be subject to more price variation than the other product lines.

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

But the variation is one direction. Is that right or -- ?

Neil Salmon - Innophos Holdings, Inc - CFO

Currently so, but it's also a product line that responds quickly on the upside when raw materials are increasing. So I don't think we are seeing a compression in margins in that segment.

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

Okay, I guess that's where I was going, okay. So margins are fairly stable.

Neil Salmon - Innophos Holdings, Inc - CFO

Yes.

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

The China ramp, and I guess if you can give any color on timing and I may have missed this, it took a long time to get in through the operator into the call, but what is your expectation I guess for the new facility?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Yes, sorry you had some difficulty getting in. I think what we have been doing is building up the sales and technical resources and capability at the site, and we have already seen some good growth within Asia Pacific, within our base products or more differentiated products. And what we have now is the food ingredient manufacturing license, which has been granted, which will allow us to continue to grow the business with additional capability there.

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

So, no more regulatory hurdles there?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

We're not expecting based on receiving the license now.

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

So what kind of contribution do you expect that to make in the second half?

Neil Salmon - Innophos Holdings, Inc - CFO

I don't think it's going to be material to the second half, Rick. This is the case where these are high value products to our customers. The custom qualification period typically takes some time and it's certainly been a frustration that without the food ingredient manufacturing license we couldn't really begin the commercialization phase, although we have made very, very good progress with our sales team in identifying opportunities and figuring out which customers are the ones who are interested in the product lines. But now we need to begin the serious business of qualifications, of confirming how the products work, of using our food lab, which is as important in the mix of things in China as the (inaudible) facility to work with customers on how the products perform. And that's going to be the focus of the next one to two quarters.

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

Okay. And the push-outs on the -- weather related push-outs on the asphalt products, are you seeing some relief now as we transition to better weather?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

No, for the most part there still seems to be some delay within these projects being launched at least so far into this quarter.

Neil Salmon - Innophos Holdings, Inc - CFO

But if you want to circle back to the comments Randy made about, fundamentally we feel very positive on that segment and on our technology. We talked in the past about there being many states that permit asphalt modification, others do not, and generally those factors seem to be trending in our favor. We are doing some very interesting product innovation like Randy mentioned and it's a very strong and differentiated product line in terms of IP and technology. So we feel very positive about that longer term in the US and in other markets as well.

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

But what you are seeing is contractors out there specking or it's being specked as part of the bid process or --

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

It's a product where the formulators are improving the performance with formulations that improve the -- or basically it's a modified asphalt to satisfy certain requirements that the DOT has supplied.

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

But you're seeing momentum in those specifications?

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

We are seeing some momentum in the acceptance across some of the states as well as the continued growth and acceptance within this product area and also some of the improved products within the range of this area, so we are seeing some good growth there.

Rick D'Auteuil - Columbia Management Investment Advisors - Analyst

And then lastly, this is speaking I guess a little bit on the 4% to 6% that has been in all your presentations. So I mean what we've seen is GDP minus and you talked about a GDP plus as the industry part of the 2% to 3% that the industry is growing, and part of that was destocking, I think you have communicated in later last year, and then in January you saw a material improvement and maybe a restocking is part of that, I don't think you were expecting that space to continue, but it dropped off again. So what are you actually -- as you dig into other reasons for these starts and stops, what is an explanation that makes sense?

Neil Salmon - Innophos Holdings, Inc - CFO

I think start-stop is a good description, Rick. We started off the quarter very strongly, as you mentioned. Actually that pace continued through February and then things really slowed really the second half of March. So I will be honest and say I don't have a full analysis of all the customer buying decisions that have contributed to this, but I think it is clear that generally people remain in a very cautious mode. I think people are watching cash growth and inventory levels very carefully and I think they are adjusting very quickly if they see that current demand is little less than was anticipated or inventory levels are a little higher.

So we saw some deferment of orders from the fourth quarter to the beginning of the first quarter, but likely we saw that again at the end of the first quarter. So I don't think over the quarter we saw much in the way of a restocking effect.

Looking at it more broadly I think this phenomenon of weak demand in the processed food market in US and Canada has been quite widely reported on by other suppliers and our customers. And I think what's positive to me is that we also saw that effect in export markets last year and that doesn't seem to be case going into this year. So in export markets a combination of our own self-help and growth initiatives plus improved market demand is contributing. Now we look to see the same in the domestic markets too.

Operator

And we have no further questions.

Randy Gress - Innophos Holdings, Inc. - Chairman, CEO, President

Okay, I would like to close by thanking everyone for joining us today and we certainly appreciate your interest in Innophos. We also look forward to speaking to you next quarter when we report our second quarter 2013 results. Thank you.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating and you may now disconnect.