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INTERNATIONAL FLAVORS & FRAGRANCES INC
Form 10-Q
November 02, 2006

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OF
THE SECURITIES EXCHANGE ACT OF 1934

For Quarterly Period Ended September 30, 2006

Commission file number 1-4858

INTERNATIONAL FLAVORS & FRAGRANCES INC.

(Exact name of registrant as specified in its charter)

New York

13-1432060

(State or other jurisdiction of
incorporation or organization)

(IRS Employer
Identification No.)

521 West 57th Street, New York, N.Y. 10019-2960
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (212) 765-5500

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [] Accelerated filer [] Non-accelerated filer []

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

Yes [] No []

Number of shares outstanding as of October 31, 2006: 89,688,025

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INTERNATIONAL FLAVORS & FRAGRANCES INC.
CONSOLIDATED BALANCE SHEET

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(DOLLARS IN THOUSANDS)

(Unaudited)

| ASSETS | 9/3 |
|--|--------|
| Current Assets: | |
| Cash and cash equivalents | \$ 1 |
| Short-term investments | 3 |
| Trade receivables | (|
| Allowance for doubtful accounts | 2 |
| Inventories: Raw materials | 2 |
| Work in process | 2 |
| Finished goods | 4 |
| Total Inventories | 4 |
| Deferred income taxes | ----- |
| Other current assets | ----- |
| Total Current Assets | 1,1 |
| Property, Plant and Equipment, at cost | 1,0 |
| Accumulated depreciation | (5) |
| Goodwill | 6 |
| Other Intangible Assets, net | ----- |
| Other Assets | 2 |
| Total Assets | \$ 2,5 |

| LIABILITIES AND SHAREHOLDERS' EQUITY | 9/30 |
|---|-------|
| Current Liabilities: | |
| Bank borrowings and current portion of long-term debt | \$ 3 |
| Accounts payable | 1 |
| Accrued payrolls and bonuses | ----- |
| Dividends payable | ----- |
| Income taxes | 1 |
| Restructuring and other charges | ----- |
| Other current liabilities | 7 |
| Total Current Liabilities | 7 |
| Other Liabilities: | |
| Long-term borrowings | 5 |
| Deferred gains | ----- |
| Retirement liabilities | 2 |
| Other liabilities | 1 |
| Total Other Liabilities | 8 |

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Commitments and Contingencies (Note 10)

Shareholders' Equity:

| | | | | | |
|--|--|--|--|----|-----------------------|
| Common stock 12 1/2(cent) par value; authorized 500,000,000 shares; issued 115,761,840 shares | | | | | |
| Restricted Stock | | | | | |
| Capital in excess of par value | | | | | |
| Retained earnings | | | | | 1,8 |
| Accumulated other comprehensive income: | | | | | |
| Cumulative translation adjustment | | | | | (|
| Accumulated losses on derivatives qualifying as hedges (net of tax) | | | | | (|
| Minimum pension liability adjustment (net of tax) | | | | | (1 |
| | | | | | ----- 1,8 |
| Treasury stock, at cost - 26,179,343 shares in 2006 and 23,047,349 shares in 2005 | | | | | ----- (8 |
| | | | | | ----- 9 |
| Total Shareholders' Equity | | | | | ----- 9 |
| Total Liabilities and Shareholders' Equity | | | | \$ | ----- 2,5 ===== |

See Notes to Consolidated Financial Statements

INTERNATIONAL FLAVORS & FRAGRANCES INC.
CONSOLIDATED STATEMENT OF INCOME
(AMOUNTS IN THOUSANDS EXCEPT PER SHARE AMOUNTS)
(Unaudited)

| | 3 Months Ended 9/30 | |
|--|---------------------|--------------------|
| | 2006 | 2005 |
| Net sales | \$ 539,135 | \$ 493,118 |
| Cost of goods sold | 310,149 | 286,712 |
| Research and development expenses | 46,471 | 44,651 |
| Selling and administrative expenses | 88,092 | 86,022 |
| Amortization of intangibles | 3,713 | 3,768 |
| Restructuring and other charges | 316 | - |
| Interest expense | 6,475 | 6,566 |
| Other (income) expense, net | (6,783) | (854) |
| | ----- 448,433 | ----- 426,865 |
| Income before taxes on income | 90,702 | 66,253 |
| Taxes on income | 27,056 | (2,319) |
| Net income | ----- 63,646 | ----- 68,572 |
| Other comprehensive income: | | |
| Foreign currency translation adjustments | 10,050 | 6,228 |
| Accumulated gains (losses) on derivatives qualifying as hedges (net of tax) | 7,351 | 697 |
| Comprehensive income | ----- \$ 81,047 | ----- \$ 75,497 |
| | ===== | ===== |
| Net Income per share - basic | \$0.71 | \$0.73 |

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| | | |
|--|---------|---------|
| Net Income per share - diluted | \$0.70 | \$0.72 |
| Average number of shares outstanding - basic | 90,053 | 93,380 |
| Average number of shares outstanding - diluted | 90,988 | 94,622 |
| Dividends declared per share | \$0.185 | \$0.185 |

See Notes to Consolidated Financial Statements

INTERNATIONAL FLAVORS & FRAGRANCES INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(DOLLARS IN THOUSANDS)
(Unaudited)

| | | 9 Mon ----- 2006 ----- |
|---|----|---------------------------------|
| Cash flows from operating activities: | | |
| Net income | \$ | 178,51 |
| Adjustments to reconcile to net cash provided by operations: | | |
| Depreciation and amortization | | 66,91 |
| Deferred income taxes | | (8,90) |
| Gain on disposal of assets | | (14,68) |
| Changes in assets and liabilities: | | |
| Current receivables | | (59,69) |
| Inventories | | 12,32 |
| Current payables | | 34,43 |
| Other assets, net | | (9,31) |
| Other liabilities, net | | 38,26 |
| Net cash provided by operations | | ----- 237,86 ----- |
| Cash flows from investing activities: | | |
| Net change in short-term investments | | 2 |
| Additions to property, plant and equipment | | (30,88) |
| Proceeds from disposal of assets | | 14,88 |
| Net cash used in investing activities | | ----- (15,97) ----- |
| Cash flows from financing activities: | | |
| Cash dividends paid to shareholders | | (50,81) |
| Net change in bank borrowings and overdrafts | | (36,80) |
| Net change in commercial paper outstanding | | |
| Proceeds from long-term debt | | 375,00 |
| Repayments of long-term debt | | (499,30) |
| Proceeds from issuance of stock under equity compensation plans | | 40,49 |
| Purchase of treasury stock | | (162,22) |
| Net cash used in financing activities | | ----- (333,64) ----- |
| Effect of exchange rate changes on cash and cash equivalents | | 1,96 |
| Net change in cash and cash equivalents | | (109,78) |
| Cash and cash equivalents at beginning of year | | 272,54 |
| Cash and cash equivalents at end of period | \$ | ----- 162,76 ===== |
| Interest paid | \$ | 27,27 |

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Income taxes paid

\$

48,68

See Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

These interim statements and management's related discussion and analysis should be read in conjunction with the consolidated financial statements and their related notes and management's discussion and analysis of results of operations and financial condition included in the Company's 2005 Annual Report on Form 10-K. These interim statements are unaudited. In the opinion of the Company's management, all adjustments, including normal recurring accruals, necessary for a fair presentation of the results for the interim periods have been made.

Note 1. New Accounting Pronouncements:

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 ("FAS No. 109"). FIN 48 clarifies the application of FAS No. 109 to the accounting for income taxes by prescribing the minimum threshold a tax position must meet before being recognized in the financial statements. Under FIN 48, the financial statement effects of a tax position are initially recognized when it is considered more likely than not, based on its technical merits, that the position will be sustained upon examination. A tax position that meets the more likely than not recognition threshold is initially and subsequently measured as the largest amount of benefit, determined on a cumulative probability basis that is more likely than not to be realized upon ultimate settlement with the taxing authority. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the potential impact of this interpretation on its financial position and results of operations.

In September 2006, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections ("FAS 154"). This Statement replaces Accounting Principles Board No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and changes the requirements for the accounting for and reporting of a change in accounting principle. FAS 154 is effective for fiscal years beginning after December 15, 2006.

In September 2006, the FASB issued SFAS No. 157 ("FAS 157"), Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures regarding fair value measurements. FAS 157 is effective for fiscal years beginning after December 15, 2007. The Company is currently evaluating the potential impact of this standard.

In September 2006, the FASB issued SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132R ("FAS 158"). This Statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position, and to recognize changes in that funded status in the year in which the changes occur through Other comprehensive income. This Statement also requires an employer to measure the funded status of a plan at the date of its year-end statement of financial position. FAS 158 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the potential impact of this standard.

In September 2006, the Securities and Exchange Commission issued Staff

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Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"), which provides interpretive guidance on the consideration of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 allows a one-time transitional cumulative effect adjustment to beginning retained earnings as of January 1, 2006, for errors that were not previously deemed material, but are material under the guidance in SAB 108. The Company does not believe the adoption of SAB 108 will have a material impact on its Consolidated Financial Statements.

Note 2. Net Income Per Share:

Net income per share is based on the weighted average number of shares outstanding. A reconciliation of shares used in the computation of basic and diluted net income per share is as follows:

| (Shares in thousands) | Three Months Ended September 30, | | Nine Mon |
|--------------------------------------|----------------------------------|--------|----------|
| | 2006 | 2005 | 2006 |
| Basic | 90,053 | 93,380 | 90,78 |
| Assumed conversion under stock plans | 935 | 1,242 | 70 |
| Diluted | 90,988 | 94,622 | 91,48 |

Stock options to purchase 1,357,000 and 1,416,000 shares were outstanding for the third quarter and first nine months of 2006, respectively, and 798,000 and 723,000 for the third quarter and first nine months of 2005, respectively, were excluded in the computation of diluted net income per share for the respective periods as their impact was anti-dilutive.

Note 3. Restructuring and Other Charges:

As described in Note 2 to the Consolidated Financial Statements in the Company's 2005 Annual Report, the Company has undertaken a significant reorganization, including management changes, consolidation of production facilities and related actions.

The Company undertook a plan to eliminate approximately 300 positions in manufacturing, selling, research and administration functions, principally in its European and North American operating regions. The majority of affected positions involve employee separation while the balance relates to open positions that will not be filled. As a result of these actions, the Company recognized pre-tax charges of \$23.3 million in the fourth quarter of 2005 and \$0.7 million in the first nine months of 2006. The Company recorded restructuring and other charges of \$0.3 million in the third quarter of 2006.

Movements in the liabilities related to the restructuring charges, included in Restructuring and other charges or Other liabilities, as appropriate, were (in millions):

| | Employee- Related | Asset- Related and Other | Total |
|---------------------------|----------------------|--------------------------------|---------|
| Balance December 31, 2005 | \$ 29.5 | \$ 4.9 | \$ 34.4 |

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| | | | |
|----------------------------|---------|--------|---------|
| Additional charges | 1.9 | 0.4 | 2.3 |
| Cash and other costs | (18.2) | (2.8) | (21.0) |
| | | | |
| Balance September 30, 2006 | \$ 13.2 | \$ 2.5 | \$ 15.7 |
| | | | |

Consistent with the original plan, the balance of employee-related liabilities is expected to be utilized by 2008 as obligations are satisfied; the asset-related charges will be utilized in 2007 on final decommissioning and disposal of the affected equipment.

Note 4. Goodwill and Other Intangible Assets, Net

Goodwill by operating segment at September 30, 2006 and December 31, 2005 is as follows:

| (Dollars in thousands) | Amount |
|------------------------|------------|
| North America | \$ 218,575 |
| Europe | 258,607 |
| India | 29,209 |
| Latin America | 49,046 |
| Asia Pacific | 110,145 |
| | |
| Total | \$ 665,582 |

Trademark and other intangible assets consist of the following:

| (Dollars in thousands) | September 30, 2006 | December 31, 2005 |
|--------------------------|-----------------------|----------------------|
| Gross carrying value | \$ 177,498 | \$ 177,498 |
| Accumulated amortization | 81,561 | 70,429 |
| | | |
| Total | \$ 95,937 | \$ 107,069 |

Amortization expense for the period ended September 30, 2006 was \$11.1 million; estimated annual amortization is \$14.8 million in 2006, \$13.5 million in 2007, \$6.8 million in 2008 and 2009, and \$6.7 million in 2010 and 2011, and \$51.7 million thereafter.

Note 5. Comprehensive Income:

Changes in the accumulated other comprehensive income component of shareholders' equity were as follows:

| | | |
|--|---|----------------|
| | Accumulated losses on derivatives | Minim Pensi |
|--|---|----------------|

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| 2006 (Dollars in thousands) | Translation adjustments | qualifying as hedges, net of tax | Obliga net o |
|-----------------------------|-------------------------|----------------------------------|--------------|
| Balance December 31, 2005 | \$ (47,369) | \$ (2,606) | \$ (100 |
| Change | 24,404 | (10,396) | - |
| Balance September 30, 2006 | \$ (22,965) | \$ (13,002) | \$ (100 |

| 2005 (Dollars in thousands) | Translation adjustments | Accumulated gains(losses) on derivatives qualifying as hedges, net of tax | Minimu Pensi Obliga net o |
|-----------------------------|-------------------------|---|---------------------------|
| Balance December 31, 2004 | \$ 8,227 | \$ (5,694) | \$ (110 |
| Change | (49,271) | 2,066 | - |
| Balance September 30, 2005 | \$ (41,044) | \$ (3,628) | \$ (110 |

Note 6. Borrowings:

Debt consists of the following:

| (Dollars in thousands) | Rate(s) | Maturities | September 30, |
|---|-------------|------------|---------------|
| Bank borrowings and overdrafts | | | \$ 3 |
| Current portion of long-term debt | 6.45% | 2006 | |
| Current portion of deferred realized gains on interest rate swaps | | | |
| Total current debt | | | 3 |
| Japanese Yen notes | 2.45% | 2008-11 | 1 |
| Senior Unsecured Notes | 5.89%-6.14% | 2009-16 | 3 |
| Other | | 2011 | |
| Deferred realized gains on interest rate swaps | | | |
| Total long-term debt | | | 5 |
| Total debt | | | \$ 8 |

The 6.45% Notes included as current debt at December 31, 2005 matured on May 15, 2006. On July 12, 2006, the Company issued \$375.0 million of Senior Unsecured Notes ("Senior Notes") in four series: (i) \$50.0 million in aggregate principal amount of 5.89% Series A Senior Notes due July 12, 2009, (ii) \$100.0 million in aggregate principal amount of 5.96% Series B Notes due July 12, 2011, (iii) \$100.0 million in aggregate principal amount of 6.05% Series C Notes due July

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12, 2013 and (iv) \$125.0 million in aggregate principal amount of 6.14% Series D Notes due July 12, 2016.

Note 7. Equity Compensation Plans:

The Company previously applied the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB 25") and provided the pro forma disclosures required by FASB Statement No 123, "Accounting for Stock-Based Compensation" ("FAS 123"). Under APB 25, no compensation expense for employee stock options was reflected in net earnings.

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123(R) "Share-Based Payment" ("FAS 123 (R)") using the modified prospective method, which requires measurement of compensation cost of all stock-based awards at fair value on the date of grant and recognition of compensation expense over the service periods for awards expected to vest. Under this transition method, 2006 compensation cost includes the portion vesting in the period for (1) all share-based payments granted prior to, but not vested, as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FAS 123, and (2) all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of FAS 123(R). The Company will recognize the cost of all employee stock options on a straight-line attribution basis over their respective vesting periods, net of estimated forfeitures. Results for prior periods have not been restated.

The Company changed its valuation model used for estimating the fair value of options granted after January 1, 2006, from a Black-Scholes option-pricing model to a Binomial lattice-pricing model, in order to provide a better estimate of fair value; the Binomial model is considered a more flexible method for valuing employee stock options than the Black-Scholes model. The flexibility of the simulated Binomial model stems from the ability to incorporate inputs that change over time, such as volatility and interest rates, and to allow for actual exercise behavior of option holders. The Company is using an average of implied and historical volatility while the expected term assumption was determined based on historical patterns.

The Company has various equity plans under which the Company's officers, senior management, directors and other key employees may be granted options to purchase the Company's common stock or other forms of equity-based awards. Prior to 2004, stock options were the primary form of equity compensation. Beginning in 2004, the Company granted Restricted Stock Units ("RSU's") as the principal element of its equity compensation for all eligible U.S. - based employees and a majority of eligible overseas employees. Vesting of the RSU's for the Company's officers and senior management has been performance and time based, and for the remainder of eligible employees, vesting is solely time based; the vesting period is primarily three years from date of grant. For a small group employees, primarily overseas, the Company continues to grant stock options.

In 2006, the Board of Directors approved a Long Term Incentive Choice program (the "Program") for the Company's senior management under the Company's 2000 Stock Award and Incentive Plan ("2000 SAIP"). Under the Program, eligible employees can choose from among three equity alternatives and will be granted such equity awards up to certain dollar awards depending on the participant's grade level. A participant may choose among (1) Purchase Restricted Stock ("PRS"), (2) Stock Settled Appreciation Rights ("SSAR's") or (3) RSU's. The balance of employees who are not eligible under the Program receive RSU's or, as noted above, options.

Purchase Restricted Stock

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PRS provides for the participant to purchase restricted shares of the Company stock at 50% of the fair market value on the grant date of the award. The shares vest on the third anniversary of the grant date, are subject to employment and other specified conditions, and pay dividends if and when paid by the Company. The Company issued 217,905 shares of PRS in 2006 for a purchase price of \$3.9 million.

Stock Options and SSAR's

Stock options generally become exercisable on the first anniversary of the grant date and have a maximum term of ten years. SSAR's become exercisable on the third anniversary of the grant date and have a maximum term of seven years. The Company awarded stock options and SSAR's in 2006 of 204,000 and 352,650, respectively.

Compensation cost and the related tax benefit for unvested stock option awards issued prior to adoption of FAS 123(R) totaled \$.5 million and \$.3 million for the third quarter 2006, respectively, and \$2.4 million and \$.9 million for the nine-month period ended September 30, 2006, respectively.

The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of FAS 123 to measure stock-based compensation expense for outstanding option awards for the quarter and nine-month periods ended September 30, 2005. Using the Black-Scholes option valuation model, the estimated fair values of options granted during 2005 were \$10.57 per share.

| (Dollars in thousands except per share amounts) | Three Months Ended September 30, 2005 |
|---|--|
| | |
| Net income, as reported | \$68,572 |
| Deduct: Total stock-based employee compensation expense determined under fair value method for all stock option awards of related tax effects | 1,997 |
| Pro-forma net income | \$66,575 |
| Net income per share: | |
| Basic - as reported | \$0.73 |
| Basic - pro-forma | \$0.71 |
| Diluted - as reported | \$0.72 |
| Diluted - pro-forma | \$0.70 |

Principal assumptions used in applying the Black-Scholes model in 2005 and the binomial model in 2006 were:

| | 2005 | 2006 |
|-------------------------|-------|-------|
| | | |
| Risk-free interest rate | 4.2% | 5.0% |
| Expected life, in years | 5 | 5 |
| Expected volatility | 26.9% | 21.3% |
| Expected dividend yield | 1.7% | 2.1% |

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The Company utilizes historical information to estimate expected life and forfeitures within the valuation model. The expected term of an option is based on historical employee exercise behavior, vesting terms and a contractual life of primarily ten years for options and seven years for SSAR's. The risk-free rate for periods within the expected life of the award is based on the U.S.

Treasury yield curve in effect at the time of grant. Expected volatility is based on an average of implied and historical volatility of the price of the Company's common stock over the calculated expected life. The Company anticipates paying cash dividends in the future and therefore uses an expected dividend yield in the valuation model; the cash dividend in effect at the time of grant was employed in this calculation. Adoption of FAS 123(R) did not change the way that the Company has accounted for stock awards in prior periods.

Stock option and SSAR activity was as follows:

| | Shares Subject to Options/SSARs | Weighted Average Exercise Price | Average Remaining Contractual Term |
|-----------------------------------|------------------------------------|--|---|
| | | | |
| Balance at January 1, 2006 | 6,698,428 | \$32.52 | |
| Granted | 556,650 | \$35.51 | |
| Exercised | (1,154,272) | \$30.36 | |
| Cancelled | (234,445) | \$40.03 | |
| | 5,866,361 | \$32.88 | 5.8 |
| | | | |
| Exercisable at September 30, 2006 | 5,071,440 | \$32.31 | 5.2 |
| | | | |

The total intrinsic value of options exercised during the third quarter and nine-month period ended September 30, 2006 was \$2.7 million and \$6.1 million, respectively. The weighted average grant date fair value of options granted during the three and nine months ended September 30, 2006 was \$7.74 and \$7.66, respectively.

The Company stock option and SSAR activity for non-vested awards was as follows:

| | Shares | Weighted Average Exercise Price |
|----------------------------------|-----------|---------------------------------------|
| | | |
| Non-vested at January 1, 2006 | 1,074,140 | \$33.05 |
| Options/SSAR's granted | 556,650 | |
| Options/SSAR's vested | (752,046) | |
| Options/SSAR's cancelled | (83,823) | |
| | 794,921 | \$36.50 |
| | | |
| Non-vested at September 30, 2006 | 794,921 | \$36.50 |
| | | |

As of September 30, 2006, there was \$5.5 million of total unrecognized compensation cost related to non-vested stock option and SSAR awards granted

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under the equity incentive plans relating to future periods. The cost is expected to be recognized over a weighted average period of 2.2 years. The total fair value of shares vested during the three and nine months ended September 30, 2006 was \$- and \$6.2 million, respectively.

Restricted Stock and Units

The Company may grant restricted shares and RSU's to eligible employees, giving them, in most instances, all of the rights of stockholders, except that they may not sell, assign, pledge or otherwise encumber such shares. Such restricted shares and RSU's are subject to forfeiture if certain employment conditions are not met. RSU's generally vest 100% at the end of three years; however, RSU's granted to all officers and senior management have a performance restriction which if not attained terminates the RSU's prior to vesting. The fair value of the RSU's is equal to the market price of the Company's stock at date of grant and is amortized to expense ratably over the vesting period. The Company recorded compensation expense related to restricted stock and RSU's for the three and nine-months ended September 30, 2006 and 2005, as follows:

| | For the Three Months Ended September 30, | | For the N Months En September |
|----------------------------|--|-------|-------------------------------------|
| (In millions) | 2006 | 2005 | 2006 |
| Restricted stock and RSU's | \$4.1 | \$2.7 | \$10.0 |

Restricted stock and RSU activity was as follows:

| | Number of Shares | Weighted Average Grant Date Fair Value Per Share |
|-------------------------------|---------------------|---|
| Balance at January 1, 2006 | 909,385 | \$38.84 |
| Granted | 595,124 | |
| Vested | (46,711) | |
| Forfeited | (125,790) | |
| Balance at September 30, 2006 | 1,332,008 | \$37.03 |

The total value of RSU's which vested during the first quarter was \$1.6 million. The adoption of FAS 123(R) resulted in a cumulative effect gain of \$0.5 million which reflects the net cumulative impact of estimating future forfeitures in the determination of periodic expense for unvested RSU awards, rather than recording forfeitures only when they occur. The cumulative effect was recorded in operating expenses and not as a cumulative effect of a change in accounting principle because the amount was not material.

Note 8. Segment Information:

The Company manages its operations by major geographical region. Flavors and fragrances have similar economic and operational characteristics including

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research and development, the nature of the creative and production processes, the type of customers, and the methods by which products are distributed. Accounting policies used for segment reporting are identical to those described in Note 1 of the Notes to the Consolidated Financial Statements included in the Company's 2005 Annual Report.

The Company evaluates the performance of its geographic regions based on segment profit which is income before taxes on income, excluding interest expense, other income and expense and the effects of restructuring and other charges and accounting changes. The Company is divided into five geographic regions for management purposes: North America, Europe, India, Latin America and Asia Pacific. The Global Expenses caption represents corporate and headquarters-related expenses including legal, finance, human resource and other administrative expenses not allocable to individual regions. Transfers between geographic regions are accounted for at prices that approximate arm's-length market prices. The Company's reportable segment information follows:

| Three Months Ended September 30, 2006 | | | | | | |
|---------------------------------------|------------------|------------------|-----------------|------------------|------------------|--------------------|
| (Dollars in thousands) | North America | Europe | India | Latin America | Asia Pacific | GL Exp |
| Sales to unaffiliated customers | \$165,950 | \$197,452 | \$13,249 | \$69,906 | \$ 92,578 | |
| Transfers between areas | 16,040 | 48,169 | 186 | 140 | 13,982 | |
| Total sales | \$181,990 | \$245,621 | \$13,435 | \$70,046 | \$106,560 | |
| Segment profit | \$ 17,326 | \$ 56,977 | \$ 2,633 | \$ 9,844 | \$ 19,794 | \$ (16,000) |
| Restructuring and other charges | (599) | 359 | (94) | 27 | (9) | |
| Operating profit | \$ 16,727 | \$ 57,336 | \$ 2,539 | \$ 9,871 | \$ 19,785 | \$ (16,000) |
| Interest expense | | | | | | |
| Other income (expense), net | | | | | | |
| Income before taxes on income | | | | | | |

| Three Months Ended September 30, 2005 | | | | | | |
|---------------------------------------|------------------|------------------|-----------------|------------------|------------------|-------------------|
| (Dollars in thousands) | North America | Europe | India | Latin America | Asia Pacific | GL Exp |
| Sales to unaffiliated customers | \$154,659 | \$178,636 | \$14,208 | \$61,577 | \$ 84,038 | |
| Transfers between areas | 17,698 | 47,907 | 17 | 98 | 11,520 | |
| Total sales | \$172,357 | \$226,543 | \$14,225 | \$61,675 | \$ 95,558 | |
| Segment profit | \$ 11,708 | \$ 44,789 | \$ 3,302 | \$ 6,079 | \$ 16,551 | \$ (9,000) |
| Restructuring and other charges | - | - | - | - | - | |
| Operating profit | \$ 11,708 | \$ 44,789 | \$ 3,302 | \$ 6,079 | \$ 16,551 | \$ (9,000) |
| Interest expense | | | | | | |
| Other income (expense), net | | | | | | |

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Income before taxes on income

| Nine Months Ended September 30, 2006 | | | | | | |
|--------------------------------------|------------------|------------------|-----------------|------------------|------------------|---------------|
| (Dollars in thousands) | North America | Europe | India | Latin America | Asia Pacific | GL Exp |
| Sales to unaffiliated customers | \$490,672 | \$587,342 | \$47,418 | \$199,835 | \$255,805 | |
| Transfers between areas | 47,667 | 139,488 | 484 | 392 | 37,019 | |
| Total sales | \$538,339 | \$726,830 | \$47,902 | \$200,227 | \$292,824 | |
| Segment profit | \$ 48,233 | \$175,788 | \$11,279 | \$ 26,452 | \$ 47,334 | \$(45) |
| Restructuring and other charges | (1,320) | 1,529 | (457) | 24 | (449) | |
| Operating profit | \$ 46,913 | \$177,317 | \$10,822 | \$ 26,476 | \$ 46,885 | \$(45) |
| Interest expense | | | | | | |
| Other income (expense), net | | | | | | |
| Income before taxes on income | | | | | | |

| Nine Months Ended September 30, | | | | | | |
|---------------------------------|------------------|------------------|-----------------|------------------|------------------|---------------|
| (Dollars in thousands) | North America | Europe | India | Latin America | Asia Pacific | GL Exp |
| Sales to unaffiliated customers | \$466,829 | \$589,276 | \$46,161 | \$182,317 | \$247,165 | |
| Transfers between areas | 58,059 | 146,669 | 21 | 536 | 32,758 | |
| Total sales | \$524,888 | \$735,945 | \$46,182 | \$182,853 | \$279,923 | |
| Segment profit | \$ 42,557 | \$157,152 | \$11,319 | \$ 18,418 | \$ 45,444 | \$(33) |
| Restructuring and other charges | - | - | - | - | - | |
| Operating profit | \$ 42,557 | \$157,152 | \$11,319 | \$ 18,418 | \$ 45,444 | \$(33) |
| Interest expense | | | | | | |
| Other income (expense), net | | | | | | |
| Income before taxes on income | | | | | | |

9. Retirement Benefits:

As described in Note 14 of the Notes to the Consolidated Financial Statements included in the Company's 2005 Annual Report, the Company and most of its subsidiaries have pension and/or other retirement benefit plans covering substantially all employees. For the third quarter and nine months ended September 30, 2006 and 2005, pension expense for the U.S. and non - U.S. plans included the following components:

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| U.S. Plans | Three Months Ended September 30, Nine M | | | |
|---|---|----------|----------|----|
| | (Dollars in thousands) | 2006 | 2005 | 20 |
| Service cost for benefits earned | | \$ 2,336 | \$ 2,301 | \$ |
| Interest cost on projected benefit obligation | | 5,394 | 5,410 | |
| Expected return on plan assets | | (5,467) | (5,461) | (|
| Net amortization and deferrals | | 1,705 | 1,489 | |
| Defined benefit plans | | 3,968 | 3,739 | |
| Defined contribution and other retirement plans | | 703 | 708 | |
| Total pension expense | | \$ 4,671 | \$ 4,447 | \$ |

| Non - U.S. Plans | Three Months Ended September 30, Nine M | | | |
|---|---|----------|----------|----|
| | (Dollars in thousands) | 2006 | 2005 | 2 |
| Service cost for benefits earned | | \$ 3,356 | \$ 2,651 | \$ |
| Interest cost on projected benefit obligation | | 8,015 | 7,431 | |
| Expected return on plan assets | | (10,768) | (8,418) | (|
| Net amortization and deferrals | | 2,448 | 2,191 | |
| Defined benefit plans | | 3,051 | 3,855 | |
| Defined contribution and other retirement plans | | 837 | 802 | |
| Total pension expense | | \$ 3,888 | \$ 4,657 | \$ |

The Company expects to contribute \$15 million to its qualified U.S. pension plans in 2006. Contributions of \$0.5 million were made to these plans in the first nine months of 2006. In the quarter and nine months ended September 30, 2006, \$0.7 million and \$2.1 million of benefit payments were made, respectively, with respect to the non-qualified plan. The Company expects to contribute \$19 million to its non-U.S. pension plans in 2006. In the quarter and nine months ended September 30, 2006, \$3.1 million and \$9.0 million of contributions were made, respectively, to these plans.

For the quarter and nine month periods ended September 30, 2006 and 2005, expense recognized for postretirement benefits other than pensions included the following components:

| (Dollars in thousands) | Three Months Ended September 30, | | Nine Mo |
|--------------------------------------|----------------------------------|----------|----------|
| | 2006 | 2005 | |
| Service cost for benefits earned | \$ 598 | \$ 900 | \$ 2,310 |
| Interest on benefit obligation | 1,169 | 1,791 | 4,319 |
| Net amortization and deferrals | (245) | 491 | 137 |
| Total postretirement benefit expense | \$ 1,522 | \$ 3,182 | \$ 6,766 |

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The Company expects to contribute \$3.9 million to its postretirement benefit plans in 2006. In the quarter and nine months ended September 30, 2006, \$1.3 million and \$3.5 million of contributions were made, respectively.

Note 10. Commitments and Contingencies:

The Company is party to a number of lawsuits and claims related primarily to flavoring supplied by the Company to manufacturers of butter flavor popcorn. At each balance sheet date, or more frequently as conditions warrant, the Company reviews the status of each pending claim, as well as its insurance coverage for such claims with due consideration given to potentially applicable deductibles, retentions and reservation of rights under its insurance policies, and the advice of its outside legal counsel and a third party expert in modeling insurance deductible amounts with respect to such matters. While the ultimate outcome of any litigation cannot be predicted, management believes that adequate provision has been made with respect to all known claims. There can be no assurance that future events will not require the Company to increase the amount it has accrued for any matter or accrue for a matter that has not been previously accounted for. Based on information presently available and in light of the merits of its defenses and the availability of insurance, the Company does not expect the outcome of the above cases, singly or in the aggregate, to have a material adverse effect on the Company's financial condition, results of operation or liquidity.

The Company recorded its expected liability with respect to these claims in Other liabilities and expected recoveries from its insurance carrier group in Other Assets. The Company believes that realization of the insurance receivable is probable due to the terms of the insurance policies, the financial strength of the insurance carrier group and the payment experience to date of the insurance carrier group as it relates to these claims.

Note 11. Reclassifications:

Certain reclassifications have been made to the prior year's financial statements to conform to 2006 classifications.

Item 2. Management's Discussion and Analysis of Results of Operations

----- and Financial Condition -----

Overview -----

The Company is a leading creator and manufacturer of flavor and fragrance compounds used to impart or improve the flavor or fragrance in a wide variety of consumer products.

Fragrance compounds are used in perfumes, cosmetics, toiletries, hair care products, deodorants, soaps, detergents and softeners as well as air care products. Flavor products are sold to the food and beverage industries for use in consumer products such as prepared foods, beverages, dairy, food and confectionery products. The Company is also a leading manufacturer of synthetic ingredients used in making fragrances.

Changing social habits resulting from such factors as changes in disposable income, leisure time, health concerns, urbanization and population growth stimulate demand for consumer products utilizing flavors and fragrances. These developments expand the market for products with finer fragrance quality, as

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well as the market for colognes and toiletries. Such developments also stimulate demand for convenience foods, soft drinks and low-fat food products that must conform to expected tastes. These developments necessitate the creation and development of flavors and fragrances and ingredients that are compatible with newly introduced materials and methods of application used in consumer products.

Flavors and fragrances are generally:

- created for the exclusive use of a specific customer;
- sold in solid or liquid form, in amounts ranging from a few kilograms to many tons depending on the nature of the end product in which they are used;
- a small percentage of the volume and cost of the end product sold to the consumer; and
- a major factor in consumer selection and acceptance of the product.

Flavors and fragrances have similar economic and operational characteristics, including research and development, the nature of the creative and production processes, the manner in which products are distributed and the type of customer; many of the Company's customers purchase both flavors and fragrances.

The flavor and fragrance industry is impacted by macroeconomic factors in all product categories and geographic regions. Such macroeconomic factors include the impact of currency translation on reported results and the impact currency has on operating costs and the price of raw materials. In addition, pricing pressure placed on the Company's customers by large and powerful retailers and distributors is inevitably passed along to the Company, and its competitors. Leadership in innovation and creativity mitigates the impact of pricing pressure. Success and growth in the industry is dependent upon creativity and innovation in meeting the many and varied needs of the customers' products in a cost-efficient and effective manner, and with a consistently high level of timely service and delivery.

The Company's strategic focus is:

- To improve customer service, in terms of both on-time deliveries and responsiveness to new product development initiatives, and to improve the win rate for new business with the Company's customers.
- To align resources of the Company with those of its strategic customers using the global reach of the Company to provide and enhance strategic partnerships.
- To focus research and development initiatives on those areas considered to be most likely, in the long-term, to yield the greatest value to the Company's customers and shareholders.

The Company has made strides in implementing a number of these strategies. On time delivery and continuous improvement in operations are supported by the global implementation of the enterprise requirements planning software package ("SAP"), and related initiatives, implementation of which are substantially completed. Product and category growth and strategic analysis of these objectives is a continual focus for management. A number of new ingredients have been commercialized and are employed in flavor and fragrance compounds.

Operations

Third Quarter 2006

Third quarter 2006 sales totaled \$539 million, increasing 9% over the prior year quarter; fragrance and flavor sales increased 12% and 6%, respectively. Reported

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sales for the 2006 quarter benefited from the generally weaker U.S. dollar during the quarter; at comparable exchange rates, sales would have increased 7% in comparison to the 2005 quarter.

Fragrance sales were led by a 24% increase in fine fragrance sales, with much of the growth driven by new product introductions. Sales of functional fragrances increased 5% mainly as a result of increased volume and new product introductions, while sales of ingredients increased 11% mainly due to increased volumes.

The 6% flavor sales growth benefited from a combination of new wins and volume growth. Flavor compounds increased in each region in both local currency and dollars.

Sales performance by region and product category in comparison to the prior year quarter in both reported dollars and local currency, where applicable, follows:

| | | Third Quarter 2006 vs. 2005 % Change in Sales by Region of Destination | | | | |
|---------------|----------------|---|---------|-------|-------------|---------|
| | | Fine | Func'l. | Ingr. | Total Frag. | Flavors |
| North America | Reported | 18% | 3% | 8% | 9% | 3% |
| Europe | Reported | 19% | 9% | 9% | 13% | 6% |
| | Local Currency | 13% | 4% | 5% | 7% | 1% |
| Latin America | Reported | 51% | 4% | 9% | 15% | 5% |
| Asia Pacific | Reported | 58% | 5% | 14% | 16% | 8% |
| | Local Currency | 60% | 2% | 15% | 14% | 7% |
| India | Reported | -19% | -13% | 61% | -3% | 11% |
| | Local Currency | -20% | -14% | 57% | -4% | 11% |
| Total | Reported | 24% | 5% | 11% | 12% | 6% |
| | Local Currency | 21% | 3% | 8% | 10% | 4% |

- North America fine fragrance and flavor growth was driven mainly by new product introductions of \$8 million and \$6 million, respectively; functional fragrance growth was primarily volume related, while the increase in ingredients was the result of both volume and price.
- European growth was strong across the continent; Western and Eastern Europe and Russia, collectively increasing 6% over the 2005 quarter; a 3% decline in the Middle East partially offset this growth. Fine and functional fragrance growth was mainly the result of new product introductions of \$12 million while the increases in the sale of ingredients and flavors were both mainly volume related.
- Latin America fine and functional fragrance sales growth resulted primarily from \$5 million and \$3 million, respectively, in new product introductions; ingredient growth was primarily volume related. Flavor sales were strong throughout the region.
- Asia Pacific fine and functional fragrance sales growth resulted from new product introductions and volume growth in existing products. Ingredient sales were primarily the result of volume increases. Flavor sales growth was mainly the result of new product introductions.
- India fragrance sales performance resulted from erosion in existing

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products not compensated by new wins, while flavor sales increased as a result of growth in existing products.

The percentage relationship of cost of goods sold and other operating expenses to sales for the third quarter are detailed below.

| | Third Quarter | |
|-------------------------------------|---------------|-------|
| | 2006 | 2005 |
| Costs of Goods Sold | 57.5% | 58.1% |
| Research and Development Expenses | 8.6% | 9.1% |
| Selling and Administrative Expenses | 16.3% | 17.4% |

- Gross profit, as a percentage of sales, improved 0.6 percentage points compared to the prior year quarter. The improvement resulted mainly from higher sales, improved manufacturing expense absorption and favorable product mix.
- Research and Development ("R&D") expenses totaled 8.6% of sales, compared to 9.1% in the prior year quarter.
- Selling, General and Administrative ("SG&A") expenses, as a percentage of sales, were 16.3% compared to 17.4% in 2005. The 2005 quarter included \$5 million relating to a product contamination issue; 2006 results include the benefit of a \$3 million insurance recovery related to this contamination matter. The 2006 quarter also included \$14 million in incentive compensation expense; the 2005 quarter included \$2 million of such expense.
- Interest expense was flat with the prior year quarter; the average interest rate on debt in the 2006 quarter was 3.2% compared to 3.4% in the prior year quarter.
- Other income (expense), net in the 2006 quarter increased over the prior year quarter, mainly as a result of gains on disposal of fixed assets, as well as somewhat higher interest income, partially offset by higher foreign exchange losses.
- The effective tax rate was 29.8% compared to (3.5%) in the prior year quarter; the prior year quarter reflects the American Jobs Creation Act of 2004 ("AJCA") benefit of \$23 million; excluding this benefit, the 2005 third quarter effective rate was 31.7%.

Net income for the 2006 quarter totaled \$64 million, a 7% decrease compared with the prior year quarter. The 2005 third quarter net income of \$69 million included the net tax benefit of \$23 million on repatriation of dividends from overseas affiliates under AJCA.

First Nine Months 2006

For the nine-month period ended September 30, 2006, sales totaled \$1,581 million, increasing 3% compared with the 2005 period. Reported sales for the 2006 period were affected by the strength of the U.S. dollar; had exchange rates remained constant, sales would have been two percentage points higher than in the 2005 nine-month period.

Sales performance by region and product category in comparison to the prior year period, in both reported dollars and local currency, where applicable, follows:

Nine Months 2006 vs. 2005
% Change in Sales by Region of Destination

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| | | Fine | Func'l. | Ingr. | Total Frag. | Flavors |
|---------------|----------------|------|---------|-------|-------------|---------|
| North America | Reported | 19% | -1% | 11% | 9% | 4% |
| Europe | Reported | 4% | 1% | -9% | - | -1% |
| | Local Currency | 6% | 4% | -7% | 2% | 1% |
| Latin America | Reported | 25% | 2% | 6% | 8% | 12% |
| Asia Pacific | Reported | 17% | 1% | 1% | 4% | 2% |
| | Local Currency | 17% | 1% | 4% | 5% | 4% |
| India | Reported | 3% | -2% | 27% | 5% | 11% |
| | Local Currency | 3% | -1% | 30% | 5% | 11% |
| Total | Reported | 11% | 1% | - | 4% | 3% |
| | Local Currency | 13% | 1% | 2% | 5% | 4% |

- North America fine fragrance and flavor growth resulted mainly from new product introductions of \$29 million while the decline in functional fragrances was volume related. Ingredient sales growth was due to a combination of volume and price.
- European growth was strongest in Eastern Europe, Africa and the Middle East, partially offset by a decline in sales in Western Europe in the first half of the year. Fine and functional fragrance growth resulted from new product introductions of \$36 million while the decline in ingredients was volume related. The local currency flavor growth was the result of new wins.
- Latin America fine fragrance sales growth resulted from new product introductions of \$8 million while functional fragrance wins of \$8 million were partially offset by volume decreases. The ingredient sales increase was volume related. Flavor sales were strong throughout the region, driven mainly by new product introductions of \$5 million and volume growth.
- Asia Pacific fragrance sales growth resulted mainly from new product introductions and volume growth amounting to \$5 million; ingredients sales growth was mainly volume related. Flavor sales growth is a result of new product introductions and volume growth totaling slightly more than \$5 million.
- India fragrance sales performance in all product categories resulted primarily from volume growth while flavor sales increased due to both volume and new product growth.

The percentage relationship of cost of goods sold and other operating expenses to sales for the nine-month period ended September 30, 2006 and 2005 are detailed below.

| | First Nine Months | |
|-------------------------------------|-------------------|-------|
| | 2006 | 2005 |
| Costs of Goods Sold | 57.4% | 58.4% |
| Research and Development Expenses | 8.7% | 8.7% |
| Selling and Administrative Expenses | 16.5% | 16.6% |

- Gross profit, as a percentage of sales, improved compared to the prior year period mainly as a result of sales performance, improved manufacturing

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expense absorption and favorable product mix. In 2005, margin was unfavorably impacted by costs attributable to the raw material contamination matter.

- R&D expenses totaled 8.7% of sales, consistent with the prior year.
- SG&A expenses, as a percentage of sales, were 16.5% compared to 16.6% in the prior year period. The comparison between 2006 and 2005 was impacted by the contamination matter and related insurance recovery discussed above. The 2006 period includes \$31 million in incentive compensation expense; the 2005 period included \$10 million of such expense.
- Interest expense was flat with the prior year period.
- Other income (expense), net primarily relates to the items recorded in the third quarter.
- The effective tax rate was 28.8% compared to 20.8% in the prior year period. The 2005 tax rate was impacted by the \$23 million benefit under AJCA. Excluding this benefit, the 2005 period effective rate would have been 31.2%; variations in the effective rate are mainly attributable to fluctuations in earnings in the countries in which the Company operates. The Company expects the effective tax rate to approximate 28.5% for 2006.

Net income for the 2006 period totaled \$178 million, the same as in the comparable 2005 period. The 2005 results included the net tax benefit of \$23 million on repatriation of dividends from overseas affiliates under AJCA.

Restructuring and Other Charges

As described in Note 2 to the Consolidated Financial Statements in the Company's 2005 Annual Report, the Company has undertaken a significant reorganization, including management changes, consolidation of production facilities and related actions.

The Company undertook a plan to eliminate approximately 300 positions in manufacturing, selling, research and administration functions, principally in its European and North American operating regions. The majority of affected positions involve employee separation while the balance relates to open positions that will not be filled. As a result of these actions, the Company recognized pre-tax charges of \$23.3 million in the fourth quarter 2005 and \$0.7 million in the first nine months of 2006; the Company recorded net restructuring and other charges of \$0.3 million in the third quarter of 2006. Annual savings from these actions are expected to approximate \$16.0 million to \$18.0 million.

Movements in the liabilities related to the restructuring charges, included in Restructuring and other charges or Other liabilities, as appropriate, were (in millions):

| | Employee- Related | Asset- Related and Other | Total |
|----------------------------|----------------------|--------------------------------|---------|
| | | | |
| Balance December 31, 2005 | \$ 29.5 | \$ 4.9 | \$ 34.4 |
| Additional charges | 1.9 | 0.4 | 2.3 |
| Cash and other costs | (18.2) | (2.8) | (21.0) |
| | | | |
| Balance September 30, 2006 | \$ 13.2 | \$ 2.5 | \$ 15.7 |
| | | | |

Consistent with the original plan the balance of employee-related liabilities

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are expected to be utilized by 2008 as obligations are satisfied; the asset-related charges will be utilized in 2007 on final decommissioning and disposal of the affected equipment.

Equity Compensation Plans

The Company previously applied the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB 25") and provided the pro forma disclosures required by FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("FAS No. 123"). Under APB 25, no compensation expense for employee or director stock options was reflected in net earnings.

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123(R) "Share-Based Payment" ("FAS 123 (R)") using the modified prospective method, which requires measurement of compensation cost of all stock-based awards at fair value on the date of grant and recognition of compensation expense over the service periods for awards expected to vest. Under this transition method, 2006 compensation cost includes the portion vesting in the period for (1) all share-based payments granted prior to, but not vested, as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FAS 123, and (2) all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of FAS 123(R). The Company will recognize the cost of all stock options on a straight-line attribution basis over their respective vesting periods, net of estimated forfeitures. Results for prior periods have not been restated.

The Company changed its valuation model used for estimating the fair value of options granted after January 1, 2006, from a Black-Scholes option-pricing model to a Binomial lattice-pricing model, in order to provide a better estimate of fair value; the Binomial model is considered a more flexible method for valuing employee stock options than the Black-Scholes model. The flexibility of the simulated Binomial model stems from the ability to incorporate inputs that change over time, such as volatility and interest rates, and to allow for actual exercise behavior of option holders. The Company is using an average of implied and historical volatility while the expected term assumption was determined based on historical patterns.

The Company has various equity plans under which the Company's officers, senior management, directors and other key employees may be granted options to purchase the Company's common stock or other forms of equity-based awards. Prior to 2004, stock options were the primary form of equity compensation. Beginning in 2004, the Company granted Restricted Stock Units ("RSU's") as the principal element of its equity compensation plan for all eligible U.S. - based employees and a majority of eligible overseas employees. Vesting of the RSU's for the Company's officers and senior management has been performance and time based, and for the remainder of eligible employees, vesting is solely time based; the vesting period is primarily three years from date of grant. For a small group of primarily overseas employees, the Company continues to grant stock options.

In 2006, the Board of Directors approved a Long Term Incentive Choice program (the "Program") for the Company's senior management under the Company's 2000 Stock Award and Incentive Plan ("2000 SAIP"). Under the Program, eligible employees can choose from among three equity alternatives and will be granted such equity awards under the 2000 SAIP up to certain dollar awards depending on the participant's grade level. A participant may choose among (1) Purchase Restricted Stock ("PRS"), (2) Stock Settled Appreciation Rights ("SSAR's") or (3) RSU's. The balance of employees who are not eligible under the Program receive RSU's or, as noted above, options.

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Developing the assumptions used in the binomial model requires significant judgment on the part of the Company and, generally, may involve analyzing all available historical data, considering whether historical data is relevant to predicting future behavior, making appropriate adjustments to historical data for future expectations, supplementing or replacing Company-specific historical

data with data from other supportable sources and appropriately weighting each of the inputs. These assumptions are evaluated at each grant date. If factors change and the Company employs different assumptions for estimating share-based compensation expense in future periods or if the Company decides to use a different valuation model, the future periods may differ significantly from what the Company has recorded in the current period and could materially affect operating income, net income and net income per share. In addition, existing valuation models, including the Black-Scholes and binomial lattice-pricing model, may not provide reliable measures of the fair values of the Company's share-based compensation. Consequently, there is a significant risk that the Company's estimates of the fair values of share-based compensation awards on the grant dates may not reflect the actual values realized upon the vesting, exercise, expiration, early termination or forfeiture of those share-based payments in the future. There currently is no market-based mechanism or other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models.

The future impact of the cost of share-based compensation on our results of operations, including net income and earnings per diluted share, will depend on, among other factors, the level of our equity awards as well as the market price of our shares at the time of award as well as various other assumptions used in valuing such awards.

See Note 7 of the Notes to the unaudited Consolidated Financial Statements for additional discussion of the impact of the adoption of, and the method of determining fair values under, FAS 123(R).

Financial Condition

Cash, cash equivalents and short-term investments totaled \$163 million at September 30, 2006. Working capital at September 30, 2006 was \$399 million compared to \$(11) million at December 31, 2005. The change in working capital relates to the refinancing of long-term debt classified as current at December 31, 2005. Gross additions to property, plant and equipment during the first nine months were \$31 million. The Company expects additions to property, plant and equipment to approximate \$50 million for the full year 2006.

At September 30, 2006, the Company had \$808 million of debt outstanding. On July 12, 2006, the Company issued an aggregate of \$375 million of Senior Unsecured Notes. The Notes were issued in four series: (i) \$50.0 million in aggregate principal amount of 5.89% Series A Senior Notes due July 12, 2009, (ii) \$100.0 million in aggregate principal amount of 5.96% Series B Notes due July 12, 2011, (iii) \$100.0 million in aggregate principal amount of 6.05% Series C Notes due July 12, 2013 and (iv) \$125.0 million in aggregate principal amount of 6.14% Series D Notes due July 12, 2016. Proceeds of the Notes were used to repay the commercial paper and for other general corporate purposes.

In April and July 2006, the Company paid a quarterly cash dividend of \$.185 per share to shareholders, unchanged from the prior quarter dividend payment. On October 11, 2006, the Company announced a 14% increase in its quarterly dividend rate to \$.21 per share effective with the dividend payable in January 2007.

Under the share repurchase program of \$200.0 million authorized in May 2005, the Company repurchased approximately 1.9 million shares in the third quarter of 2006 at a cost of \$71 million. In 2006, the Company has repurchased 4.6 million

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shares at a cost of \$162 million. At September 30, 2006, the Company had approximately \$15 million remaining under this repurchase plan. On October 11, 2006, the Company announced that its Board of Directors had authorized a new \$300 million share repurchase program, expected to be completed over the next 18 - 24 months. At the current market price, the new program would enable the repurchase of approximately 7.5 million shares, or 8% of shares currently outstanding. Repurchases will be made from time to time on the open market or through private transactions as market and business conditions warrant. Repurchased shares will be available for use in connection with the Company's employee compensation plans and for other general corporate purposes.

The Company anticipates that its financing requirements will be funded from internal sources and credit facilities currently in place. Cash flows from operations and availability under its existing credit facilities are expected to be sufficient to fund the Company's anticipated normal capital spending, dividends and other expected requirements for at least the next eighteen months.

Non-GAAP Financial Measures

To supplement the Company's financial results presented in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"), the Company uses certain non-GAAP financial measures. These non-GAAP financial measures should not be considered in isolation, or as a substitute for, or superior to, financial measures calculated in accordance with GAAP. These non-GAAP financial measures as disclosed by the Company may also be calculated differently from similar measures disclosed by other companies. To ease the use and understanding of our

supplemental non-GAAP financial measures, the Company includes the most directly comparable GAAP financial measure.

The Company discloses, and management internally monitors, the sales performance of international operations on a basis that eliminates the positive or negative effects that result from translating foreign currency sales into U.S. dollars. Management uses this measure because it believes that it enhances the assessment of the sales performance of its international operations and the comparability between reporting periods.

The Company has also provided net income and the effective tax rate for the 2005 third quarter which excludes the impact of a one-time benefit under the AJCA of repatriation of dividends from overseas affiliates. Management believes that given the unique nature of these items, including this information without the impact of repatriation in the prior year period is more representative of the Company's operational performance and may assist investors in evaluating the Company's period to period financial results, in a manner consistent with how management has evaluated such performance.

Cautionary Statement Under The Private Securities Litigation Reform Act

of 1995

Statements in this Quarterly Report, which are not historical facts or information, are "forward-looking statements" within the meaning of The Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based on management's reasonable current assumptions and expectations. Such forward-looking statements which may be identified by such words as "expect," "believe," "anticipate," "outlook," "guidance," "may," and similar forward-looking terminology, involve significant risks, uncertainties and other factors, which may cause the actual results of the Company to be materially different from any future results expressed or implied by such forward-looking statements, and there can be no assurance that actual results will not differ

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materially from management's expectations. Such factors include, among others, the following: general economic and business conditions in the Company's markets, including economic, population health and political uncertainties; weather, geopolitical, civil hostilities and region specific uncertainties; interest rates; the price, quality and availability of raw materials; the Company's ability to implement its business strategy, including the achievement of anticipated cost savings, profitability, growth and market share targets; the impact of currency fluctuation or devaluation in the Company's principal foreign markets and the success of the Company's hedging and risk management strategies; the impact of possible pension funding obligations and increased pension expense on the Company's cash flow and results of operations; and the effect of legal and regulatory proceedings, as well as restrictions imposed on the Company, its operations or its representatives by foreign governments; and the fact that the outcome of litigation is highly uncertain and unpredictable and there can be no assurance that the triers of fact or law, at either the trial level or at any appellate level, will accept the factual assertions, factual defenses or legal positions of the Company or its factual or expert witnesses in any such litigation or other proceedings. The Company intends its forward-looking statements to speak only as of the time of such statements and does not plan to update or revise them as more information becomes available or to reflect changes in expectations, assumptions or results.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There are no material changes in market risk from the information provided in the Company's 2005 Annual Report on Form 10-K.

Item 4. Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer, with the assistance of other members of the Company's management, have evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective as of the end of the reporting period covered by this report.

The Company's Chief Executive Officer and Chief Financial Officer have also concluded that there have not been any changes in the Company's internal control over financial reporting during the quarter ended September 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is subject to various claims and legal actions in the ordinary course of its business.

Since September 2001 the Company has been involved in actions where plaintiffs allege respiratory injuries in the workplace due to the use by their employers of an International Flavors & Fragrances Inc. ("IFF") and/or Bush Boake Allen Inc. ("BBA") flavor. For purposes of reporting on these actions, IFF and BBA are jointly referred to as the "Company". See the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2006 under "Legal Proceedings" for an update on these cases. Since this Report, all plaintiff cases related to

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the Benavides case have been resolved by confidential settlement. Also, in the Arthur case, the first trial group of 2 workers and 1 spouse which was due to commence trial on August 29, 2006 was resolved by confidential settlement. In August 2006, 2 additional cases were filed against the Company, another flavor supplier and 2 chemical companies in the Circuit Court of Jasper County, Missouri. The first involves 29 current and former employees and/or a neighbor of the Gilster-Mary Lee microwave popcorn plant in Jasper, Missouri (Arles case) and the second 5 current and former employees of the same plant (Bowen case).

The Company believes that all IFF and BBA flavors at issue in these matters met the requirements of the U.S. Food and Drug Administration and were safe for handling and use by workers in food manufacturing plants when used according to specified safety procedures. These procedures are detailed in instructions that IFF and BBA provided to all its customers for the safe handling and use of these flavors. It is the responsibility of the Company's customers to ensure that these instructions, which include the use of appropriate engineering controls, such as adequate ventilation, proper handling procedures and respiratory protection for workers, were followed in the workplace.

At each balance sheet date the Company reviews the status of each of these claims, as well as its insurance coverage for such claims with due consideration of potentially applicable deductibles, retentions and reservations of rights under its insurance policies, and the advice of its outside legal counsel with respect to all of these matters. Ultimate outcome of any litigation cannot be predicted with certainty; management believes that adequate provision has been made with respect to such pending claims. In addition, based on information presently available and in light of the merits of its defenses and the availability of insurance, the Company does not expect the outcome of the above cases, singly or in the aggregate, to have a material adverse effect on the Company's financial condition, results of operation or liquidity. There can be no assurance, however, that future events will not require the Company to increase the amount it has accrued for any matter or accrue for a matter that had not been previously accrued because it was not considered probable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Issuer Purchases of Equity Securities

| | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program (1) |
|---------------------|--|---------------------------------|---|
| July 1 - 31, 2006 | 64,800 | \$37.15 | 64,800 |
| August 1 - 31, 2006 | 1,630,254 | \$38.04 | 1,630,254 |
| Sept. 1 - 30, 2006 | 166,000 | \$39.04 | 166,000 |

(1) An aggregate of 1,861,054 shares of common stock were repurchased during the third quarter of 2006 under a repurchase program announced in May 2005. Under the program, the Board of Directors approved the repurchase by the Company of up to \$200 million of its common stock. This program is near completion.

(2) The Board of Directors approved an additional share repurchase program of \$300 million of its common stock in October 2006.

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Item 6. Exhibits

- 3(ii) By-Laws of the Company, as amended effective as of October 10, 2006 (incorporated by reference to Exhibit 99.1 to the Company's Form 8-K filed with the SEC on October 11, 2006).
- 4.1 Note Purchase Agreement, dated as of July 12, 2006, by and among the Company and the various purchasers named therein (incorporated by reference to Exhibit 4.7 to the Company's Form 8-K filed with the SEC on July 13, 2006).
- 4.2 Form of Series A, Series B, Series C and Series D Senior Notes (incorporated by reference to Exhibit 4.8 to the Company's Form 8-K filed with the SEC on July 13, 2006).
- 10.1 Restricted Stock Units Agreement dated July 25, 2006 between International Flavors & Fragrances Inc. and Arthur C. Martinez (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on July 26, 2006).
- 10.2 Letter Agreement dated June 28, 2006 between the Company and Robert M. Amen, Chairman of the Board of Directors and Chief Executive Officer (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed with the SEC on June 29, 2006).
- 31.1 Certification of Robert M. Amen pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Douglas J. Wetmore pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of Robert M. Amen and Douglas J. Wetmore pursuant to 18 U.S.C. Section 1350 as adopted pursuant to the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTERNATIONAL FLAVORS & FRAGRANCES INC.

Dated: November 2, 2006 By: /s/ DOUGLAS J. WETMORE

Douglas J. Wetmore, Senior Vice President
and Chief Financial Officer

Dated: November 2, 2006 By: /s/ DENNIS M. MEANY

Dennis M. Meany, Senior Vice President,
General Counsel and Secretary

EXHIBIT INDEX

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- | Number | Description |
|--------|--|
| ----- | ----- |
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Exhibit 31.1

CERTIFICATION

I, Robert M. Amen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of International Flavors & Fragrances Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined

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in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

- (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 2, 2006

By: /s/ Robert M. Amen

Name: Robert M. Amen
Title: Chairman of the Board
and Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Douglas J. Wetmore, certify that:

- 1. I have reviewed this Quarterly Report on Form 10-Q of International Flavors & Fragrances Inc.;

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2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 2, 2006

By: /s/ Douglas J. Wetmore

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Name: Douglas J. Wetmore
Title: Senior Vice President
and Chief Financial Officer

Exhibit 32

CERTIFICATION OF CEO AND CFO PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of International Flavors & Fragrances Inc. (the "Company") for the quarterly period ended September 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Robert M. Amen, as Chief Executive Officer of the Company, and Douglas J. Wetmore, as Chief Financial Officer, each hereby certifies, pursuant to 18 U.S.C. (section) 1350, as adopted pursuant to (section) 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Robert M. Amen

Name: Robert M. Amen
Title: Chairman of the Board
and Chief Executive Officer
Dated: November 2, 2006

By: /s/ Douglas J. Wetmore

Name: Douglas J. Wetmore
Title: Senior Vice President
and Chief Financial Officer
Dated: November 2, 2006