Actavis, Inc.
Form 10-Q
May 07, 2013
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

## FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2013

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

## Commission file number 001-13305

# ACTAVIS, INC.

(Exact name of registrant as specified in its charter)

| **Nevada** | **95-3872914** |
|---|---|
| (State or other jurisdiction of<br><br>incorporation or organization) | (I.R.S. Employer Identification No.) |

**Morris Corporate Center III**

**400 Interpace Parkway**

**Parsippany, New Jersey 07054**

(Address of principal executive offices, including zip code)

**(862) 261-7000**

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the Registrant (1) has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

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

| | |
|---|---|
| Large accelerated filer [X] | Accelerated filer [ ] |
| Non-accelerated filer [ ] (Do not check if a smaller reporting company) | Smaller reporting company [ ] |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

The number of shares outstanding of the Registrant s only class of common stock as of April 19, 2013 was approximately 127,745,980.

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**ACTAVIS, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

(Unaudited, in millions)

| | March 31, 2013 | December 31, 2012 (Revised) See Note 2 |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 328.4 | $ 319.0 |
| Marketable securities | 9.0 | 9.0 |
| Accounts receivable, net | 1,275.5 | 1,330.9 |
| Inventories, net | 1,544.3 | 1,546.5 |
| Prepaid expenses and other current assets | 322.9 | 323.6 |
| Deferred tax assets | 355.7 | 309.3 |
| Total current assets | 3,835.8 | 3,838.3 |
| Property and equipment, net | 1,450.4 | 1,485.0 |
| Investments and other assets | 102.0 | 91.2 |
| Deferred tax assets | 149.0 | 61.8 |
| Product rights and other intangibles, net | 3,798.3 | 3,784.3 |
| Goodwill | 4,837.5 | 4,854.2 |
| Total assets | $ 14,173.0 | $ 14,114.8 |
| **LIABILITIES AND EQUITY** | | |
| Current Liabilities: | | |
| Accounts payable and accrued expenses | $ 2,517.9 | $ 2,467.9 |
| Income taxes payable | 151.7 | 68.1 |
| Short-term debt and current portion of long-term debt | 178.3 | 176.2 |
| Deferred revenue | 36.3 | 32.3 |
| Deferred tax liabilities | 50.7 | 4.8 |
| Total current liabilities | 2,934.9 | 2,749.3 |
| Long-term debt | 6,243.2 | 6,257.1 |
| Deferred revenue | 35.1 | 11.3 |
| Other long-term liabilities | 200.0 | 162.6 |
| Other taxes payable | 83.2 | 70.3 |
| Deferred tax liabilities | 1,054.3 | 1,007.8 |
| Total liabilities | 10,550.7 | 10,258.4 |
| Commitments and contingencies: | | |
| Equity: | | |
| Common stock | 0.4 | 0.4 |
| Additional paid-in capital | 1,980.9 | 1,956.7 |
| Retained earnings | 2,079.9 | 2,182.7 |
| Accumulated other comprehensive income (loss) | (91.7) | 36.8 |

| | | | | |
|---|---|---|---|---|
| Treasury stock, at cost | | (364.7) | | (342.8) |
| Total stockholders equity | | 3,604.8 | | 3,833.8 |
| Noncontrolling interest | | 17.5 | | 22.6 |
| Total equity | | 3,622.3 | | 3,856.4 |
| Total liabilities and equity | $ | 14,173.0 | $ | 14,114.8 |

*See accompanying Notes to Condensed Consolidated Financial Statements.*

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**ACTAVIS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(Unaudited; in millions, except per share amounts)**

| | Three Months Ended March 31, 2013 | 2012 |
|---|---|---|
| Net revenues | $ 1,895.5 | $ 1,524.3 |
| Operating expenses: | | |
| Cost of sales (excludes amortization, presented below) | 1,086.2 | 904.3 |
| Research and development | 132.1 | 88.5 |
| Selling and marketing | 227.2 | 118.1 |
| General and administrative | 185.8 | 164.4 |
| Amortization | 158.4 | 131.9 |
| Asset sales, impairments, and contingent consideration adjustment, net | 148.0 | 0.2 |
| Total operating expenses | 1,937.7 | 1,407.4 |
| Operating income (loss) | (42.2) | 116.9 |
| Non-operating income (expense): | | |
| Interest income | 0.8 | 0.4 |
| Interest expense | (54.5) | (21.7) |
| Other income (expense), net | 20.6 | 1.5 |
| Total other income (expense), net | (33.1) | (19.8) |
| Income (loss) before income taxes and noncontrolling interests | (75.3) | 97.1 |
| Provision for income taxes | 28.2 | 42.3 |
| Net income (loss) | (103.5) | 54.8 |
| Loss attributable to noncontrolling interest | 0.7 | - |
| Net income (loss) attributable to common shareholders | $ (102.8) | $ 54.8 |
| Earnings (loss) per share attributable to common shareholders: | | |
| Basic | $ (0.79) | $ 0.44 |
| Diluted | $ (0.79) | $ 0.43 |
| Weighted average shares outstanding: | | |
| Basic | 130.2 | 125.3 |
| Diluted | 130.2 | 127.7 |

*See accompanying Notes to Condensed Consolidated Financial Statements.*

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**ACTAVIS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(Unaudited; in millions)

| | Three Months Ended March 31, | |
|---|---|---|
| | **2013** | **2012** |
| Net income (loss) | $ (103.5) | $ 54.8 |
| Other comprehensive income (loss): | | |
| Foreign currency translation gains (losses) | (128.5) | 37.5 |
| Total other comprehensive income (loss) | (128.5) | 37.5 |
| Comprehensive income (loss) | (232.0) | 92.3 |
| Comprehensive loss attributable to noncontrolling interest | 0.7 | - |
| Comprehensive income (loss) attributable to common shareholders | $ (231.3) | $ 92.3 |

*See accompanying Notes to Condensed Consolidated Financial Statements.*

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## ACTAVIS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

## (Unaudited; in millions)

| | Three Months Ended March 31, | |
|---|---|---|
| | **2013** | **2012** |
| **Cash Flows From Operating Activities:** | | |
| Net income (loss) | $ (103.5) | $ 54.8 |
| Reconciliation to net cash provided by operating activities: | | |
| Depreciation | 47.4 | 20.4 |
| Amortization | 158.4 | 131.9 |
| Provision for inventory reserve | 3.5 | 13.6 |
| Share-based compensation | 12.5 | 10.3 |
| Deferred income tax benefit | (118.0) | (15.9) |
| Earnings on equity method investments | (0.9) | (0.3) |
| (Gain) loss on asset sales and impairment, net | (2.3) | 0.2 |
| Amortization of inventory step up | 93.5 | - |
| Amortization of deferred financing costs | 1.9 | - |
| Increase in allowance for doubtful accounts | 3.8 | 1.6 |
| Accretion of preferred stock and contingent consideration obligations | 0.4 | 7.9 |
| Contingent consideration fair value adjustment | 150.3 | - |
| Excess tax benefit from stock-based compensation | (11.9) | (6.2) |
| Other, net | 0.7 | 0.1 |
| Changes in assets and liabilities (net of effects of acquisitions): | | |
| Accounts receivable, net | 66.7 | 159.7 |
| Inventories | (122.6) | 3.3 |
| Prepaid expenses and other current assets | 50.1 | (2.9) |
| Accounts payable and accrued expenses | (123.3) | (241.7) |
| Deferred revenue | 29.1 | (2.5) |
| Income and other taxes payable | 84.3 | (37.3) |
| Other assets and liabilities | (1.5) | 3.4 |
| Total adjustments | 322.1 | 45.6 |
| Net cash provided by operating activities | 218.6 | 100.4 |
| **Cash Flows From Investing Activities:** | | |
| Additions to property and equipment | (29.2) | (22.8) |
| Additions to product rights and other intangibles | (2.2) | (1.8) |
| Proceeds from sales of property and equipment | 1.1 | 1.9 |
| Proceeds from sales of marketable securities and other investments | - | 2.5 |
| Acquisition of business, net of cash acquired | (141.3) | (384.1) |
| Net cash used in investing activities | (171.6) | (404.3) |
| **Cash Flows From Financing Activities:** | | |
| Proceeds from borrowings on credit facility | 75.0 | 375.0 |
| Principal payments on debt | (97.1) | (60.0) |
| Proceeds from stock plans | 3.2 | 3.8 |
| Payment of contingent consideration | (4.4) | (43.5) |
| Repurchase of common stock | (21.9) | (11.4) |
| Acquisition of noncontrolling interest | (9.2) | (4.0) |

| | | | | |
|---|---|---|---|---|
| Excess tax benefit from stock-based compensation | | 11.9 | | 6.2 |
| Net cash provided by (used in) financing activities | | (42.5) | | 266.1 |
| Effect of currency exchange rate changes on cash and cash equivalents | | 4.9 | | (2.8) |
| Net increase (decrease) in cash and cash equivalents | | 9.4 | | (40.6) |
| Cash and cash equivalents at beginning of period | | 319.0 | | 209.3 |
| Cash and cash equivalents at end of period | $ | 328.4 | $ | 168.7 |

*See accompanying Notes to Condensed Consolidated Financial Statements.*

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# ACTAVIS, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 GENERAL

On the close of business January 24, 2013, the Company was renamed to Actavis, Inc. and began trading under its new symbol ACT on the New York Stock Exchange.

Actavis, Inc. ( Actavis, Company, or We ) is an integrated global specialty pharmaceutical company engaged in the development, manufacturing, marketing, sale and distribution of generic and brand pharmaceutical products. Through its third-party business within the Actavis Pharma segment, Actavis out-licenses generic pharmaceutical products rights developed or acquired by the Company, primarily in Europe. Actavis is also developing biosimilar products within the Actavis Specialty Brands segment. Additionally, we distribute generic and certain select brand pharmaceutical products manufactured by third parties through our Anda Distribution segment. Our largest market is the United States of America ( U.S. ), followed by our key international markets including Europe, Canada, Australia, Southeast Asia, South America and South Africa.

The accompanying condensed consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2012. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles ( GAAP ) have been condensed or omitted from the accompanying condensed consolidated financial statements. The accompanying year end condensed consolidated balance sheet was derived from the audited financial statements. The accompanying interim financial statements are unaudited, but reflect all adjustments which are, in the opinion of management, necessary for a fair statement of Actavis consolidated financial position, results of operations and cash flows for the periods presented. Unless otherwise noted, all such adjustments are of a normal, recurring nature. The Company s results of operations and cash flows for the interim periods are not necessarily indicative of the results of operations and cash flows that it may achieve in future periods.

*Acquisition of Uteron Pharma, SA*

On January 23, 2013, the Company completed the acquisition of Belgium-based Uteron Pharma, SA. The acquisition was consummated for a cash payment of $142.0 million, plus assumption of debt and other liabilities of $7.7 million, and up to $155.0 million in potential milestone payments. The acquisition expands our Specialty Brands pipeline of Women s Health products including two potential near term commercial opportunities in contraception and infertility, and one oral contraceptive project expected to launch by 2018. Several additional products in earlier stages of development are also included in the acquisition. For additional information on the Uteron acquisition, refer to Note 2 Acquisitions and Divestitures.

*Acquisition of Actavis Group*

On October 31, 2012, Actavis, Inc. completed the acquisition of the Actavis Group. The acquisition was consummated for a cash payment of 4.2 billion, or approximately $5.5 billion, and a contingent consideration payment in the form of 5.5 million newly issued shares of Actavis, Inc. common stock. Actavis Group was a privately held generic pharmaceutical company specializing in the development, manufacture and sale of generic pharmaceuticals. Actavis Group s results are included in the Actavis Pharma and Actavis Specialty Brands segments as of the acquisition date. For additional information on the Actavis Group acquisition, refer to Note 2 Acquisitions and Divestitures.

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*Business Development*

On April 5, 2013, the Company and Valeant Pharmaceuticals International, Inc. entered into an agreement for Actavis to be the exclusive marketer and distributor of the authorized generic version of Valeant s Zovirax® ointment (acyclovir 5%) product. Under the terms of the agreement, Valeant will supply Actavis with a generic version of Valeant s Zovirax® ointment product and Actavis will market and distribute the product in the United States. Actavis will record all of the net sales of the generic ointment product and Valeant will receive a share of the economics. Additionally, Valeant granted Actavis the exclusive right to co-promote Zovirax® cream (acyclovir 5%) to obstetricians and gynecologists in the U.S. and Actavis has granted Valeant the exclusive right to co-promote Actavis Specialty Brands Cordran® Tape (flurandrenolide) product in the U.S. Under terms of the agreement related to the co-promotion of Zovirax® cream, Actavis will utilize its existing Specialty Brands sales and marketing structure to promote the product and will receive a co-promotion fee from sales generated by prescriptions written by its defined targeted physician group. Under the terms of the Cordran® Tape co-promotion agreement, Valeant will utilize its existing Dermatology sales and marketing structure to promote the product, and will receive a co-promotion fee on sales.

*Agreements*

The Company entered into an exclusive agreement with Ortho-McNeil-Janssen Pharmaceuticals, Inc. ( OMJPI ) to market the authorized generic version of Concerta® (methylphenidate ER). Under the terms of the agreement, OMJPI supplies Actavis with product. Actavis launched its authorized generic of Concerta® on May 1, 2011.

Under the terms of its agreement with OMJPI, the Company pays a royalty to OMJPI based on the gross profit of product revenues as defined in the agreement. During 2012, the royalty payable to OMJPI ranged from 50% to 55% of sales. This royalty includes the cost of the product supplied by OMJPI. Our royalty payable on sales of methylphenidate ER declines when a third party competitor launches a competing bioequivalent product. The change in royalty is a one-time event and is applied on a strength-by-strength basis following the launch of the first third-party generic competitor. Generic version of the 27mg strength was launched by a third-party competitor in January 2013 and of the 36mg and 54mg strengths in March 2013, triggering a decline in royalty on these strengths. Accordingly, for the 27mg and the 36mg and 54mg strengths, commencing in January 2013 and March 2013, respectively, the royalty payable to OMJPI is approximately 30% of sales, which includes the cost of the product supplied by OMJPI. The royalty on the 18mg strength will remain at approximately 50% until a competitive launch occurs, at which point the royalty rate will be reduced to approximately 30%. The agreement with OMJPI expires on December 31, 2014 and is subject to normal and customary early termination provisions.

*Common Stock*

As of March 31, 2013 and December 31, 2012, there were 500.0 million shares of $0.0033 par value per common stock authorized, 138.2 million and 138.0 million shares issued and 127.7 million and 127.7 million shares outstanding, respectively. Of the issued shares, 10.5 million and 10.3 million shares were held as treasury shares as of March 31, 2013 and December 31, 2012, respectively.

*Revenue Recognition*

Revenue is generally realized or realizable and earned when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller s price to the buyer is fixed or determinable, and collectability is reasonably assured. The Company records revenue from product sales when title and risk of ownership have been transferred to the customer, which is typically upon delivery to the customer. Revenues recognized from research, development and licensing agreements (including milestone payments) are recorded on the contingency-adjusted performance model which requires deferral of revenue until such time as contract milestone requirements, as specified in the individual agreements, have been met. Under this model, revenue

related to each payment is recognized over the entire contract performance period, starting with the contract s commencement, but not prior to earning and/or receiving the milestone payment (i.e., removal of any contingency). The amount of revenue recognized is based on the ratio of costs incurred to date to total estimated cost to be incurred. In certain circumstances, it may be appropriate to recognize consideration that is contingent upon achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. Royalty and commission revenue is recognized in accordance with the terms of their respective contractual agreements when collectability is reasonably assured and revenue can be reasonably measured.

*Revenue and Provision for Sales Returns and Allowances*

As customary in the pharmaceutical industry, the Company s gross product sales are subject to a variety of deductions in arriving at reported net product sales, most significantly in the U.S. When the Company recognizes revenue from the sale of products, an estimate of sales returns and allowances ( SRA ) is recorded, which reduces product sales. Accounts receivable and/or accrued expenses are also reduced and/or increased by the SRA amount. These adjustments include estimates for chargebacks, rebates, cash discounts and returns and other allowances. These provisions are estimated based on historical payment experience, historical relationship to revenues, estimated customer inventory levels and current contract sales terms with direct and indirect customers. The estimation process used to determine our SRA provision has been applied on a consistent basis and no material adjustments have been necessary to increase or decrease our reserves for SRA as a result of a significant change in underlying estimates. The Company uses a variety of methods to assess the adequacy of our SRA reserves to ensure that our financial statements are fairly stated. This includes periodic reviews of customer inventory data, customer contract programs and product pricing trends to analyze and validate the SRA reserves.

The provision for chargebacks is our most significant sales allowance. A chargeback represents an amount payable in the future to a wholesaler for the difference between the invoice price paid to the Company by our wholesale customer for a particular product and the negotiated contract price that the wholesaler s customer pays for that product. The Company s chargeback provision and related reserve vary with changes in product mix, changes in customer pricing and changes to estimated wholesaler inventories. The provision for chargebacks also takes into account an estimate of the expected wholesaler sell-through levels to indirect customers at contract prices. The Company validates the chargeback accrual quarterly through a review of the inventory reports obtained from our largest wholesale customers. This customer inventory information is used to verify the estimated liability for future chargeback claims based on historical chargeback and contract rates. These large wholesalers represent 85% - 90% of the Company s chargeback payments. The Company continually monitors current pricing trends and wholesaler inventory levels to ensure the liability for future chargebacks is fairly stated.

Net revenues and accounts receivable balances in the Company s consolidated financial statements are presented net of SRA estimates. Certain SRA balances are included in accounts payable and accrued expenses. Accounts receivable are presented net of SRA balances of $942.8 and $814.3 million at March 31, 2013 and December 31, 2012, respectively. SRA balances in accounts receivable at March 31, 2013 increased $128.5 million compared to December 31, 2012 primarily due to an increase in shelf stock, promotions and other allowances mainly resulting from higher sales volumes of certain products ($63.0 million), an increase in sales returns accruals primarily resulting from the launch of new products ($15.8 million) and higher annual rebate accruals on certain large wholesale customer accounts ($19.7 million). SRA balances in accounts payable and accrued expenses were $579.3 million and $634.4 million at March 31, 2013 and December 31, 2012, respectively. SRA balances in accounts payable and accrued expenses at March 31, 2013 decreased $55.1 million compared to December 31, 2012 primarily due to higher indirect rebate payments.

*Comprehensive Income (Loss)*

Comprehensive income (loss) includes all changes in equity during a period except those that resulted from investments by or distributions to the Company s stockholders. Other comprehensive income (loss) refers to revenues, expenses, gains and losses that, under GAAP, are included in comprehensive income (loss), but excluded from net income as these amounts are recorded directly as an adjustment to stockholders equity. Actavis other comprehensive income (loss) is composed of unrealized gains (losses) on certain holdings of publicly traded equity securities, net of realized gains (losses) included in net income, net of tax and foreign currency translation adjustments.

*Earnings Per Share ( EPS )*

Basic EPS is computed by dividing net income by the weighted average common shares outstanding during a period. Diluted EPS is based on the treasury stock method and includes the effect from potential issuance of common stock, such as shares issuable pursuant to the exercise of stock options, assuming the exercise of all in-the-money stock options and restricted stock units. Common share equivalents have been excluded where their inclusion would be anti-dilutive.

A reconciliation of the numerators and denominators of basic and diluted EPS consisted of the following (in millions, except per share amounts):

| | Three months ended March 31, | |
|---|---|---|
| | **2013** | **2012** |
| **EPS - basic** | | |
| Net income (loss) attributable to common shareholders | $ (102.8) | $ 54.8 |
| Basic weighted average common shares outstanding | 130.2 | 125.3 |
| EPS - basic | $ (0.79) | $ 0.44 |
| **EPS - diluted** | | |
| Net income (loss) attributable to common shareholders | $ (102.8) | $ 54.8 |
| Basic weighted average common shares outstanding | 130.2 | 125.3 |
| Effect of dilutive securities: | | |
| Dilutive stock awards | - | 1.9 |
| Diluted weighted average common shares outstanding | 130.2 | 127.2 |
| EPS - diluted | $ (0.79) | $ 0.43 |

Awards to purchase 2.2 million and 0.1 million common shares for the three month periods ended March 31, 2013 and 2012, respectively, were outstanding but were not included in the computation of diluted earnings per share because they were anti-dilutive. As of December 31, 2012, the estimated number of shares contingently issuable in connection with the Actavis Group earn-out was calculated to be 3,850,000 shares and are included in the basic weighted average common shares outstanding for the three month period ended March 31, 2013. On March 28, 2013, based on further evaluation, the decision was made to award the remaining 1,650,000 shares. The 1,650,000 additional shares are included in the basic weighted average common shares outstanding for the three month period ended March 31, 2013 beginning on March 28, 2013. The additional 1,650,000 shares are not included in the computation of diluted earnings per share as of the beginning of the current year period because they were anti-dilutive.

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*Share-Based Compensation*

The Company recognizes compensation expense for all share-based compensation awards made to employees and directors based on estimated fair values. Share-based compensation expense recognized during a period is based on the value of the portion of share-based awards that are expected to vest with employees. Accordingly, the recognition of share-based compensation expense has been reduced for estimated future forfeitures. These estimates will be revised in future periods if actual forfeitures differ from the estimates. Changes in forfeiture estimates impact compensation expense in the period in which the change in estimate occurs.

As of March 31, 2013, the Company had $94.1 million of total unrecognized compensation expense, net of estimated forfeitures, which will be recognized over the remaining weighted average period of 3.0 years. During the three months ended March 31, 2013, the Company issued approximately 730,740 restricted stock grants and performance awards with an aggregate intrinsic value of $63.5 million. Certain restricted stock units are performance-based awards issued at a target number, subject to adjustments up or down based upon achievement of certain financial targets. During the three months ended March 31, 2013, the Company issued 225,000 stock option grants with an aggregate fair value of $4.9 million.

*Recent Accounting Pronouncements*

In February 2013, the FASB issued guidance that supersedes the presentation requirements for reclassifications out of accumulated other comprehensive income. The new guidance requires entities to separately provide information about the effects on net income of significant amounts reclassified out of each component of accumulated other comprehensive income if those amounts are required to be reclassified to net income in their entirety in the same reporting period. This information is to be provided, in one location, in either the face of the statement where net income is presented or as a separate disclosure in the notes to the financial statements. This guidance is effective for fiscal years beginning after December 15, 2013 and interim and annual periods thereafter. The adoption of this guidance did not have any impact on the Company s consolidated financial statements.

In March 2013, the FASB issued clarifying guidance for the release of the cumulative translation adjustment in other comprehensive income when an entity ceases to have a controlling financial interest in the subsidiary or group of assets that is a nonprofit activity or a business *within* a foreign entity. This guidance is effective prospectively for fiscal years, and interim reporting periods within those years, beginning after December 15, 2013. The adoption of this guidance did not have any impact on the Company s consolidated financial statements.

## NOTE 2 ACQUISITIONS AND DIVESTITURES

Business acquisitions occurring during 2013 and updates to 2012 business acquisitions were as follows:

***Acquisition of the Uteron Pharma, SA***

On January 23, 2013, the Company completed the acquisition of Uteron Pharma, SA for approximately $142.0 million in cash, plus assumption of debt and other liabilities of $7.7 million and up to $155.0 million in potential future milestone payments. The acquisition expands our Specialty Brands pipeline of Women s Health products including two potential near term commercial opportunities in contraception and infertility, and one oral contraceptive project projected to launch by 2018. Several additional products in earlier stages of development are also included in the acquisition.

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*Recognition and Measurement of Assets Acquired and Liabilities Assumed at Fair Value*

The transaction has been accounted for using the acquisition method of accounting. This method requires, among other things, that assets acquired and liabilities assumed in a business combination be recognized at their fair values as of the acquisition date and that in-process research and development ( IPR&D ) be recorded at fair value on the balance sheet regardless of the likelihood of success of the related product or technology.

The following table summarizes the preliminary fair values of the tangible and identifiable intangible assets acquired and liabilities assumed at acquisition date, with the excess being allocated to goodwill. At March 31, 2013, certain amounts have not been finalized including intangible asset values, uncertain tax positions, as well as evaluation of contingencies. The finalization of these matters may result in changes to the goodwill and the Company expects to finalize such matters in the second half of 2013.

| (in millions) | Amount |
|---|---|
| Accounts receivable | $ 1.6 |
| Other current assets | 1.2 |
| Property, plant & equipment | 5.7 |
| Other long term assets | 0.5 |
| IPR&D intangible assets | 250.0 |
| Goodwill | 24.3 |
| Current liabilities, excluding current portion of debt | (7.7) |
| Long-term deferred tax and other tax liabilities | (82.5) |
| Contingent consideration | (43.4) |
| Debt | (5.2) |
| Other long term liabilities | (2.5) |
| Net assets acquired | $ 142.0 |

*IPR&D*

IPR&D intangible assets represent the value assigned to product acquired R&D projects that, as of the acquisition date had not established technological feasibility and had no alternative future use. The IPR&D intangible assets are capitalized and accounted for as indefinite-lived intangible assets and will be subject to impairment testing until completion or abandonment of the projects. Upon successful completion of each project and launch of the product, the Company will make a separate determination of useful life of the IPR&D intangible assets and the related amortization will be recorded as an expense over the estimated useful life.

The fair value of the IPR&D intangible assets was determined using the income approach, which is a valuation technique that provides an estimate of the fair value of an asset based on market participant expectations of the cash flows an asset would generate over its remaining useful life. Some of the more significant assumptions inherent in the development of those asset valuations include the estimated net cash flows for each year for each asset or product (including net revenues, cost of sales, research and development costs, selling and marketing costs and working capital/asset contributory asset charges), the appropriate discount rate to select in order to measure the risk inherent in each future cash flow stream, the assessment of each asset s life cycle, competitive trends impacting the asset and each cash flow stream as well as other factors. The discount rates used to arrive at the present value of IPR&D intangible assets as of the acquisition date was 22% to reflect the internal rate of return and incremental commercial uncertainty in the cash flow projections. No assurances can be given that the underlying assumptions used to prepare the discounted cash flow analysis will not change. For these and other reasons, actual results may vary significantly from estimated results.

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*Contingent Consideration*

Additional consideration is due to the seller conditional upon the achievement of certain milestones in respect to the development and commercialization of the products as well as reaching certain sales targets. The Company estimated the fair value of the contingent consideration to be $43.4 million using a probability weighting approach that considered the possible outcomes based on assumptions related to the timing and probability of the product launch date, discount rates matched to the timing of first payment, and probability of success rates and discount adjustments on the related cash flows.

*Long-Term Deferred Tax Liabilities and Other Tax Liabilities*

Long-term deferred tax liabilities and other tax liabilities result from identifiable intangible assets fair value adjustments. These adjustments create excess book basis over the tax basis which is multiplied by the statutory tax rate for the jurisdiction in which the deferred taxes exist.

*Acquisition-Related Expenses*

Included in general and administrative expenses for the three months ended March 31, 2013 are costs totaling $3.3 million for acquisition costs including advisory, legal, and regulatory in connection with the Uteron acquisition.

*Unaudited Pro Forma Results of Operations*

Pro forma results of operations have not been presented because the effect of the acquisition was not material.

***Acquisition of Actavis Group***

On October 31, 2012, the Company acquired the Actavis Group, in exchange for the following consideration:

- A cash payment of 4,219.7 million, or approximately $5,469.8 million, subject to net working capital adjustment;
- Contingent consideration of 5.5 million newly issued shares of Common Stock, $0.0033 par value per share, of the Company stock ( Common Shares ) based on Actavis financial performance in 2012 as described in the purchase agreement.

The Actavis Group was a privately held generic pharmaceutical company specializing in the development, manufacture and sale of generic pharmaceuticals. With the acquisition, Actavis significantly expands its international market presence in established markets including Europe (Europe, Russia, Commonwealth of Independent States (CIS) and Turkey), and MEAAP (Middle East, Africa, Australia and Asia Pacific). In addition, the acquisition expands the Company s product portfolio and pipeline in modified release, solid oral dosage and transdermal products into semi-solids, liquids and injectables. Actavis results are included in the Actavis Pharma and Actavis Brands segments as of the acquisition date.

The Company funded the cash portion of the transaction through a combination of term loan borrowings and senior unsecured notes. For additional information, refer to Note 6 Debt.

*Recognition and Measurement of Assets Acquired and Liabilities Assumed at Fair Value*

The transaction has been accounted for using the acquisition method of accounting. This method requires, among other things, that assets acquired and liabilities assumed in a business combination be recognized at their fair values as of the acquisition date and that in-process research and development ( IPR&D ) be recorded at fair value on the balance sheet regardless of the likelihood of success of the related product or technology.

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The following table summarizes the preliminary fair values of the tangible and identifiable intangible assets acquired and liabilities assumed at acquisition date, with the excess being allocated to goodwill. During the quarter ended March 31, 2013, further adjustments were made to the preliminary amounts recorded in the prior year in connection with the acquisition of the Actavis Group primarily related to working capital, intangible assets and deferred taxes. These adjustments are reflected in the values presented below and in our revised December 31, 2012 balance sheet. At March 31, 2013, certain amounts have not been finalized including intangible asset values, uncertain tax positions as well as evaluation of contingencies pending the finalization of the Company s evaluation of certain matters in connection with historical rebate programs. The finalization of these matters may result in changes to the goodwill and the Company expects to finalize such matters in the second half of 2013.

| (in millions) | Amount |
|---|---|
| Cash and cash equivalents | $ 110.5 |
| Accounts receivable | 527.9 |
| Inventories | 680.1 |
| Other current assets | 285.1 |
| Property, plant & equipment | 763.0 |
| Other long term assets | 16.9 |
| IPR&D intangible assets | 272.9 |
| Intangible assets | 2,254.8 |
| Goodwill | 2,904.2 |
| Current liabilities | (1396.1) |
| Long-term deferred tax and other liabilities | (737.5) |
| Other long term liabilities | (176.0) |
| Long-term debt | (14.1) |
| Minority interest | (21.9) |
| Net assets acquired | $ 5,469.8 |

*Inventories*

The fair value of inventories acquired included a step-up in the value of inventories of approximately $137.3 million. Approximately $44.1 million was amortized to cost of sales during 2012, and the remaining $93.5 million was amortized to cost of sales during the first quarter of 2013.

*IPR&D and Intangible Assets*

IPR&D intangible assets represent the value assigned to product acquired R&D projects that, as of the acquisition date, were expected to be approved for marketing over the next one to two years, had not established technological feasibility and had no alternative future use. The IPR&D intangible assets are capitalized and accounted for as indefinite-lived intangible assets and will be subject to impairment testing until completion or abandonment of the projects. Upon successful completion of each project and launch of the product, the Company will make a separate determination of useful life of the IPR&D intangible assets and the related amortization will be recorded as an expense over the estimated useful life. Intangible assets represent product rights, trademarks, customer relationships and technology rights and have an estimated weighted average useful life of 8.7 years.

The fair value of the IPR&D and identifiable intangible assets was determined using the income approach, which is a valuation technique that provides an estimate of the fair value of an asset based on market participant expectations of the cash flows an asset would generate over its remaining useful life. Some of the more significant assumptions inherent in the development of those asset valuations include the estimated net cash flows for each year for each asset or product (including net revenues, cost of sales, research and development costs, selling and marketing costs and working capital/asset contributory asset charges), the appropriate discount rate to select in order to measure the risk inherent in each future cash flow stream, the assessment of each asset s life cycle, competitive trends impacting the asset and each cash flow stream as well as other factors. The discount rates used to arrive at the present value of product right intangible assets as of the acquisition date ranged from 8.8% to

11.5% to reflect the internal rate of return and incremental commercial uncertainty in the cash flow projections. No assurances can be given that the underlying assumptions used to prepare the discounted cash flow analysis will not change. For these and other reasons, actual results may vary significantly from estimated results.

*Goodwill*

Among the primary reasons the Company acquired the Actavis Group and factors that contributed to the preliminary recognition of goodwill were a strong commercial presence on an expanded global basis. In addition, the acquisition expands the Company s product portfolio and pipeline in modified release, solid oral dosage and transdermal products into semi-solids, liquids and injectables. The goodwill recognized from the Actavis Group acquisition is not deductible for tax purposes. Goodwill from the Actavis Group acquisition was assigned to the Actavis Pharma and Actavis Specialty Brands segments.

*Contingent Consideration*

At December 31, 2012, the Company estimated the Actavis Group earn-out to be 3,850,000 shares. On March 28, 2013, based on further evaluation, the decision was made to award the remaining 1,650,000 contingent shares. Accordingly, during the first quarter, the Company recorded expense of approximately $150.3 million for contingent consideration as a result of the decision to award all remaining contingent shares.

*Long-Term Deferred Tax Liabilities and Other Tax Liabilities*

Long-term deferred tax liabilities and other tax liabilities result from identifiable intangible assets fair value adjustments. These adjustments create excess book basis over the tax basis which is multiplied by the statutory tax rate for the jurisdiction in which the deferred taxes exist.

*Acquisition-Related Expenses*

Included in general and administrative expenses for the three months ended March 31, 2013 are costs totaling $9.0 million for acquisition and integration costs including advisory, legal, and regulatory in connection with the Actavis Group acquisition.

*Unaudited Pro Forma Results of Operations*

The following table presents the unaudited pro forma consolidated operating results for the Company, as though the Actavis Group acquisition had occurred as of the beginning of the prior annual reporting period. The unaudited pro forma results reflect certain adjustments related to past operating performance, acquisition costs and acquisition accounting adjustments, such as increased depreciation and amortization expense based on the fair valuation of assets acquired, the impact of acquisition financing in place at January 1, 2012 and the related tax effects. The pro forma results do not include any anticipated synergies which may be achievable subsequent to the acquisition date. Accordingly, such pro forma amounts are not necessarily indicative of the results that actually would have occurred had the acquisition been completed on the dates indicated, nor are they indicative of the future operating results of the combined company (in millions, except per share amounts):

| | (Unaudited) Three Months Ended March 31, 2012 |
|---|---|
| Net revenues | $ 2,799.9 |
| Net income attributable to common shareholders | 4.7 |
| Earnings (loss) per share: | |
| Basic | $ 0.04 |
| Diluted | $ 0.04 |

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## NOTE 3 REPORTABLE SEGMENTS

Actavis has three reportable segments: Actavis Pharma, Actavis Specialty Brands and Anda Distribution. The Actavis Pharma segment includes off-patent pharmaceutical products that are therapeutically equivalent to proprietary products. The Actavis Specialty Brands segment includes patent-protected products and certain trademarked off-patent products that Actavis sells and markets as brand pharmaceutical products. The Anda Distribution segment mainly distributes generic pharmaceutical products manufactured by third parties, as well as by Actavis, primarily to independent pharmacies, pharmacy chains, pharmacy buying groups and physicians offices. The Anda Distribution segment operating results exclude sales of products developed, acquired, or licensed by the Actavis Pharma and Actavis Specialty Brands segments.

The Company evaluates segment performance based on segment contribution. Segment contribution represents segment net revenues less cost of sales (excluding amortization), R&D expenses and selling and marketing expenses. The Company does not report total assets, capital expenditures, corporate general and administrative expenses, amortization, gains or losses on asset sales or disposals and impairments by segment as not all such information has been accounted for at the segment level, nor is such information used by all segments.

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Segment net revenues, segment operating expenses and segment contribution information for the Company s Actavis Pharma, Actavis Specialty Brands and Anda Distribution segments consisted of the following (in millions):

| | Three Months Ended March 31, 2013 | | | | Three Months Ended March 31, 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| | Actavis Pharma | Actavis Specialty Brands | Anda Distribution | Total | Actavis Pharma | Actavis Specialty Brands | Anda Distribution | Total |
| Product sales | $ 1,524.1 | $ 116.2 | $ 231.0 | $ 1,871.3 | $ 1,108.0 | $ 92.9 | $ 298.6 | $ 1,499.5 |
| Other | 9.7 | 14.5 | - | 24.2 | 8.1 | 16.7 | - | 24.8 |
| Net revenues | 1,533.8 | 130.7 | 231.0 | 1,895.5 | 1,116.1 | 109.6 | 298.6 | 1,524.3 |
| Operating expenses: | | | | | | | | |
| Cost of sales(1) | 861.9 | 29.8 | 194.5 | 1,086.2 | 614.2 | 25.8 | 264.3 | 904.3 |
| Research and development | 98.8 | 33.3 | - | 132.1 | 56.1 | 32.4 | - | 88.5 |
| Selling and marketing | 159.3 | 43.6 | 24.3 | 227.2 | 47.5 | 47.7 | 22.9 | 118.1 |
| Contribution | $ 413.8 | $ 24.0 | $ 12.2 | $ 450.0 | $ 398.3 | $ 3.7 | $ 11.4 | $ 413.4 |
| Contribution margin | 27.0% | 18.4% | 5.3% | 23.7% | 35.7% | 3.4% | 3.8% | 27.1% |
| General and administrative | | | | 185.8 | | | | 164.4 |
| Amortization | | | | 158.4 | | | | 131.9 |
| Loss on asset sales, impairments and contingent consideration adjustment, net | | | | 148.0 | | | | 0.2 |
| Operating income (loss) | | | | $ (42.2) | | | | $ 116.9 |
| Operating margin | | | | -2.2% | | | | 7.7% |

(1) Excludes amortization of acquired intangibles including product rights.

## NOTE 4 INVENTORIES

Inventories consist of finished goods held for sale and distribution, raw materials and work-in-process. Included in inventory at March 31, 2013 and December 31, 2012 is approximately $59.2 million and $49.7 million, respectively, of inventory that is pending approval by the U.S. Food and Drug Administration ( FDA ), by other regulatory agencies or has not been launched due to contractual restrictions. This inventory consists of generic pharmaceutical products that are capitalized only when the bioequivalence of the product is demonstrated or the product has already received regulatory approval and is awaiting a contractual triggering event to enter the marketplace.

Inventories are stated at the lower of cost (first-in, first-out method) or market (net realizable value). The Company writes down inventories to net realizable value based on forecasted demand and market conditions, which may differ from actual results. Inventory consisted of the following (in millions):

| | March 31, 2013 | December 31, 2012 (Revised) |
|---|---|---|
| **Inventories:** | | |

| | | |
|---|---|---|
| Raw materials | $ 451.8 | $ 426.9 |
| Work-in-process | 129.3 | 126.2 |
| Finished goods | 1,067.2 | 1,104.6 |
| | 1,648.3 | 1,657.7 |
| Less: Inventory reserves | (104.0) | (111.2) |
| | $ 1,544.3 | $ 1,546.5 |

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## NOTE 5 GOODWILL AND INTANGIBLE ASSETS

Goodwill consisted of the following (in millions):

| | March 31, 2013 | December 31, 2012 (Revised) |
|---|---|---|
| Actavis Pharma segment | $ 4,253.5 | $ 4,293.2 |
| Actavis Specialty Brands segment | 497.7 | 474.7 |
| Anda Distribution segment | 86.3 | 86.3 |
| Total goodwill | $ 4,837.5 | $ 4,854.2 |

Intangible assets consisted of the following (in millions):

| | March 31, 2013 | December 31, 2012 (Revised) |
|---|---|---|
| Intangibles with definite lives: | | |
| Product rights and other related intangibles | $ 5,273.0 | $ 5,117.6 |
| Core technology | 91.0 | 92.2 |
| Customer relationships | 164.5 | 169.0 |
| | 5,528.5 | 5,378.8 |
| Less: accumulated amortization | (2,239.3) | (2,055.3) |
| | 3,289.2 | 3,323.5 |
| Intangibles with indefinite lives: | | |
| IPR&D | 432.9 | 384.6 |
| Trade Name | 76.2 | 76.2 |
| | 509.1 | 460.8 |
| Total intangible assets, net | $ 3,798.3 | $ 3,784.3 |

The increase in in-process research and development ( IPR&D ) in 2013 is primarily due to IPR&D of $250.0 million acquired as part of the Uteron acquisition partially offset by IPR&D transfers to currently marketed products ( CMP ) of $181.9 million and foreign currency translation losses.

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## NOTE 6 DEBT

Debt consisted of the following (in millions):

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Senior Notes, | | |
| $450.0 million 5.00% notes due August 14, 2014 | $ 450.0 | $ 450.0 |
| $1,200.0 million 1.875% notes due October 1, 2017 | 1,200.0 | 1,200.0 |
| $400.0 million 6.125% notes due August 14, 2019 | 400.0 | 400.0 |
| $1,700.0 million 3.250% notes due October 1, 2022 | 1,700.0 | 1,700.0 |
| $1,000.0 million 4.625% notes due October 1, 2042 | 1,000.0 | 1,000.0 |
| Less: Unamortized discount | (34.4) | (35.1) |
| Senior Notes, net | 4,715.6 | 4,714.9 |
| Term Loan Credit Agreement | 1,657.5 | 1,700.0 |
| Revolving Credit Facility | 25.0 | - |
| Other, including capital leases | 23.4 | 18.4 |
| Total debt | 6,421.5 | 6,433.3 |
| Less: Current portion | 178.3 | 176.2 |
| Total long-term debt | $ 6,243.2 | $ 6,257.1 |

***Senior Notes***

*Senior Notes Issued in 2012*

On October 2, 2012, the Company issued $1,200.0 million aggregate principal amount of 1.875% senior notes due 2017, $1,700.0 million aggregate principal amount of 3.250% senior notes due 2022, and $1,000.0 million aggregate principal amount of 4.625% senior notes due 2042 (collectively the 2012 Senior Notes ) in a registered offering pursuant to an effective Registration Statement on Form S-3 filed with the Securities and Exchange Commission ( SEC ). The 2012 Senior Notes were issued pursuant to an indenture dated as of August 24, 2009 (the Base Indenture ), between the Company and Wells Fargo Bank, National Association, as trustee (the Trustee ), as supplemented by a third supplemental indenture dated as of October 2, 2012, between the Company and the trustee.

Interest payments are due on the 2012 Senior Notes semi-annually in arrears on April 1 and October 1 beginning April 1, 2013.

The Company may redeem the 2012 Senior Notes, in whole at any time or in part from time to time, at the Company s option, at a redemption price equal to the greater of 100% of the principal amount of notes to be redeemed and the sum of the present values of the remaining scheduled payments of principal and interest in respect of the 2012 Senior Notes being redeemed discounted on a semi-annual basis at the Treasury Rate plus 20 basis points in the case of the 2017 Notes, 25 basis points in the case of the 2022 Notes and 30 basis points in the case of the 2042 Notes, plus in each case accrued and unpaid interest, if any, to, but excluding, the date of redemption.

In addition, the Company may redeem the 2022 Notes on or after July 1, 2022 (three months prior to their maturity date), and the 2042 Notes on or after April 1, 2042 (six months prior to their maturity date) in each case, in whole at any time or in part from time to time, at the Company s option at a redemption price equal to 100% of the aggregate principal amount of the 2012 Senior Notes being redeemed, plus, in each case, accrued and unpaid interest, if any, to, but excluding, the date of redemption.

Upon a change of control triggering event and a downgrade of the 2012 Senior Notes below an investment grade rating by each of Moody s Investors Service, Inc. and Standard & Poor s Rating Services, the Company will be required to make an offer to purchase each of the 2012 Senior Notes at a price equal to 101% of the principal amount of the 2012 Senior Notes to be repurchased, plus any accrued and unpaid interest, if any, to, but excluding, the date of repurchase.

Net proceeds from the offering of the 2012 Senior Notes were used for the acquisition of the Actavis Group. The outstanding balance under the 2012 Senior Notes at March 31, 2013 was $3,866.7 million.

*Senior Notes Issued in 2009*

On August 24, 2009, the Company issued $450.0 million aggregate principal amount of 5.00% senior notes due 2014 and $400.0 million aggregate principal amount of 6.125% senior notes due 2019 (collectively the 2009 Senior Notes ) pursuant to an effective Registration Statement on Form S-3 filed with the SEC. The Senior Notes issued in 2009 were issued pursuant to the Base Indenture, as supplemented by a first supplemental indenture dated August 24, 2009.

Interest payments are due on the 2009 Senior Notes semi-annually in arrears on February 15 and August 15, respectively, beginning February 15, 2010.

The Company may redeem the 2009 Senior Notes in whole at any time or in part from time to time, at the Company s option at a redemption price equal to the greater of (1) 100% of the principal amount of the notes to be redeemed and (2) the sum of the present values of the remaining scheduled payments of principal and interest in respect of the 2009 Senior Notes being redeemed, discounted on a semi-annual basis at the Treasury Rate plus 40 basis points, plus accrued and unpaid interest, if any, to, but excluding, the date of redemption.

Upon a change of control triggering event, as defined by the Indenture, the Company is required to make an offer to repurchase the 2009 Senior Notes for cash at a repurchase price equal to 101% of the principal amount of the 2009 Senior Notes to be repurchased plus accrued and unpaid interest to the date of purchase.

Net proceeds from the offering of 2009 Senior Notes were used to repay certain debt with the remaining net proceeds being used to fund a portion of the cash consideration for the Arrow acquisition. The outstanding balance under the 2012 Senior Notes at March 31, 2013 was $848.9 million.

***Term Loan Credit Agreement***

On June 22, 2012, the Company, Bank of America, N.A., as Administrative Agent, Wells Fargo Bank, N.A. as Syndication Agent, and a syndicate of banks participating as lenders entered into a senior unsecured Term Loan Credit Agreement (the Term Loan Credit Agreement ) pursuant to which the lenders agree to provide the Company a Term Loan in an aggregate amount not to exceed $1.8 billion. On October 31, 2012, the Company borrowed $1.8 billion under the Term Loan Credit Agreement to fund the Actavis Group acquisition. Debt related costs for the borrowing were $5.9 million, which the Company paid on the date of the borrowing. On December 10, 2012, the Company prepaid $100.0 million of the Term Loan Credit Agreement.

Borrowings under the Term Loan Credit Agreement are subject to several conditions, including (i) no Target Material Adverse Effect (as defined in the Term Loan Credit Agreement) having occurred, (ii) receipt of certain financial statements as more fully set forth in the Term Loan Credit Agreement, (iii) receipt of customary closing documents and (iv) other customary closing conditions more fully set forth in the Term Loan Credit Agreement. Borrowings under the Term Loan Credit Agreement will bear interest at the Company s choice of a per annum rate equal to either a base rate or Eurodollar rate, plus an applicable margin. The base rate is the higher

of (a) the Federal Funds Rate plus 0.50%, (b) the prime rate as publicly announced by the Administrative Agent or (c) the one-month London Interbank Offered Rate plus 1.00%. The applicable margin is a percentage determined in accordance with a pricing grid based on the Company s credit rating and is currently set at 0.50% for base rate loans and 1.50% for Eurodollar rate loans.

The Term Loan Credit Agreement will mature on the fifth anniversary of the closing date of the Actavis Group acquisition. The outstanding principal amount under the Term Loan Credit Agreement is payable in equal quarterly amounts of 2.50% per quarter prior to the fifth anniversary of the closing date of the Actavis Group acquisition (beginning with the quarter ending March 31, 2013), with the remaining balance payable on the maturity date. The Term Loan Credit Agreement contains covenants that are substantially similar to those in the Company s Revolving Credit Facility. The Term Loan Credit Agreement contains standard events of default (the occurrence of which may trigger an acceleration of amounts outstanding under the Term Loan Credit Agreement). The Term Loan Credit Agreement became effective in accordance with its terms on June 22, 2012. The Company is subject to, and, at March 31, 2013, was in compliance with, all financial and operational covenants under the terms of the Term Loan Credit Agreement. The outstanding balance of the Term Loan Credit Agreement at March 31, 2013 was $1,657.5 million.

***Amended Revolving Credit Facility***

On May 21, 2012, the Company entered into Amendment 1 to Credit Agreement and Joinder Agreement (the Amendment ) to the Company s existing credit agreement that closed on September 16, 2011, with Bank of America, N.A., as Administrative Agent, Wells Fargo Bank, N.A., as Syndication Agent, and a syndicate of banks establishing a senior unsecured revolving credit facility (as amended by the Agreement, the Revolving Credit Facility ). The Revolving Credit Facility provides an aggregate principal amount of $750.0 million in senior unsecured revolving loans. The revolving loans may be borrowed, repaid and re-borrowed through September 16, 2016 and, subject to certain minimum amounts, may be prepaid in whole or in part without premiums or penalties.

Committed borrowings under the Revolving Credit Facility bear interest at the Company s choice of a per annum rate equal to either a base rate or Eurocurrency rate, plus an applicable margin. The base rate is the higher of (a) the Federal Funds Rate plus 0.50%, (b) prime rate as publicly announced by the Administrative Agent, or (c) one-month London Interbank Offered Rate plus 1.00%. The applicable margin is a percentage determined in accordance with a pricing grid based on the Company s credit rating and is currently set at 0.25% for base rate loans and 1.25% for Eurocurrency rate loans. Additionally, to maintain availability of funds, the Company pays an unused commitment fee, which according to the pricing grid is set at 0.15% of the unused portion of the Revolving Credit Facility.

Subject to certain limitations, borrowings under the Revolving Credit Facility may be made in alternative currencies, including Euros, British Pounds Sterling and other currencies. The Revolving Credit Facility contains sublimits on letters of credit and swingline loans in the amount of $100.0 million and $50.0 million, respectively. The issuance of letters of credit and borrowings of swingline loans reduces the amount available to be borrowed under the Revolving Credit Facility on a dollar-for-dollar basis. Amounts borrowed under the Revolving Credit Facility may be used to finance working capital and other general corporate purposes.

The Revolving Credit Facility imposes certain customary restrictions including, but not limited to, limits on the incurrence of debt or liens upon the assets of the Company or its subsidiaries, investments and restricted payments. The Revolving Credit Facility includes a Consolidated Leverage Ratio covenant providing that the aggregate principal amount of Acquisition Indebtedness (as such term is defined in the Amendment) that includes a special mandatory redemption provision (or other similar provision) requiring the Company to redeem such Acquisition Indebtedness will be excluded for purposes of determining Consolidated Total Debt at any time prior to the proposed Actavis Group acquisition as more fully set forth in the Amendment. The Amendment also provides that (a) during the period prior to the date on which the Actavis Group acquisition is consummated (such date, the Acquisition Date ), the Company is permitted to have a maximum Consolidated Leverage Ratio as of the last date of any period of four consecutive fiscal quarters of the Company of up to 3.50 to 1.00, and (b) as of the Acquisition Date and thereafter the Company is permitted to have a maximum Consolidated Leverage Ratio as of the last day of any period of four consecutive fiscal quarters of the Company of up to (i) with respect

to the four consecutive fiscal quarters from the Acquisition Date through December 31, 2013, 4.25 to 1.00; (ii) with respect to the four consecutive fiscal quarters from January 1, 2014 through December 31, 2014, 4.00 to 1.00; and (iii) with respect to the period of four consecutive fiscal quarters ending from January 1, 2015 and thereafter, 3.50 to 1.00. To the extent litigation, settlement charges and unusual charges in each case which are paid in cash exceed 7.50% of the Company s net worth for the prior twelve month period for the most recent ended fiscal quarter, the Company would be subject to maintenance of a springing minimum net worth covenant not less than the sum of (x) 75% of the Company s consolidated net worth as of June 30, 2011 plus (y) 50% of the Company s consolidated net income (but not loss) for each fiscal quarter ending after June 30, 2011.

The Company is subject to, and, at March 31, 2013, was in compliance with, all financial and operational covenants under the terms of the Revolving Credit Facility. The Credit Agreement contains standard events of default (the occurrence of which may trigger an acceleration of amounts outstanding under the credit facilities). At March 31, 2013, loans and letters of credit outstanding were $25.0 million and $6.7 million, respectively. The net availability under the Revolving Credit Facility was $718.3 million.

***Fair Value of Debt Instruments***

As of March 31, 2013, the fair value of our Senior Notes was $171.1 million greater than the carrying value. Generally changes in market interest rates affect the fair value of fixed-rate debt, but do not impact earnings or cash flows. Accordingly, we believe the effect, if any, of reasonably possible near-term changes in the fair value of our debt would not be material on our financial condition, results of operations or cash flows.

## NOTE 7 INCOME TAXES

The Company s effective tax rate for the three months ended March 31, 2013 was (37.5%) compared to 43.6% for the three months ended March 31, 2012. The negative effective tax rate for the three months ended March 31, 2013, was due to certain non-deductible pre-tax expenses including consideration due to the former Actavis stakeholders of $150.3 million. This was partially offset by non-taxable pre-tax income of $15.0 million related to the Arrow acquisition. In addition, during the quarter the Company recorded a charge of $11.5 million relating to tax rate changes and a tax benefit of $5.0 million relating to the 2012 research credit. The Company s effective rate is also impacted by losses in certain foreign jurisdictions for which no tax benefit is provided and the amortization of intangible assets being tax benefited at a lower rate than the U.S. federal tax rate.

The Company conducts business globally and, as a result, it files federal, state and foreign tax returns. The Company strives to resolve open matters with each tax authority at the examination level and could reach agreement with a tax authority at any time. While the Company has accrued for amounts it believes are the probable outcomes, the final outcome with a tax authority may result in a tax liability that is more or less than that reflected in the condensed consolidated financial statements. Furthermore, the Company may later decide to challenge any assessments, if made, and may exercise its right to appeal. The uncertain tax positions are reviewed quarterly and adjusted as events occur that affect potential liabilities for additional taxes, such as lapsing of applicable statutes of limitations, proposed assessments by tax authorities, negotiations between tax authorities, identification of new issues and issuance of new legislation, regulations or case law. Management believes that adequate amounts of tax and related penalty and interest have been provided for any adjustments that may result from these uncertain tax positions.

With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations for years before 2008. In the first quarter of 2013, the Company resolved the 2007-2009 examination for Arrow s U.S. business, resulting in a reduction of the uncertain tax positions by $3.9 million with no impact on the effective tax rate. For the Company s 2008-2009 tax years, the IRS has agreed on all issues except the timing of the deductibility of certain litigation costs. The IRS is examining the 2009-2011 tax returns for Actavis pre-acquisition U.S. business. Additionally, the IRS has indicated that it will begin the examination of the Company s 2010-2011 tax years in the second quarter of 2013. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, the Company has accrued for amounts it believes are the likely outcomes.

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## NOTE 8 STOCKHOLDERS EQUITY

A summary of the changes in stockholders equity for the three months ended March 31, 2013 consisted of the following (in millions):

| | |
|---|---|
| Stockholders equity, December 31, 2012 | $ 3,833.8 |
| Common stock issued under employee plans | 3.2 |
| Increase in additional paid-in capital for share-based compensation plans | 12.2 |
| Net Income | (102.8) |
| Other comprehensive income | (128.5) |
| Tax benefit from employee stock plans | 11.9 |
| Repurchase of common stock | (21.9) |
| Acquisition of noncontrolling interest | (3.1) |
| Stockholders equity, March 31, 2013 | $ 3,604.8 |

## NOTE 9 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company s revenue, earnings, cash flows and fair value of its assets and liabilities can be impacted by fluctuations in foreign exchange risks and interest rates. The Company manages the impact of foreign exchange risk and interest rate movements through operational means and through the use of various financial instruments, including derivative instruments such as foreign currency contracts.

*Foreign Currency Forward Contracts*

As a result of the Actavis Group acquisition, the Company s exposure to foreign exchange fluctuations has increased. The Company has entered into foreign currency forward contracts to mitigate volatility in anticipated foreign currency cash flows resulting from changes in foreign currency exchange rates, primarily associated with non-functional currency denominated revenues and expenses of foreign subsidiaries. The foreign currency forward contracts outstanding at March 31, 2013 have settlement dates within 12 months. These foreign currency forward contracts are not accounted for as hedges and any unrealized gains or losses are recognized in income during the period. The impact of the forward contracts increased other income and expense by $0.3 million for the quarter ended March 31, 2013. The forward contracts are classified in the condensed consolidated balance sheet in accounts payable and other expenses.

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The foreign currency forward contracts to buy/sell Euros with the foreign currencies noted below at March 31, 2013 were as follows:

| | Notional Amount | |
|---|---|---|
| Foreign Currency | Buy | Sell |
| Czech Republic Koruna | 3.5 | - |
| Great Britain Pound | 6.8 | - |
| Hungarian Forint | 0.9 | - |
| New Zealand Dollar | 0.8 | - |
| Norwegian Krone | 3.6 | - |
| Polish Zloty | 9.9 | - |
| Romanian Leu | - | 6.0 |
| Swedish Krona | 15.9 | - |
| | 41.4 | 6.0 |

## NOTE 10 FAIR VALUE MEASUREMENT

Fair value is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants. Fair values determined based on Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Fair values determined based on Level 2 inputs utilize observable quoted prices for similar assets and liabilities in active markets and observable quoted prices for identical or similar assets in markets that are not very active. Fair values determined based
ONT>13,172 10,077 -87.3% 30.7%

Operating profit

486,618 427,729 416,361

Interest expense

41,753 44,639 48,709 -6.5% -8.4%

Other expense, net

1,450 9,544 8,059 -84.8% 18.4%

Income before taxes

443,415 373,546 359,593

Taxes on income

189,281 106,680 96,036 77.4% 11.1%

Net income

$254,134 $266,866 $263,557

Net income per share diluted

$3.09 $3.26 $3.26 -5.0% -0.1%

Gross margin

41.7% 39.6% 41.7% 210.0 -210.0

R&D as a percentage of sales

8.3% 7.9% 8.3% 40.0 -40.0

S&A as a percentage of sales

16.1% 15.9% 17.1% 20.0 -120.0

Operating margin

17.2% 15.3% 15.9% 190.0 -60.0

Effective tax rate

42.7% 28.6% 26.7% 1410.0 190.0

Segment net sales

Flavors

$1,378,377 $1,347,340 $1,203,274 2.3% 12.0%

Fragrances

1,443,069 1,440,678 1,419,588 0.2% 1.5%

| Consolidated | $2,821,446 | $2,788,018 | $2,622,862 |
| --- | --- | --- | --- |

Cost of goods sold includes the cost of materials and manufacturing expenses; raw materials generally constitute 70.0% of the total. R&D expenses relate to the development of new and improved products, technical product support and compliance with governmental regulations. S&A expenses include expenses necessary to support our commercial activities and administrative expenses principally associated with staff groups that support our overall operating activities.

**2012 IN COMPARISON TO 2011**

**Sales**

Sales for 2012 totaled $2.8 billion, an increase of 1% from the prior year. Excluding currency impacts, LC sales grew by 4% (or 5% on a like-for-like basis, excluding the effects of the exit of low margin sales activities in Flavors), driven principally by new wins and the realization of price increases. LC sales growth was largely driven by new customer wins, with price offset by volume reductions on existing business, primarily in Fragrance Ingredients.

***Flavors Business Unit***

On a reported basis, Flavors sales increased 2%; excluding the impact of foreign currency, LC sales for the Flavors business increased 5% versus the prior year period. Excluding the impact of a 3% decline in sales associated with the strategic decision to exit certain lower margin sales activities, LC sales increased 8% on a like-for-like basis. The increase was driven by new wins and the realization of price increases. LC growth was led by double-digit gains in Beverages and single-digit gains in Dairy and Savory, all of which benefited from new wins, supported by our innovative technology, and price increases that have compensated for volume

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declines. Regionally, the business benefited from high single-digit LC growth in GA and single-digit LC growth in NOAM, EAME and LA. LC growth in GA reflects growth in all categories led by high single-digit gains in Savory, Sweet and Dairy. Overall, like-for-like sales growth was stable, with mid to high single-digit growth in each quarter of 2012. Sales in NOAM were led by double-digit gains in Beverages. The improvement in EAME reflects high single-digit gains in Savory and mid single-digit gains in Beverages. EAME performance continues to be led by our performance in the emerging market countries within the region. LA LC growth of 4% was driven by mid single-digit gains in Beverages and Savory and double-digit gains in Dairy. Globally, Flavors growth was led by high single-digit growth in emerging markets. Overall, emerging markets represented approximately 49% of total Flavors sales.

***Fragrances Business Unit***

The Fragrances business remained flat in reported sales and was up 3% in LC terms compared to a 1% LC sales decrease in 2011 over 2010. New wins and the realization of price increases across Fragrance Compounds were partially offset by volume declines in existing business, most notably in Fragrance Ingredients principally related to commodity products. However, we saw an improvement in Fragrance Ingredients growth during the fourth quarter driven by short-term customer order patterns. Year-over-year 2012 LC sales performance was led by high single-digit growth in Fabric Care and Beauty Care categories along with mid single-digit gains in Personal Wash and Fine Fragrance. Fragrance Compounds sales improved in each quarter of 2012. Offsetting these gains was a 10% decline in Fragrance Ingredients. LC growth within the regions was led by LA at 15% reflecting double-digit gains in all Fine and Beauty Care categories and double-digit and high single-digit gains in the Functional Fragrance categories, which was partially offset by declines in Fragrance Ingredients of approximately 8%. NOAM and GA experienced sales growth of 2% and 1%, respectively, reflecting mid-to-high single-digit gains in Fine Fragrance, Fabric Care and Personal Wash categories and double-digit growth in NOAM Hair Care, which were partially offset by volume declines in Fragrance Ingredients. EAME sales decreased slightly reflecting double-digit gains in Fabric Care and single-digit gains in Personal Wash that were more than offset by double-digit volume declines in Fragrance Ingredients. Emerging markets accounted for all of the growth on a global basis. Overall, emerging markets represented 46% of total Fragrances sales.

***Sales Performance by Region and Category***

| | | % Change in Sales 2012 vs 2011 | | | | | |
|---|---|---|---|---|---|---|---|
| | | **Fine & Beauty Care** | **Functional** | **Ingredients** | **Total Frag.** | **Flavors** | **Total** |
| **NOAM** | **Reported** | **6%** | **3%** | **-5%** | **2%** | **3%** | **2%** |
| **EAME** | **Reported** | **-7%** | **-1%** | **-17%** | **-7%** | **-1%** | **-5%** |
| | ***Local Currency*[1]** | ***0%*** | ***6%*** | ***-13%*** | ***-1%*** | ***6%*** | ***2%*** |
| **LA** | **Reported** | **22%** | **11%** | **-9%** | **13%** | **0%** | **9%** |
| | ***Local Currency*[1]** | ***26%*** | ***12%*** | ***-8%*** | ***15%*** | ***4%*** | ***12%*** |
| **GA** | **Reported** | **1%** | **5%** | **-16%** | **1%** | **5%** | **4%** |
| | ***Local Currency*[1]** | ***3%*** | ***6%*** | ***-16%*** | ***1%*** | ***7%*** | ***5%*** |
| **Total** | **Reported** | **3%** | **4%** | **-12%** | **0%** | **2%** | **1%** |
| | ***Local Currency*[1]** | ***7%*** | ***7%*** | ***-10%*** | ***3%*** | ***5%*** | ***4%*** |

(1) Local currency sales growth is calculated by translating prior year sales at the exchange rates for the corresponding 2012 period.

NOAM reported growth reflects 3% Flavors growth as strong new wins and realization of price increases in Beverages and Dairy more than offset volume declines in Sweet and Savory. In Fragrances, Fine and Beauty Care sales increased 6% as compared to a decline of 3% in the comparable 2011 period. Functional Fragrances sales were up 3% versus last year as new wins and volume gains in Fabric Care

and Personal Wash offset lower volumes on existing business in Home Care. On a like-for-like basis, excluding the effects of the exit of low margin sales activities, NOAM Flavors sales experienced high single-digit growth.

EAME LC growth was led by 6% growth in Flavors resulting from high single-digit growth in Savory along with mid single-digit growth in Beverages and low single-digit growth in Sweet. This growth was mainly due to new wins within our emerging markets in the region, as well as the realization of price increases. Functional Fragrances experienced 6% growth driven by double-digit gains in Fabric Care, which was more than offset volume declines in Fragrance Ingredients of 13% year-over-year.

LA LC sales growth of 12% was driven by double-digit gains in Fragrance Compounds, reflecting double-digit LC sales growth in Fine and Beauty Care and double-digit and high single-digit growth in Functional Fragrance categories, which were only partially offset by high single-digit volume declines in Fragrance Ingredients. Flavors LC sales growth was 4%, driven by mid single-digit gains in Beverages and Savory and double-digit gains in Dairy, which were only partially offset by low single-digit declines in Sweet.

GA delivered solid LC sales growth of 5%, led by high single-digit gains in Savory, Sweet and Dairy, along with mid single-digit growth in Beverages. Functional Fragrances experienced mid single-digit growth led by mid single-digit growth in Fabric Care and high single-digit growth in Personal Wash. Within Fine and Beauty Care, Fine Fragrance experienced mid single-digit LC sales growth followed by low single-digit growth in Hair Care. Fragrance Compounds were partially offset by double-digit declines in Fragrance Ingredients.

**Cost of Goods Sold**

Cost of goods sold, as a percentage of sales, decreased 210 bps to 58.3% in 2012 compared to 60.4% in 2011. The improvement versus last year was mainly driven by price realization, manufacturing efficiencies and favorable sales mix that more than offset higher raw material costs. Overall, raw material costs have increased approximately 4% on a year-over-year basis. Late in the fourth quarter, we began to see slight year-over-year declines in raw material costs. We expect to see further declines in 2013, albeit minor in value.

**Research and Development (R&D)**

R&D expenses increased approximately $13.9 million versus the prior year as a result of additional investments in technology and innovation, consistent with our strategy to accelerate levels of innovation into the marketplace. Our product portfolio is actively managed to support gross margin expansion and growth initiatives in advantaged categories, while improving margins in less advantaged categories, which included exiting lower margin sales activities. Overall R&D expenses increased 40 bps as a percentage of sales from 7.9% in 2011 to 8.3% in 2012.

**Selling and Administrative (S&A)**

S&A, as a percentage of sales, increased 20 bps to 16.1% versus 15.9%. The 2011 amount includes $33.5 million related to the Mane patent litigation settlement. Excluding this amount, our adjusted S&A in 2011 would have been 14.7% of sales. The increase in S&A expenses was driven by planned spend in sales activities (mainly in emerging markets), higher incentive compensation and pension expenses, and provision adjustments for allowance for doubtful accounts.

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**Restructuring and Other Charges**

Restructuring and other charges primarily consist of separation costs for employees, including severance, outplacement and other benefit costs.

| | Restructuring Charges (In Thousands) | |
|---|---|---|
| | 2012 | 2011 |
| Flavors | $ (36) | $ 1,475 |
| Fragrances | 1,636 | 11,224 |
| Global | 68 | 473 |
| Total | $ 1,668 | $ 13,172 |

***Strategic Initiative***

In December 2011, we recorded a charge to cover a restructuring which involved a reduction in workforce as well as a realignment of responsibilities in our Fragrances business unit. This alignment partly addresses issues identified in our 2010 strategic review process towards improving the underperforming areas of our portfolio. It resulted in the redeployment of creative resources in emerging markets and the reorganization from a regional to a global category structure. We implemented a plan to streamline business operations globally which resulted in the elimination of 72 positions, across Fragrances, Flavors and Corporate functions. As a result, we recorded a provision for severance costs of $9.8 million to Restructuring and other charges. We recorded an additional net charge of $1.7 million during the twelve months ended December 31, 2012, principally attributable to adjustments based on the final separation terms with affected employees. We realized pre-tax savings of approximately $8 million in 2012.

***European Rationalization Plan***

During the second quarter 2011, we executed a partial settlement of our pension obligations with the former employees of the Drogheda, Ireland facility. As a result, we recorded a charge of $3.9 million related to the European rationalization plan to cover settlements and special termination benefits. This settlement was funded primarily through pension plan investment trust assets.

We also reversed $1.2 million of employee-related liabilities in 2011 due to certain employees accepting other roles within the Company, offset by $0.6 million of additional costs incurred.

Based upon the period-end estimates regarding the separation agreements, we increased our provision for severance costs in by $4.4 million in 2010. The remaining $5.7 million of the restructuring charges in 2010 was mainly due to accelerated depreciation and other restructuring related costs pertaining to the rationalization of our Fragrances and Ingredients operations in Europe.

In the aggregate as of December 31, 2012, we have recorded expenses of $34.1 million relating to the European Rationalization Plan and $11.5 million for the Strategic Initiative, of which $39.3 million was recorded to Restructuring and other charges, net and $6.3 million was recorded to Cost of goods sold, R&D and Selling and administrative expenses. We do not anticipate any further expenses related to the European Rationalization Plan.

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**Operating Results by Business Unit**

We evaluate the performance of business units based on segment profit which is operating profit before Restructuring and other charges, net, Interest expense, Other expense, net and Taxes on income. See Note 12 to our Consolidated Financial Statements for the reconciliation to Income before taxes.

| *(DOLLARS IN THOUSANDS)* | **For the Year Ended December 31, 2012** | **2011** |
|---|---|---|
| **Segment profit:** | | |
| Flavors | $ 298,326 | $ 284,246 |
| Fragrances | 238,379 | 226,560 |
| Global Expenses | (48,419) | (36,410) |
| Restructuring and other charges, net | (1,668) | (13,172) |
| Mane patent litigation settlement | | (33,495) |
| Operating Profit | $ 486,618 | $ 427,729 |
| Profit margin | | |
| Flavors | 21.6% | 21.1% |
| Fragrances | 16.5% | 15.7% |
| Consolidated | 17.2% | 15.3% |

***Flavors Business Unit***

Flavors segment profit totaled $298.3 million in 2012 (21.6% of sales) compared to $284.2 million (21.1% of sales) in the comparable 2011 period. The improvement in profitability was mainly driven by strong sales performance, favorable category mix and the realization of price increases that more than offset higher raw material costs and ongoing investments in R&D.

***Fragrances Business Unit***

Fragrances segment profit totaled $238.4 million in 2012 (16.5% of sales), compared to $226.6 million (15.7% of sales) reported in 2011. The increase in profitability was driven by the improved category mix and pricing, combined with ongoing cost discipline and other margin improvement initiatives, including the Strategic Initiative that was announced in early 2012, that more than offset higher raw material costs.

***Global Expenses***

Global expenses represent corporate and headquarters-related expenses which include legal, finance, human resources and R&D and other administrative expenses that are not allocated to an individual business unit. In 2012, Global expenses were $48.4 million compared to $36.4 million during 2011. The increase principally includes higher incentive compensation and pension costs.

**Interest Expense**

In 2012, interest expense decreased $2.9 million to $41.8 million. The decrease in interest expense reflects lower levels of outstanding debt. Average cost of debt was 4.6% for the 2012 period compared to 4.7% in 2011.

**Other Expense, Net**

Other expense, net decreased approximately $8.1 million to $1.5 million in 2012 versus $9.5 million in 2011. The improvement was largely driven by favorable realized and unrealized foreign exchange losses/gains on working capital balances.

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**Income Taxes**

The effective tax rate was 42.7% in 2012 as compared to 28.6% in 2011. Included in 2012 results are tax charges of $72.4 million associated with the Spanish tax settlement and pre-tax restructuring charges of $1.7 million ($1.1 million after-tax). Excluding these items, the adjusted effective tax rate for 2012 was 26.4%. The 2011 period included $33.5 million of pre-tax expense related to the patent litigation settlement and pre-tax restructuring charges of $13.2 million. Excluding these items and $7.3 million of associated tax benefits, the adjusted effective tax rate for 2011 was 27.1%. The reduction of the adjusted effective tax rate in 2012 versus the prior year period reflects a lower cost of repatriation, a $10.6 million benefit related to the corporate restructuring of certain of our foreign subsidiaries, and the absence of a write-off in 2011 of deferred tax assets in the U.S. associated with state law changes, partially offset by approximately $12.0 million of charges related to the Spanish dividend withholding cases and the absence of the U.S. R&D tax credit in 2012.

**2011 IN COMPARISON TO 2010**

**Sales**

Sales for 2011 totaled $2.8 billion, an increase of 6% from the prior year. Excluding currency impacts, LC sales grew by 4%, driven principally by new business and the realization of price increases that were implemented to mitigate the effects of higher raw material costs. LC sales growth was primarily driven by the realization of price increases across both business units, while new win performance was largely offset by volume declines in the second half of 2011, mainly in Fragrances. Overall LC growth was driven by 8% growth in the emerging markets.

***Flavors Business Unit***

On a reported basis, Flavors sales increased 12%; excluding the impact of foreign currency, LC sales for the Flavors business increased 9% versus the prior year period. The increase was driven by new business with our customers, followed by the realization of price increases and growth in the underlying demand for our customers products. Sales growth in 2011 includes the impact of exiting approximately $6 million of low margin sales activities. LC growth was led by double-digit gains in Savory and Beverages and single-digit gains in Sweet (Confectionery), all of which benefited from new business, higher volumes and realization of price increases. Regionally, the business benefited from double-digit growth in NOAM and EAME whereas GA had high single-digit LC growth. The improvement in EAME reflects growth in all categories led by near or double-digit gains in Savory, Beverages and Sweet. EAME performance continues to be led by our performance in the emerging market countries within the region. Sales in NOAM were led by double-digit gains in Savory and Beverages. LC growth in GA was driven by double-digit gains in Beverages and Dairy followed by high single-digit gains in Sweet. LA LC growth of 4% was driven by double-digit gains in Sweet and Dairy as well as mid single-digit growth in Savory. Globally, Flavors growth was led by double-digit growth in emerging markets.

***Fragrances Business Unit***

The Fragrances business experienced a 1% increase in reported sales and was down 1% in LC terms compared to 16% LC sales growth during 2010. New wins and the realization of price increases were more than offset by declines in existing business, most notably in Fragrance Ingredients, principally related to commodity products, and Fine Fragrance. Year-over-year 2011 LC sales performance was led by double-digit growth in Home Care along with low single-digit gains in Beauty Care and Fabric Care categories. Offsetting these gains was a 9% decline in Fragrance Ingredients compared to an 18% increase during 2010. LC growth within the regions was led by GA at 2%, mainly due to new business and slightly higher volumes, notably within the Fabric Care which had double-digit LC gains. All other regions were flat to slightly down reflecting gains in Hair Care and Home Care that were largely offset by volume declines in Fine Fragrance in North America as well as declines in Fragrance Ingredients in all regions. Global growth was led by single-digit growth in emerging markets which represented more than 40% of total Fragrance sales.

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*Sales Performance by Region and Category*

| | | % Change in Sales | 2011 vs 2010 | | | | |
|---|---|---|---|---|---|---|---|
| | | Fine & Beauty Care | Functional | Ingredients | Total Frag. | Flavors | Total |
| **NOAM** | **Reported** | **-3%** | **3%** | **-4%** | **-1%** | **10%** | **4%** |
| **EAME** | **Reported** | **6%** | **6%** | **-10%** | **2%** | **15%** | **7%** |
| | ***Local Currency*** (1) | ***1%*** | ***2%*** | ***-13%*** | ***-2%*** | ***10%*** | ***2%*** |
| **LA** | **Reported** | **1%** | **3%** | **-8%** | **1%** | **5%** | **2%** |
| | ***Local Currency*** (1) | ***-1%*** | ***3%*** | ***-9%*** | ***0%*** | ***4%*** | ***1%*** |
| **GA** | **Reported** | **4%** | **5%** | **1%** | **4%** | **14%** | **10%** |
| | ***Local Currency*** (1) | ***2%*** | ***4%*** | ***-2%*** | ***2%*** | ***9%*** | ***6%*** |
| **Total** | **Reported** | **3%** | **5%** | **-6%** | **1%** | **12%** | **6%** |
| | ***Local Currency*** (1) | ***0%*** | ***3%*** | ***-9%*** | ***-1%*** | ***9%*** | ***4%*** |

(1) Local currency sales growth is calculated by translating 2010 sales at the exchange rates for the corresponding 2011 period.

NOAM reported growth was led by 10% Flavors growth as strong new wins and realization of price increases in Savory and Beverages more than offset volume declines in Sweet and Dairy. Fine and Beauty Care sales declined 3% reflecting very strong year-ago comparables of +11% (including re-stocking benefits in 2010). Functional Fragrance sales were up 3% versus last year as new wins and volume gains in Home Care offset lower volumes on existing business in Fabric Care and Personal Wash.

EAME LC growth was led by 10% growth in Flavors resulting from double-digit growth in Savory along with high single-digit growth in Beverages and Sweet. This growth was mainly due to new wins within our emerging markets in the region, as well as the realization of price increases and volume. Fine and Beauty Care delivered 1% year-over-year LC growth despite exceptional performance of 31% growth in the prior year period. Fragrance Ingredients LC sales decreased 13% coming off very strong growth of 17% in the comparable 2010 period.

LA LC sales growth of 1% was driven by double-digit gains in Sweet and Dairy that was offset by a flat performance in Beverages. Within Fragrances, single-digit LC sales growth in Fabric Care and Home Care were offset by volume softness in Fragrance Ingredients, which experienced 14% growth in 2010.

GA delivered solid LC sales growth of 6%, led by near double-digit gains in Flavors, due to double-digit gains in Beverages and Dairy, along with double-digit gains in Fabric Care and single-digit sales growth in Hair Care and Home Care.

**Cost of Goods Sold**

Cost of goods sold, as a percentage of sales, increased 210 basis points (bps) to 60.4% in 2011 compared to 58.3% in 2010. The increase versus prior year was mainly driven by higher raw material costs combined with a slightly less favorable sales mix. Overall, raw material costs have increased approximately 10% on a year-over-year basis. These effects were partially offset by improved operating leverage, ongoing margin recovery efforts in both businesses, including pricing, and benefits associated with the European rationalization that was completed in late 2010.

**Research and Development (R&D)**

R&D expenses increased approximately $1.0 million versus the prior year as investments in technology and innovation were largely offset by lower provisions for incentive compensation. Overall R&D expenses decreased 40 bps as a percentage of sales from 8.3% in 2010 to 7.9% in 2011.

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**Selling and Administrative (S&A)**

S&A, as a percentage of sales, decreased 120 bps to 15.9% versus 17.1%. The 2011 amount includes $33.5 million related to the Mane patent litigation settlement. Excluding this amount, S&A would have declined 240 bps to 14.7% of sales. The decrease in S&A expenses was driven by lower provisions for incentive compensation and ongoing cost discipline that more than offset planned spend in sales activities (mainly in emerging markets) to support our growth initiatives.

**Restructuring and Other Charges**

| | Restructuring Charges *( In Thousands)* | | Positions Affected | |
|---|---|---|---|---|
| | **2011** | **2010** | **2011** | **2010** |
| Flavors | $ 1,475 | | 14 | 0 |
| Fragrances | 11,224 | 10,077 | 54 | (10) |
| Global | 473 | | 4 | 0 |
| Total | $ 13,172 | $ 10,077 | 72 | (10) |

***Strategic Initiative***

In December 2011, we recorded a charge to cover a restructuring which involved a reduction in workforce as well as a realignment of responsibilities in our Fragrances business unit. This alignment partly addresses issues identified in our 2010 strategic review process towards improving the underperforming areas of our portfolio. It will result in the redeployment of creative resources in emerging markets and the reorganization from a regional to a global category structure. We implemented a plan to streamline business operations globally which resulted in the elimination of 72 positions, across Fragrances, Flavors and Corporate functions. As a result, we recorded a provision for severance costs of $9.8 million to Restructuring and other charges, net in our 2011 Consolidated Statement of Income and Comprehensive Income.

***European Rationalization Plan***

During the second quarter 2011, we executed a partial settlement of its pension obligations with the former employees of the Drogheda, Ireland facility. As a result we recorded a charge of $3.9 million related to the European Rationalization Plan to cover settlements and special termination benefits. This settlement was funded primarily through pension plan investment trust assets.

We also reversed $1.2 million of employee-related liabilities in 2011 due to certain employees accepting other roles within the Company, offset by $0.6 million of additional costs incurred.

Based upon the period-end estimates regarding the separation agreements, we increased our provision for severance costs in by $4.4 million in 2010. The remaining $5.7 million of the restructuring charges in 2010 was mainly due to accelerated depreciation and other restructuring related costs pertaining to the rationalization of our Fragrances and Ingredients operations in Europe.

In the aggregate as of December 31, 2011, we have recorded expenses of $34.1 million relating to the European Rationalization Plan and $9.8 million for the Strategic Initiative, of which $37.6 million was recorded to Restructuring and other charges, net and $6.3 million recorded to Cost of goods sold, R&D and Selling and administrative expenses. We do not anticipate any further expenses related to the European Rationalization Plan.

**Operating Results by Business Unit**

We evaluate the performance of business units based on profit before Restructuring and other charges, net, Interest expense, Other expense, net and Taxes on income. See Note 12 to our Consolidated Financial Statements for the reconciliation to Income before taxes.

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| (DOLLARS IN THOUSANDS) | For the Year Ended December 31, 2011 | 2010 |
|---|---|---|
| **Segment profit:** | | |
| Flavors | $ 284,246 | $ 242,528 |
| Fragrances | 226,560 | 244,966 |
| Global Expenses | (36,410) | (61,056) |
| Restructuring and other charges, net | (13,172) | (10,077) |
| Mane patent litigation settlement | (33,495) | |
| Operating Profit | $ 427,729 | $ 416,361 |
| Profit margin | | |
| Flavors | 21.1% | 20.2% |
| Fragrances | 15.7% | 17.3% |
| Consolidated | 15.3% | 15.9% |

***Flavors Business Unit***

Flavors segment profit totaled $284.2 million in 2011 (21.1% of sales) compared to $242.5 million (20.2% of sales) in the comparable 2010 period. The improvement in profitability was mainly driven by strong sales growth and increased operating leverage, the realization of price increases and margin improvement initiatives that more than offset the effects of higher raw material costs and less favorable sales mix.

***Fragrances Business Unit***

Fragrances segment profit totaled $226.6 million in 2011 (15.7% of sales), compared to $245.0 million (17.3% of sales) reported in 2010. The decline in profit was driven by sharply higher input costs and weaker sales mix that could only be partially offset by the realization of price increases, the benefits of the European restructuring, other margin improvement initiatives, and lower incentive compensation.

***Global Expenses***

Global expenses represent corporate and headquarters-related expenses which include legal, finance, human resources and R&D and other administrative expenses that are not allocated to an individual business unit. In 2011, Global expenses were $36.4 million compared to $61.1 million during 2010. The decline principally reflects lower incentive compensation.

**Interest Expense**

In 2011, interest expense decreased $4.1 million to $44.6 million. The decrease in interest expense reflects lower levels of outstanding debt mainly due to $123.7 million of long-term debt repayments in 2011. Average cost of debt was 4.7% for the 2011 period compared to 5.0% in 2010.

**Other Expense, Net**

Other expense, net increased approximately $1.4 million to $9.5 million in 2011 versus $8.1 million in 2010. The change was driven by higher foreign exchange losses on outstanding working capital balances, principally associated with a general weakening of the U.S. dollar.

**Income Taxes**

The effective tax rate was 28.6% in 2011 as compared to a rate of 26.7% in the prior year. The current period included a $5.8 million adjustment of deferred tax assets as a result of U.S. state law changes enacted during the second quarter 2011 and a low effective tax rate on the Mane patent litigation settlement.

**Liquidity and Capital Resources**

***CASH AND CASH EQUIVALENTS***

We had cash and cash equivalents of $324.4 million at December 31, 2012 compared to $88.3 million at December 31, 2011, of which $102.7 million of the balance at December 31, 2012 was held outside the United States. Cash balances held in foreign jurisdictions are, in most circumstances, available to be repatriated to the United States; however, they would be subject to United States federal income taxes, less applicable foreign tax credits. We have not provided U.S. income tax expense on accumulated earnings of our foreign subsidiaries because we have the ability and plan to reinvest the undistributed earnings indefinitely.

Effective utilization of the cash generated by our international operations is a critical component of our tax strategy. Strategic dividend repatriation from foreign subsidiaries creates U.S. taxable income, which enables us to realize U.S. deferred tax assets. The Company regularly repatriates, in the form of dividends from its non-U.S. subsidiaries, a portion of its current year earnings to fund financial obligations in the U.S. These repatriations of current year earnings totaled $97.6 million, $119.5 million and $360.5 million in 2012, 2011 and 2010, respectively.

***CASH FLOWS FROM OPERATING ACTIVITIES***

Operating cash flows in 2012 were $323.8 million, which includes an outflow of cash of $105.5 million associated with the Spanish tax settlement (as discussed in Note 9 to the Consolidated Financial Statements), compared to an inflow of $189.2 million, which included a patent litigation settlement payment of $40.0 million, and $315.1 million in 2011 and 2010, respectively. The cash flow impact associated with core working capital (trade receivables, inventories and accounts payable) decreased compared to 2011. Operating cash flows versus the prior year also reflects lower incentive compensation payments and tax payments made in 2012 compared to 2011 (as a result of strong 2010 performance).

Working capital (current assets less current liabilities) totaled $949.8 million at year-end 2012 compared to $752.7 million at December 31, 2011. This increase in working capital primarily reflects a $236 million increase in cash balances partly associated with additional drawdowns under the New Facility.

As of December 31, 2012, net trade receivables increased by $27.1 million as compared to December 31, 2011 principally related to higher sales levels during the fourth quarter 2012 versus the fourth quarter.

***CASH FLOWS USED IN INVESTING ACTIVITIES***

Net investing activities in 2012 utilized $114.3 million compared to $131.2 million and $106.8 million in 2011 and 2010, respectively. The improvement in the investing activities was principally driven by the proceeds from the termination of life insurance contracts which are used to informally fund our Deferred Compensation Plan as discussed in Note 13 to the Consolidated Financial Statements.

Additions to property, plant and equipment were $126.1 million, $127.5 million and $106.3 million in 2012, 2011 and 2010, respectively, and are again expected to approach 5% of sales in 2013. Investments were largely focused on emerging markets and new technology consistent with our strategy.

***CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES***

Net financing activities in 2012 had an inflow of $25.4 million compared to outflows of $100.7 million and $156.7 million in 2011 and 2010, respectively. The inflow of cash provided by financing activities in 2012 over the outflow of cash in 2011 principally reflects changes in the revolving credit facility borrowings in 2012 compared to 2011, which was partially offset by increased dividend payments in 2012 compared to 2011.

At December 31, 2012, we had $1,031.2 million of debt outstanding compared to $894.9 million outstanding at December 31, 2011.

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We paid dividends totaling $130.9 million, $90.3 million and $81.2 million in 2012, 2011 and 2010, respectively. The cash dividend declared per share in 2012, 2011 and 2010 was $1.30, $1.16 and $1.04, respectively. The increase in the dividends paid from 2011 to 2012 reflects both a higher level of dividends declared in 2012 as well as the accelerated payment in December 2012 of our fourth quarter dividend.

In December 2012, the Board of Directors authorized a $250 million share repurchase program, which commenced in the first quarter of 2013 and is expected to be completed by the end of 2014. Based on the total authorized amount of $250 million available under the repurchase program, approximately 3.8 million shares, or 4.7% of shares outstanding (based on the market price and shares outstanding as of December 31, 2012) could be repurchased under the program. The purchases 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 placed into treasury stock. No repurchases were made during the fourth quarter of 2012.

***CAPITAL RESOURCES***

Operating cash flow provides the primary source of funds for capital investment needs, dividends paid to shareholders and debt repayments. We anticipate that cash flows from operations and availability under our existing credit facilities are sufficient to meet our investing and financing needs for at least the next eighteen months. We regularly assess our capital structure, including both current and long-term debt instruments, as compared to our cash generation and investment needs in order to provide ample flexibility and to optimize our leverage ratios. While we are comfortable with our current leverage ratios, our cash generation and capital structure would support some increase in leverage. We believe our existing cash balances are sufficient to meet our debt service requirements, including $100 million, which is due July 12, 2013 related to our Senior Unsecured Notes issued in 2006.

We supplement short-term liquidity with access to capital markets, mainly through bank credit facilities and issuance of commercial paper. We did not issue commercial paper during 2012 and 2011.

On November 9, 2011, IFF and certain subsidiaries (the Borrowers ), entered into a new credit agreement with Citibank, N.A., as administrative agent and the other lenders, agents, arrangers and bookrunners to replace the previous credit agreement set to expire November 23, 2012. The Credit Agreement which was amended and restated on March 9, 2012 provides for a revolving loan facility in an aggregate amount up to an equivalent of $942.0 million (the New Facility ). There are three tranches under the New Facility. The Tranche A facility is available to all of the Borrowers other than IFF Spain in U.S. dollars, euros, Swiss francs, Japanese yen and British sterling in an aggregate amount up to an equivalent of $458 million and contains sublimits of $50.0 million for swing line borrowings. The Tranche B facility is available to all of the Borrowers in euros, Swiss francs, Japanese yen and British sterling in an aggregate amount up to an equivalent of $354.0 million and contains sublimits of 50.0 million for swing line borrowings. The Tranche C facility is available to all of the Borrowers in euros only in an aggregate amount up to 100,505,400. The New Facility will be available for general corporate purposes of each Borrower and its subsidiaries. The obligations under the New Facility are unsecured and the Company has guaranteed the obligations of each other Borrower under the New Facility. The New Facility will mature on November 9, 2016, but may be extended for up to two additional one-year periods at the Company s request, subject to the agreement of the lenders having commitments representing more than 50% of the aggregate commitments of all lenders under the New Facility. Borrowings under the New Facility bear interest at an annual rate of LIBOR plus a margin, currently 125 bps, linked to our credit rating. The interest rate under the New Facility at December 31, 2012 and 2011 was 1.41% and 1.77%, respectively. The New Facility contains various affirmative and negative covenants, including the requirement for us to maintain, at the end of each fiscal quarter, a ratio of net debt for borrowed money to adjusted EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) in respect of the previous 12-month period of not more than 3.25 to 1.

Under the New Facility, we are required to maintain, at the end of each fiscal quarter, a ratio of net debt for borrowed money to adjusted EBITDA in respect of the previous 12-month period of not more than 3.25 to 1.

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Based on this ratio, at December 31, 2012 our covenant compliance would provide overall borrowing capacity of $1,186.2 million.

As of December 31, 2012 we had total borrowings under the New Facility of $296.7 million. The amount which we are able to draw down on under the Agreement is limited by financial covenants as described in more detail below. However, our drawdown capacity on the New Facility was limited to $648.2 million based on existing balances outstanding under the Facility at December 31, 2012.

At December 31, 2012 and 2011 we were in compliance with all financial and other covenants, including the net debt to adjusted EBITDA ratio. At December 31, 2012 our Net Debt/adjusted EBITDA [(1)] ratio was 1.20 to 1 as defined by the New Facility, well below the financial covenants of existing outstanding debt. Failure to comply with the financial and other covenants under our debt agreements would constitute default and would allow the lenders to accelerate the maturity of all indebtedness under the related agreement. If such acceleration were to occur, we would not have sufficient liquidity available to repay the indebtedness. We would likely have to seek amendments under the agreements for relief from the financial covenants or repay the debt with proceeds from the issuance of new debt or equity, and/or asset sales, if necessary. We may be unable to amend the agreements or raise sufficient capital to repay such obligations in the event the maturities are accelerated.

(1) *Adjusted EBITDA and Net Debt, which are non-GAAP measures used for these covenants, are calculated in accordance with the definition in the debt agreements. In this context, these measures are used solely to provide information on the extent to which we are in compliance with debt covenants and may not be comparable to adjusted EBITDA and Net Debt used by other companies. Reconciliations of adjusted EBITDA to net income and net debt to total debt are as follows:*

| | **12 Months Ended December 31,** | |
|---|---|---|
| *(DOLLARS IN MILLIONS)* | **2012** | **2011** |
| ***Net income*** | *$ 254.1* | *$ 266.9* |
| ***Interest expense*** | *41.8* | *44.6* |
| ***Income taxes*** | *189.3* | *106.7* |
| ***Depreciation and amortization*** | *76.7* | *75.3* |
| ***Specified items[(1)]*** | *1.7* | *46.7* |
| ***Non-cash items[(2)]*** | *16.1* | *20.9* |
| ***Adjusted EBITDA*** | *$ 579.7* | *$ 561.1* |

(1) *Specified items for the 12 months ended December 31, 2012 of $1.7 million of restructuring charges related to the 2011 Strategic Initiative. Specified items for the 12 months ended December 31, 2011 of $46.7 million consists of $33.5 million of the Mane patent litigation settlement and $13.2 million of restructuring charges related to the 2011 Strategic Initiative and pension settlement costs related to our European rationalization.*

(2) *Non-cash items, defined as part of Adjusted EBITDA in the terms of the Company s New Facility agreement, represent all other adjustments to reconcile net income to net cash provided by operations as presented on the Statement of Cash Flows, including gain on disposal of assets, stock-based compensation and pension settlement/curtailment.*

| | **December 31,** | |
|---|---|---|
| *(DOLLARS IN MILLIONS)* | **2012** | **2011** |
| *Total debt* | *$ 1,031.2* | *$ 894.9* |
| *Adjustments:* | | |
| *Deferred gain on interest rate swaps* | *(9.0)* | *(11.0)* |
| *Cash and cash equivalents* | *(324.4)* | *(88.3)* |
| *Net debt* | *$ 697.8* | *$ 795.6* |

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Compliance with existing governmental requirements regulating the discharge of materials into the environment has not materially affected our operations, earnings or competitive position. In 2012 and 2011, we spent $2 million on capital projects and $16 million and $17 million, respectively, in operating expenses and governmental charges for the purpose of complying with such regulations. Expenditures for these purposes will continue for the foreseeable future. In addition, we are party to a number of proceedings brought under the Comprehensive Environmental Response, Compensation and Liability Act or similar state statutes. It is expected that the impact of any judgments in or voluntary settlements of such proceedings will not be material to our financial condition, results of operations or liquidity.

***CONTRACTUAL OBLIGATIONS***

At December 31, 2012, we had contractual payment obligations due within the time periods as specified in the following table:

| **Contractual Obligations** | | **Payments Due** | | | |
|---|---|---|---|---|---|
| ***(Dollars In Millions)*** | **Total** | **2013** | **2014-2015** | **2016-2017** | **2018 and thereafter** |
| Borrowings[1] | $ 1,022 | $ 150 | $ | $ 622 | $ 250 |
| Interest on borrowings[1] | 284 | 48 | 79 | 64 | 93 |
| Operating leases[2] | 269 | 29 | 49 | 39 | 152 |
| Pension funding obligations[3] | 66 | 22 | 44 | | |
| Postretirement obligations[4] | 119 | 5 | 11 | 13 | 90 |
| Purchase commitments[5] | 136 | 64 | 72 | | |
| Total | $ 1,896 | $ 318 | $ 255 | $ 738 | $ 585 |

(1) See Note 8 to the Consolidated Financial Statements for a further discussion of our various borrowing facilities.
(2) Operating leases include facility and other lease commitments executed in the normal course of the business, including sale leaseback obligations included in Note 7 of the Notes to the Consolidated Financial Statements. Further details concerning worldwide aggregate operating leases are contained in Note 16 of the Notes to the Consolidated Financial Statements.
(3) See Note 13 to the Consolidated Financial Statements for a further discussion of our retirement plans. Anticipated funding obligations are based on current actuarial assumptions. The projected contributions beyond fiscal year 2015 are not currently determinable.
(4) Amounts represent expected future benefit payments for our postretirement benefit plans.
(5) Purchase commitments include agreements for raw material procurement and contractual capital expenditures. Amounts for purchase commitments represent only those items which are based on agreements that are enforceable and legally binding.

The table above does not include $41.2 million of the total unrecognized tax benefits for uncertain tax positions and approximately $7.4 million of associated accrued interest. Due to the high degree of uncertainty regarding the timing of potential cash flows, the Company is unable to make a reasonable estimate of the amount and period in which these liabilities might be paid.

**Critical Accounting Policies and Use of Estimates**

Our significant accounting policies are more fully described in Note 1 to the Consolidated Financial Statements. As disclosed in Note 1, the preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires management to make estimates and assumptions that affect reported amounts and accompanying disclosures. These estimates are based on management s best judgment of current events and actions that we may undertake in the future. Actual results may ultimately differ from estimates.

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Those areas requiring the greatest degree of management judgment or deemed most critical to our financial reporting involve:

*The periodic assessment of potential impairment of intangible assets acquired in business combinations.* We currently have net intangible assets, including goodwill, of $702.3 million. In the fourth quarter of fiscal 2011, we early adopted ASU No. 2011-8 Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment. We conduct a qualitative assessment as of November 30th on an annual basis or more frequently when significant change in circumstances that would be considered a triggering event indicate that the carrying amount of goodwill may not be recoverable. The goodwill qualitative impairment assessment requires us to perform an assessment for each reporting unit to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. In 2012, the Company re-evaluated its reporting unit structure and identified three reporting units: (1) Flavors, (2) Fragrance Compounds and (3) Fragrance Ingredients. Prior to 2012, the Company had identified two reporting units, Flavors and Fragrances. As a result, in 2012 the Company reallocated the goodwill previously allocated to its Fragrances reporting unit to its Fragrance Compounds and Fragrance Ingredients reporting units.

The qualitative assessment considers various factors for each reporting unit, including the macroeconomic environment, industry and market specific conditions, financial performance, cost impacts, and issues or events specific to the reporting unit. If it is determined that it is more likely than not the carrying amount exceeds the fair value of a reporting unit, we perform a step one goodwill impairment test. We completed our annual qualitative assessment as of November 30, 2012 for the Flavors reporting unit, which indicated no impairment of goodwill, as it was determined it is more likely than not that the fair values exceed the carrying value of our reporting unit. The Company performed the annual goodwill impairment test, utilizing the two-step approach for the Fragrance Compounds and Fragrance Ingredients reporting units, by assessing the fair value of our reporting units based on discounted cash flows, which indicated no impairment of goodwill, as the estimated fair values substantially exceeded the carrying values of each of these reporting units.

*The analysis and evaluation of income taxes.* We account for taxes under the asset and liability method. Under this method, deferred income taxes are recognized for temporary differences between the financial statement and tax return bases of assets and liabilities. A valuation allowance is recognized if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. The assessment of the need for a valuation allowance requires management to make estimates and assumptions about future earnings, reversal of existing temporary differences and available tax planning strategies. If actual experience differs from these estimates and assumptions, the recorded deferred tax asset may not be fully realized resulting in an increase to income tax expense in our results of operations.

The Company has not established deferred tax liabilities for undistributed foreign earnings as it has plans to and intends to indefinitely reinvest those earnings to finance foreign activities.

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. We first determine whether it is more likely than not that we would sustain our tax position if the relevant tax authority were to audit the position with full knowledge of all the relevant facts and other information. For those tax positions that meet this threshold, we measure the amount of tax benefit based on the largest amount of tax benefit that we have a greater than 50% chance of realizing in a final settlement with the relevant authority. Those tax positions failing to qualify for initial recognition are recognized in the first interim period in which they meet the more likely than not standard. This evaluation is made at the time that we adopt a tax position and whenever there is new information and is based upon management s evaluation of the facts, circumstances and information available at the reporting date. We maintain a cumulative risk portfolio relating to all of our uncertainties in income taxes in order to perform this analysis, but the evaluation of our tax positions requires significant judgment and estimation in part because, in certain cases,

tax law is subject to varied interpretation, and whether a tax position will ultimately be sustained may be uncertain. We do not currently believe that any of our pending tax assessments, even if ultimately resolved against us, would have a material impact on our results of operations and cash flows.

*The evaluation of potential litigation and environmental liabilities, where changing circumstances, rules and regulations require regular reassessment of related practices and anticipated costs.* We are subject to certain legal claims regarding products and other matters, as well as environmental-related matters. Significant management judgment is involved in determining when it is probable that a liability has been incurred and the extent to which it can be reasonably estimated.

We regularly assess potential liabilities with respect to all legal claims based on the most recent available information, in consultation with outside counsel we have engaged on our behalf to handle the defense of such matters. To the extent a liability is considered to be probable and reasonably estimable, we recognize a corresponding liability; if the reasonably estimated liability is a range, we recognize that amount considered most likely, or in the absence of such a determination, the minimum reasonably estimated liability. To the extent such claims are covered by various insurance policies, we separately evaluate the right to recovery and estimate the related insurance claim receivable. Management judgments involve determination as to whether a liability has been incurred, the reasonably estimated amount of that liability, and any potential insurance recovery.

We regularly evaluate potential environmental exposure in terms of total estimated cost and the viability of other potentially responsible parties ( PRP s ) associated with our exposure. Recorded liabilities are adjusted periodically as remediation efforts progress and additional information becomes available. Critical management assumptions relate to expected total costs to remediate and the financial viability of PRP s to share such costs.

*Determination of the various assumptions employed in the valuation of pension and retiree health care expense and associated obligations.* Amounts recognized in the Consolidated Financial Statements related to pension and other postretirement benefits are determined from actuarial valuations. Inherent in such valuations are assumptions including expected return on plan assets, discount rates at which the liabilities could be settled, rates of increase in future compensation levels, mortality rates and health care cost trend rates. These assumptions are updated annually and are disclosed in Note 13 to the Consolidated Financial Statements. In accordance with GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, affect expense recognized and obligations recorded in future periods.

We consider a number of factors in determining and selecting assumptions for the overall expected long-term rate of return on plan assets. We consider the historical long-term return experience of our assets, the current and expected allocation of our plan assets, and expected long-term rates of return. We derive these expected long-term rates of return with the assistance of our investment advisors. We base our expected allocation of plan assets on a diversified portfolio consisting of domestic and international equity securities, fixed income, real estate, and alternative asset classes.

We consider a variety of factors in determining and selecting our assumptions for the discount rate at December 31. For the U.S. plans, the discount rate was based on the internal rate of return for a portfolio of Moody s Aaa, Aa and Merrill Lynch AAA-AA high quality bonds with maturities that are consistent with the projected future benefit payment obligations of the plan. The rate of compensation increase for all plans and the medical cost trend rate for the applicable U.S. plans are based on plan experience.

With respect to the U.S. plans, the expected rate of return on plan assets was determined based on an asset allocation model using the current target allocation, real rates of return by asset class and an anticipated inflation rate. The target asset allocation consists of approximately: 50% in equity securities and 50% in fixed income securities. The plan has achieved a compounded annual rate of return of 7.8% over the previous 20 years. At December 31, 2012, the actual asset allocation was: 50% in equity securities; 49% in fixed income securities; and 1% in cash equivalents.

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The expected rate of return for the non-U.S. plans employs a similar set of criteria adapted for local investments, inflation rates and in certain cases specific government requirements. The target asset allocation, for the non-U.S. plans, consists of approximately: 55%-60% in fixed income securities; 20%- 25% in equity securities; 5%-10% in real estate; and 5%-10% in alternative investments. At December 31, 2012, the actual asset allocation was: 59% in fixed income investments; 22% in equity investments; 9% in real estate investments; 8% in alternative investments and 2% in cash and cash equivalents.

Changes in pension and other post-employment benefits, and associated expenses, may occur in the future due to changes in these assumptions. The impact that a 0.25% decrease in the discount rate or a 1% change in the medical cost trend rate would have on our pension and other post-employment benefit expense, as applicable, is as follows:

| | **Sensitivity of Disclosures to Changes in Selected Assumptions** | | | |
|---|---|---|---|---|
| | **25 BP Decrease in Discount Rate** | | **25 BP Decrease in Discount Rate** | **25 BP Decrease in Long-Term Rate of Return** |
| *(DOLLARS IN THOUSANDS)* | **Change in PBO** | **Change in ABO** | **Change in pension expense** | **Change in pension expense** |
| U.S. Pension Plans | $ 17,816 | $ 17,687 | $ 1,181 | $ 843 |
| Non-U.S. Pension Plans | $ 33,889 | $ 31,185 | $ 2,733 | $ 1,929 |
| Postretirement Benefit Plan | N/A | $ 3,677 | $ 236 | N/A |

The effect of a 1% increase in the medical cost trend rate would increase the accumulated postretirement benefit obligation and the annual postretirement expense by approximately $7.3 million and $0.4 million, respectively; a 1% decrease in the rate would decrease the obligation and expense by approximately $6.9 million and $0.4 million, respectively.

*The ongoing assessment of the valuation of inventory, given the large number of natural ingredients employed, the quality of which may be diminished over time.* We hold a majority of our inventory as raw materials, providing the greatest degree of flexibility in manufacture and use. As of December 31, 2012, we maintained 47% of our inventory as raw materials. Materials are evaluated based on shelf life, known uses and anticipated demand based on forecasted customer order activity and changes in product/sales mix. Management policy provides for an ongoing assessment of inventory with adjustments recorded when an item is deemed to be slow moving or obsolete.

We believe that we have considered relevant circumstances that we may be currently subject to, and the financial statements accurately reflect our best estimate of the impact of these items in our results of operations, financial condition and cash flows for the years presented. We have discussed the decision process and selection of these critical accounting policies with the Audit Committee of the Board of Directors.

**New Accounting Standards**

In May 2011, the Financial Accounting Standards Board ( FASB ) issued authoritative guidance that provides a consistent definition of fair value and ensures that the fair value measurements and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. This guidance enhances the disclosure requirements particularly for level 3 fair value measurements. This guidance was effective as of January 1, 2012 and did not have a material impact on the Company s Consolidated Financial Statements.

In June 2011, the FASB issued revised guidance on the presentation of comprehensive income. This revised guidance eliminates the option to present the components of Other comprehensive income ( OCI ) as part of the Consolidated Statement of Shareholders Equity and provides two alternatives for presenting the components of net income and OCI, either: (i) in a single continuous statement of comprehensive income or (ii) in two separate but consecutive financial statements, consisting of an income statement followed by a separate statement of comprehensive income. Additionally, items that are reclassified from OCI to net income must be presented on the face of the financial statements. Although in December 2011, the FASB deferred the reclassification

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requirement of this guidance indefinitely, the Company has adopted this revised guidance as of January 1, 2012 and it did not have an impact on the Company s consolidated financial statements.

**Non-GAAP Financial Measures**

The Company uses non-GAAP financial operating measures in this Annual Report, including: (i) local currency sales (which eliminates the effects that result from translating its international sales in U.S. dollars), (ii) like-for-like sales (which eliminates the effects of local currency and the strategic decision to exit certain low margin sales), (iii) adjusted cash flow from operations (which excludes the impact of the payment pursuant to the Spanish tax settlement), (iv) adjusted S&A (which excludes the impact of the Mane patent settlement litigation) and (v) adjusted effective tax rate (which excludes the Spanish tax charge). The Company also provides the non-GAAP measures adjusted EBITDA (which excludes certain specified items and non-cash items as set forth in the Company s debt agreements) and net debt (which is adjusted for deferred gain on interest rate swaps and cash and cash equivalents) solely for the purpose of providing information on the extent to which the Company is in compliance with debt covenants contained in its debt agreements.

We have included each of these non-GAAP measures in order to provide additional information regarding our underlying operating results and comparable year-over-year performance. Such information is supplemental to information presented in accordance with GAAP and is not intended to represent a presentation in accordance with GAAP. In discussing our historical and expected future results and financial condition, we believe it is meaningful for investors to be made aware of and to be assisted in a better understanding of, on a period-to-period comparable basis, financial amounts both including and excluding these identified items, as well as the impact of exchange rate fluctuations and the exit of certain low margin sales activities on operating results and financial condition. We believe such additional non-GAAP information provides investors with an overall perspective of the period-to-period performance of our business. In addition, management internally reviews each of these non-GAAP measures to evaluate performance on a comparative period-to-period basis in terms of absolute performance, trends and expected future performance with respect to our business. A material limitation of these non-GAAP measures is that such measures do not reflect actual GAAP amounts and payments pursuant to the Spanish tax settlement include actual cash outlays. We compensate for such limitations by using these measures as one of several metrics, including GAAP measures. These non-GAAP measures may not be comparable to similarly titled measures used by other companies.

International Flavors & Fragrances Inc.

Like-for-Like Flavors Sales Reconciliation

Twelve Months Ended December 31, 2012

| | Reported Sales Growth | Local Currency Sales Growth(1) | Exit of Low Margin Sales Activities | Like-for-Like Sales Growth(2) |
|---|---|---|---|---|
| Total Company | 1% | 4% | 1% | 5% |
| Flavors | | | | |
| North America | 3% | 3% | 6% | 9% |
| EAME | -1% | 6% | 1% | 7% |
| Latin America | 0% | 4% | 2% | 6% |
| Greater Asia | 5% | 7% | 1% | 8% |
| Total | 2% | 5% | 3% | 8% |

(1) Local currency sales growth is calculated by translating prior year sales at the exchange rates used for the corresponding 2012 period.
(2) Like-for-like is a non-GAAP metric that excludes the impact of exiting low margin sales activities and foreign exchange.

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**Cautionary Statement Under the Private Securities Litigation Reform Act of 1995**

Statements in this Annual 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 current assumptions, estimates and expectations and include statements concerning (i) improving business trends in 2012, (ii) our ability to capitalize on our strong emerging market presence to achieve our growth targets, (iii) the impact of our profit improvement initiatives, (iv) our competitive position in the market and financial performance in 2013, (v) future local currency growth rates and drivers of growth, (vi) the impact of our strategy to exit certain low margin sales activities in Flavors, (vii) our ability to continue to recover margins and offset the effects of elevated raw material costs, and (viii) our ability to leverage our knowledge of consumer trends and engage in collaborations that lead to new technologies, and (ix) the ultimate resolution of pending tax matters with the Spanish tax authorities. These forward-looking statements should be evaluated with consideration given to the many risks and uncertainties inherent in the Company s business that could cause actual results and events to differ materially from those in the forward-looking statements. Certain of such forward-looking information may be identified by such terms as expect , anticipate , believe , outlook , may , estimate , should and predict similar terms or variations thereof. Such forward-looking statements are based on a se expectations, assumptions, estimates and projections about the Company, are not guarantees of future results or performance, and involve significant risks, uncertainties and other factors, including assumptions and projections, for all forward periods. Actual results of the Company may differ materially from any future results expressed or implied by such forward-looking statements. Such factors include, among others, the following:

the economic climate for the Company s industry and demand for the Company s products;

the ability of the Company to successfully implement its strategic plan and achieve the estimated savings;

fluctuations in the price, quality and availability of raw materials;

decline in consumer confidence and spending;

changes in consumer preferences;

the Company s ability to predict the short and long-term effects of global economic conditions;

movements in interest rates;

the Company s ability to implement its business strategy, including the achievement of anticipated cost savings, profitability, realization of price increases and growth targets;

the Company s ability to successfully develop new and competitive products and enter and expand its sales in new and other emerging markets;

the effects of any unanticipated costs and construction or start-up delays in the expansion of any of the Company s facilities;

the impact of currency fluctuations or devaluations in the Company s principal foreign markets;

any adverse impact on the availability, effectiveness and cost of the Company s hedging and risk management strategies;

uncertainties regarding the outcome of, or funding requirements, related to litigation or settlement of pending litigation, uncertain tax positions or other contingencies, including the final assessment for the Company s Spanish subsidiaries 2011 tax return and appeal regarding the tax assessments for the 2002-2003 fiscal years;

the impact of possible pension funding obligations and increased pension expense, particularly as a result of changes in asset returns or discount rates, on the Company s cash flow and results of operations;

the effect of legal and regulatory proceedings, as well as restrictions imposed on the Company, its operations or its representatives by U.S. and foreign governments;

adverse changes in federal, state, local and foreign tax legislation or adverse results of tax audits, assessments, or disputes;

the direct and indirect costs and other financial impact that may result from any business disruptions due to political instability, armed hostilities, incidents of terrorism, natural disasters, including Hurricane Sandy, or the responses to or repercussion from any of these or similar events or conditions;

the Company s ability to quickly and effectively implement its disaster recovery and crisis management plans; and

adverse changes due to accounting rules or regulations.

The foregoing list of important factors does not include all such factors, nor necessarily present them in order of importance. In addition, you should consult other disclosures made by the Company (such as in our other filings with the Securities and Exchange Commission ( SEC ) or in company press releases) for other factors that may cause actual results to differ materially from those projected by the Company. Please refer to Part I. Item 1A., Risk Factors, of this 2012 Form 10-K for additional information regarding factors that could affect the Company s results of operations, financial condition and liquidity.

The Company intends its forward-looking statements to speak only as of the time of such statements and does not undertake or plan to update or revise them as more information becomes available or to reflect changes in expectations, assumptions or results. The Company can give no assurance that such expectations or forward-looking statements will prove to be correct. An occurrence of, or any material adverse change in, one or more of the risk factors or risks and uncertainties referred to in this report or included in our other periodic reports filed with the SEC could materially and adversely impact our operations and our future financial results.

Any public statements or disclosures by IFF following this report that modify or impact any of the forward-looking statements contained in or accompanying this report will be deemed to modify or supersede such outlook or other forward-looking statements in or accompanying this report.

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**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

We operate on a global basis and are exposed to currency fluctuation related to the manufacture and sale of our products in currencies other than the U.S. dollar. The major foreign currencies involve the markets in the European Union, Great Britain, Mexico, Brazil, China, India, Indonesia, Australia and Japan, although all regions are subject to foreign currency fluctuations versus the U.S. dollar. We actively monitor our foreign currency exposures in all major markets in which we operate, and employ a variety of techniques to mitigate the impact of exchange rate fluctuations, including foreign currency hedging activities.

We have established a centralized reporting system to evaluate the effects of changes in interest rates, currency exchange rates and other relevant market risks. Our risk management procedures include the monitoring of interest rate and foreign exchange exposures and hedge positions utilizing statistical analyses of cash flows, market value and sensitivity analysis. However, the use of these techniques to quantify the market risk of such instruments should not be construed as an endorsement of their accuracy or the accuracy of the related assumptions. For the year ended December 31, 2012, the Company s exposure to market risk was estimated using sensitivity analyses, which illustrate the change in the fair value of a derivative financial instrument assuming hypothetical changes in foreign exchange rates and interest rates.

We enter into foreign currency forward contracts with the objective of reducing exposure to cash flow volatility associated with foreign currency receivables and payables, and with anticipated purchases of certain raw materials used in operations. These contracts, the counterparties to which are major international financial institutions, generally involve the exchange of one currency for a second currency at a future date, and have maturities not exceeding twelve months. The gain or loss on the hedging instrument and services is recorded in earnings at the same time as the transaction being hedged is recorded in earnings. At December 31, 2012, the Company s foreign currency exposures pertaining to derivative contracts exist with the Euro, Japanese Yen, British Pound, Indonesia Rupiah, Chinese Renminbi and South African Rand. Based on a hypothetical decrease or increase of 10% in the applicable balance sheet exchange rates (primarily against the U.S. dollar), the estimated fair value of the Company s foreign currency forward contracts would increase or decrease by approximately $25 million. However, any change in the value of the contracts, real or hypothetical, would be significantly offset by a corresponding change in the value of the underlying hedged items.

We have a Japanese Yen/U.S. dollar currency swap related to monthly sale and purchase of products between the U.S. and Japan. A hypothetical decrease or increase of 10% in the value of the U.S. dollar against the Japanese Yen, the estimated fair value of the Company s foreign currency forward contracts would not have a material effect.

We have also used non-U.S. dollar borrowings and foreign currency forward contracts, to hedge the foreign currency exposures of our net investment in certain foreign subsidiaries, primarily in the European Union. Based on a hypothetical decrease or increase of 10% in the value of the U.S. dollar against the Euro, the estimated fair value of the Company s foreign currency forward contracts would change by approximately $1.5 million. However, any change in the value of the contracts, real or hypothetical, would be significantly offset by a corresponding change in the value of the underlying hedged items.

We use derivative instruments as part of our interest rate risk management strategy. The derivative instruments used are comprised principally of fixed to variable rate interest rate swaps based on the LIBOR plus an interest mark up. The notional amount, interest payment and maturity date of the swaps match the principal, interest payment and maturity date of the related debt and the swaps are valued using observable benchmark rates. Based on a hypothetical decrease or increase of one percentage point in LIBOR, the estimated fair value of the Company s interest rate swaps would change by less than $1.0 million.

At December 31, 2012, the fair value of our fixed rate debt was $882 million. Based on a hypothetical decrease of 10% in interest rates, the estimated fair value of the Company s fixed debt would increase by $4 million.

We purchase certain commodities, such as natural gas, electricity, petroleum based products and certain crop related items. We generally purchase these commodities based upon market prices that are established with the vendor as part of the purchase process. In general, we do not use commodity financial instruments to hedge commodity prices.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

See index to Consolidated Financial Statements on page 53. See Item 6 on page 25 for supplemental quarterly data.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**ITEM 9A. CONTROLS AND PROCEDURES.**

***Evaluation of Disclosure Controls and Procedures and Changes in Internal Control over Financial Reporting.***

Our Chief Executive Officer and Chief Financial Officer, with the assistance of other members of our management, have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective as of the end of the period covered by this Annual Report on Form 10-K.

We have established controls and procedures designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission s rules and forms and is accumulated and communicated to management, including the principal executive officer and the principal financial officer, to allow timely decisions regarding required disclosure.

Our Chief Executive Officer and Chief Financial Officer have concluded that there have not been any changes in our internal control over financial reporting during the fourth quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

***Management s Report on Internal Control Over Financial Reporting.***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is a process designed 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.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in *Internal Control Integrated Framework.*

Based on this assessment, management determined that, as of December 31, 2012, our internal control over financial reporting was effective.

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PricewaterhouseCoopers LLP, our independent registered public accounting firm, has audited the effectiveness of our internal control over financial reporting as of December 31, 2012 as stated in their report which is included herein.

***Certifications to NYSE and SEC***

Our Chief Executive Officer certification was timely filed with the NYSE as required by NYSE Rule 303A(12). We have filed the required Sarbanes-Oxley Section 302 certifications of the Chief Executive Officer and Chief Financial Officer regarding the quality of our public disclosures as exhibits to our most recently filed Form 10-K.

**ITEM 9B. OTHER INFORMATION.**

None.

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## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

The information relating to directors and nominees of the Company is set forth in the IFF 2013 Proxy Statement and is incorporated by reference herein. The information relating to Section 16(a) beneficial ownership reporting compliance that appears in the IFF 2013 Proxy Statement is also incorporated by reference herein. See Part I, Item 1 of this Form 10-K for information relating to the Company s Executive Officers.

We have adopted a Code of Business Conduct and Ethics (the Code of Ethics ) that applies to all of our employees, including our chief executive officer and our chief financial officer (who is also our principal accounting officer). We have also adopted a Code of Conduct for Directors and a Code of Conduct for Executive Officers (together with the Code of Ethics, the Codes ). The Codes are available through the Investors Corporate Governance link on our website *www.iff.com*.

Only the Board of Directors or the Audit Committee of the Board may grant a waiver from any provision of our Codes in favor of a director or executive officer, and any such waiver will be publicly disclosed. We will disclose substantive amendments to and any waivers from the Codes provided to our chief executive officer and principal financial officer (principal accounting officer), as well as any other executive officer or director, on the Company s website: *www.iff.com*.

The information regarding the Company s Audit Committee and its designated audit committee financial experts is set forth in the IFF 2013 Proxy Statement and such information is incorporated by reference herein.

The information concerning procedures by which shareholders may recommend director nominees is set forth in the IFF 2013 Proxy Statement and such information is incorporated by reference herein.

### ITEM 11. EXECUTIVE COMPENSATION.

The information relating to executive compensation and the Company s policies and practices as they relate to the Company s risk management is set forth in the IFF 2013 Proxy Statement and such information is incorporated by reference herein; except that the information under the caption Compensation Committee Report shall be deemed furnished with this report and shall not be deemed filed with this report, not deemed incorporated by reference into any filing under the Securities Act of 1933 except only as may be expressly set forth in any such filing by specific reference.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information relating to security ownership of management, certain beneficial owners and the Company s equity plans is set forth in the IFF 2013 Proxy Statement and such information is incorporated by reference herein.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information regarding certain relationships and related party transactions and director independence is set forth in the IFF 2013 Proxy Statement and such information is incorporated by reference herein.

### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

The information regarding the independent registered public accounting firm ( independent accountant ) fees and services and the Company s pre-approval policies and procedures for audit and non-audit services provided by the Company s independent accountant are set forth in the IFF 2013 Proxy Statement and such information is incorporated by reference herein.

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## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a)(1) FINANCIAL STATEMENTS: The following consolidated financial statements, related notes, and independent registered public accounting firm s report are included in this report on Form 10-K:


| | |
|---|---|
| Report of Independent Registered Public Accounting Firm | 54 |
| Consolidated Statement of Income and Comprehensive Income for the three years ended December 31, 2012, 2011 and 2010 | 55 |
| Consolidated Balance Sheet as of December 31, 2012 and 2011 | 56 |
| Consolidated Statement of Cash Flows for the three years ended December 31, 2012, 2011 and 2010 | 57 |
| Consolidated Statement of Shareholders Equity for the three years ended December 31, 2012, 2011 and 2010 | 58 |
| Notes to Consolidated Financial Statements | 59-90 |


(a)(2) FINANCIAL STATEMENT SCHEDULES


| | |
|---|---|
| Schedule II Valuation and Qualifying Accounts and Reserves for the three years ended December 31, 2012, 2011 and 2010 | S-1 |


All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of International Flavors & Fragrances Inc.:

In our opinion, the consolidated financial statements listed in the index appearing under item 15(a)(1) present fairly, in all material respects, the financial position of International Flavors & Fragrances Inc. and its subsidiaries at December 31, 2012 and December 31, 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control Over Financial Reporting, appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed 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. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
New York, New York
February 26, 2013

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**INTERNATIONAL FLAVORS & FRAGRANCES INC.**

**CONSOLIDATED STATEMENT OF INCOME AND COMPREHENSIVE INCOME**

| | Year Ended December 31, | | |
|---|---|---|---|
| *(DOLLARS IN THOUSANDS EXCEPT PER SHARE AMOUNTS)* | **2012** | **2011** | **2010** |
| Net sales | $ 2,821,446 | $ 2,788,018 | $ 2,622,862 |
| Cost of goods sold | 1,645,912 | 1,683,362 | 1,530,260 |
| Research and development expenses | 233,713 | 219,781 | 218,772 |
| Selling and administrative expenses | 453,535 | 443,974 | 447,392 |
| Restructuring and other charges, net | 1,668 | 13,172 | 10,077 |
| Interest expense | 41,753 | 44,639 | 48,709 |
| Other expense, net | 1,450 | 9,544 | 8,059 |
| | 2,378,031 | 2,414,472 | 2,263,269 |
| Income before taxes | 443,415 | 373,546 | 359,593 |
| Taxes on income | 189,281 | 106,680 | 96,036 |
| Net income | 254,134 | 266,866 | 263,557 |
| Other comprehensive income: | | | |
| Foreign currency translation adjustments | 17,687 | (36,581) | (6,220) |
| (Losses) gains on derivatives qualifying as hedges | (4,455) | 8,420 | (1,442) |
| Pension and postretirement liability adjustment | (41,548) | (71,797) | 3,285 |
| Comprehensive income | $ 225,818 | $ 166,908 | $ 259,180 |

| | **2012** | **2011** | **2010** |
|---|---|---|---|
| Net income per share basic | $ 3.11 | $ 3.30 | $ 3.29 |
| Net income per share diluted | $ 3.09 | $ 3.26 | $ 3.26 |

See Notes to Consolidated Financial Statements

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**INTERNATIONAL FLAVORS & FRAGRANCES INC.**

**CONSOLIDATED BALANCE SHEET**

| *(DOLLARS IN THOUSANDS)* | **December 31, 2012** | **2011** |
|---|---|---|
| **ASSETS** | | |
| **Current Assets:** | | |
| Cash and cash equivalents | $ 324,422 | $ 88,279 |
| Receivables: | | |
| Trade | 508,736 | 478,177 |
| Allowance for doubtful accounts | (9,293) | (5,831) |
| Inventories | 540,658 | 544,439 |
| Deferred income taxes | 65,635 | 54,054 |
| Prepaid expenses and other current assets | 142,401 | 158,102 |
| Total Current Assets | 1,572,559 | 1,317,220 |
| Property, plant and equipment, net | 654,641 | 608,065 |
| Goodwill | 665,582 | 665,582 |
| Other intangible assets, net | 36,688 | 42,763 |
| Deferred income taxes | 160,610 | 152,118 |
| Other assets | 159,520 | 179,833 |
| Total Assets | $ 3,249,600 | $ 2,965,581 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| **Current Liabilities:** | | |
| Bank borrowings, overdrafts and current portion of long-term debt | $ 150,071 | $ 116,688 |
| Accounts payable | 199,272 | 208,759 |
| Dividends payable | | 25,086 |
| Restructuring and other charges | 3,149 | 10,198 |
| Other current liabilities | 270,240 | 203,835 |
| Total Current Liabilities | 622,732 | 564,566 |
| **Other Liabilities:** | | |
| Long-term debt | 881,104 | 778,248 |
| Deferred gains | 44,674 | 47,855 |
| Retirement liabilities | 337,927 | 315,633 |
| Other liabilities | 110,608 | 151,872 |
| Total Other Liabilities | 1,374,313 | 1,293,608 |
| **Commitments and Contingencies (Note 16)** | | |
| **Shareholders Equity:** | | |
| Common stock 12 $^{1}/_{2}$¢ par value; authorized 500,000,000 shares; issued 115,761,840 shares as of December 31, 2012 and 2011; and outstanding 81,626,874 and 80,921,208 shares as of December 31, 2012 and 2011 | 14,470 | 14,470 |
| Capital in excess of par value | 127,504 | 128,631 |
| Retained earnings | 2,841,166 | 2,692,893 |
| Accumulated other comprehensive (loss) income: | | |
| Cumulative translation adjustments | (93,722) | (111,409) |

| | | |
|---|---|---|
| Accumulated (losses) gains on derivatives qualifying as hedges | (218) | 4,237 |
| Pension and postretirement liability adjustment | (309,685) | (268,137) |
| Treasury stock, at cost 34,134,966 and 34,840,632 shares as of December 31, 2012 and 2011 | (1,330,707) | (1,356,273) |
| Total Shareholders Equity | 1,248,808 | 1,104,412 |
| Noncontrolling interest | 3,747 | 2,995 |
| Total Shareholders Equity including noncontrolling interest | 1,252,555 | 1,107,407 |
| Total Liabilities and Shareholders Equity | $ 3,249,600 | $ 2,965,581 |

See Notes to Consolidated Financial Statements

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**INTERNATIONAL FLAVORS & FRAGRANCES INC.**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

| *(DOLLARS IN THOUSANDS)* | Year Ended December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Net income | $ 254,134 | $ 266,866 | $ 263,557 |
| Adjustments to reconcile to net cash provided by operating activities: | | | |
| Depreciation and amortization | 76,667 | 75,327 | 79,242 |
| Deferred income taxes | (15,878) | 25,357 | (13,301) |
| Gain on disposal of assets | (4,461) | (3,184) | (3,681) |
| Stock-based compensation | 19,716 | 20,547 | 18,382 |
| Pension settlement/curtailment | 874 | 3,583 | |
| Spanish tax charges | 72,362 | | |
| Payments pursuant to Spanish tax settlement | (105,503) | | |
| Changes in assets and liabilities: | | | |
| Trade receivables | (33,056) | (35,697) | (12,143) |
| Inventories | 4,571 | (25,199) | (86,250) |
| Accounts payable | (740) | (5,859) | 39,973 |
| Accruals for incentive compensation | 34,632 | (49,964) | 45,709 |
| Other current payables and accrued expenses | 29,203 | (45,491) | 31,135 |
| Changes in other assets | (9,969) | (22,428) | (49,786) |
| Changes in other liabilities | 1,244 | (14,668) | 2,299 |
| Net cash provided by operating activities | 323,796 | 189,190 | 315,136 |
| **Cash flows from investing activities:** | | | |
| Additions to property, plant and equipment | (126,140) | (127,457) | (106,301) |
| Proceeds from disposal of assets | 1,763 | 705 | 1,657 |
| Maturity/termination of net investment hedges | 1,960 | (2,475) | 1,719 |
| Purchase of life insurance contracts | (1,127) | (1,936) | (3,858) |
| Proceeds from termination of life insurance contracts | 9,283 | | |
| Net cash used in investing activities | (114,261) | (131,163) | (106,783) |
| **Cash flows from financing activities:** | | | |
| Cash dividends paid to shareholders | (130,943) | (90,250) | (81,181) |
| Net change in revolving credit facility borrowings and overdrafts | 138,756 | 92,662 | (103,190) |
| Repayments of long-term debt | | (123,708) | |
| Proceeds from issuance of stock under stock plans | 9,211 | 14,656 | 26,224 |
| Excess tax benefits on stock-based payments | 8,380 | 5,933 | 1,403 |
| Net cash provided by (used in) financing activities | 25,404 | (100,707) | (156,744) |
| Effect of exchange rate changes on cash and cash equivalents | 1,204 | (373) | (412) |
| **Net change in cash and cash equivalents** | 236,143 | (43,053) | 51,197 |
| **Cash and cash equivalents at beginning of year** | 88,279 | 131,332 | 80,135 |
| **Cash and cash equivalents at end of year** | $ 324,422 | $ 88,279 | $ 131,332 |
| **Cash paid for:** | | | |
| Interest | $ 48,077 | $ 54,310 | $ 54,087 |

| | | | |
|---|---|---|---|
| Taxes[1] | $ 184,592 | $ 87,785 | $ 70,807 |
| **Noncash investing activities:** | | | |
| Accrued capital expenditures | $ 26,565 | $ 24,050 | $ 1,378 |

(1) The 2012 amount includes $105.5 million pursuant to the Spanish tax settlement (see Note 9).

See Notes to Consolidated Financial Statements

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**INTERNATIONAL FLAVORS & FRAGRANCES INC.**

**CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY**

| *(DOLLARS IN THOUSANDS)* | Common stock | Capital in excess of par value | Retained earnings | Accumulated other comprehensive (loss) income | Treasury stock | | Noncontrolling interest |
|---|---|---|---|---|---|---|---|
| | | | | | Shares | Cost | |
| Balance at December 31, 2009 | $ 14,470 | $ 110,374 | $ 2,339,205 | $ (270,974) | (36,604,447) | $ (1,424,072) | $ 2,907 |
| Net income | | | 263,557 | | | | 826 |
| Cumulative translation adjustment | | | | (6,220) | | | |
| Losses on derivatives qualifying as hedges; net of tax $639 | | | | (1,442) | | | |
| Pension liability and postretirement adjustment; net of tax $(2,429) | | | | 3,285 | | | |
| Cash dividends declared ($1.04 per share) | | | (83,056) | | | | |
| Stock options | | (333) | | | 779,317 | 30,461 | |
| Vested restricted stock units and awards | | (11,544) | | | 111,484 | 4,337 | |
| Stock-based compensation | | 13,844 | | | 162,171 | 6,062 | |
| Other | | 11,468 | | | | | |
| Balance at December 31, 2010 | $ 14,470 | $ 123,809 | $ 2,519,706 | $ (275,351) | (35,551,475) | $ (1,383,212) | $ 3,733 |
| Net income | | | 266,866 | | | | (738) |
| Cumulative translation adjustment | | | | (36,581) | | | |
| Gains on derivatives qualifying as hedges; net of tax $(3,504) | | | | 8,420 | | | |
| Pension liability and postretirement adjustment; net of tax $33,171 | | | | (71,797) | | | |
| Cash dividends declared ($1.16 per share) | | | (93,679) | | | | |
| Stock options/SSAR s | | 517 | | | 385,405 | 15,018 | |
| Vested restricted stock units and awards | | (16,284) | | | 190,813 | 7,449 | |
| Stock-based compensation | | 20,589 | | | 134,625 | 4,472 | |
| Balance at December 31, 2011 | $ 14,470 | $ 128,631 | $ 2,692,893 | $ (375,309) | (34,840,632) | $ (1,356,273) | $ 2,995 |
| Net income | | | 254,134 | | | | 752 |
| Cumulative translation adjustment | | | | 17,687 | | | |
| Losses on derivatives qualifying as hedges; net of tax $1,327 | | | | (4,455) | | | |
| Pension liability and postretirement adjustment; net of tax $11,696 | | | | (41,548) | | | |
| Cash dividends declared ($1.30 per share) | | | (105,861) | | | | |
| Stock options/SSAR s | | 4,248 | | | 336,296 | 13,144 | |
| Vested restricted stock units and awards | | (23,113) | | | 263,645 | 10,298 | |
| Stock-based compensation | | 17,738 | | | 105,725 | 2,124 | |
| Balance at December 31, 2012 | $ 14,470 | $ 127,504 | $ 2,841,166 | $ (403,625) | (34,134,966) | $ (1,330,707) | $ 3,747 |

See Notes to Consolidated Financial Statements

**INTERNATIONAL FLAVORS & FRAGRANCES INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Nature of Operations** International Flavors & Fragrances Inc., and its subsidiaries (the Registrant , IFF , the Company , we , us and our ) leading creator and manufacturer of flavor and fragrance compounds used to impart or improve flavor or fragrance in a wide variety of consumer products. Our products are sold principally to manufacturers of perfumes and cosmetics, hair and other personal care products, soaps and detergents, cleaning products, dairy, meat and other processed foods, beverages, snacks and savory foods, sweet and baked goods, and pharmaceutical and oral care products.

**Fiscal Year End** The Company has historically operated on a 52/53 week fiscal year generally ending on the Friday closest to the last day of the year. For ease of presentation, December 31 is used consistently throughout the financial statements and notes to represent the period-end date. All periods presented were 52 week periods. For the 2012, 2011 and 2010 fiscal years, the actual closing dates were December 28, December 30 and December 31, respectively.

**Use of Estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts and accompanying disclosures. These estimates are based on management s best knowledge of current events and actions the Company may undertake in the future. Actual results may ultimately differ from estimates.

**Principles of Consolidation** The consolidated financial statements include the accounts of International Flavors & Fragrances Inc. and those of its subsidiaries. Significant intercompany balances and transactions have been eliminated. To the extent a subsidiary is not wholly-owned, any related noncontrolling interest is included as a separate component of Shareholders Equity. Any applicable expense (income) attributable to the noncontrolling interest is included in Other expense, net in the accompanying Consolidated Statement of Income and Comprehensive Income due to its immateriality and, as such, is not presented separately.

**Revenue Recognition** The Company recognizes revenue when the earnings process is complete. This generally occurs when (i) title and risk of loss have been transferred to the customer in accordance with the terms of sale and (ii) collection is reasonably assured. Sales are reduced, at the time revenue is recognized, for applicable discounts, rebates and sales allowances based on historical experience. Related accruals are included in Other current liabilities in the accompanying Consolidated Balance Sheet.

**Foreign Currency Translation** The Company translates the assets and liabilities of non-U.S. subsidiaries into U.S. dollars at year-end exchange rates. Income and expense items are translated at average exchange rates during the year. Cumulative translation adjustments are shown as a separate component of Shareholders Equity.

**Research and Development** Research and development ( R&D ) expenses relate to the development of new and improved flavors or fragrances, technical product support and compliance with governmental regulation. All research and development costs are expensed as incurred.

**Cash Equivalents** Cash equivalents include highly liquid investments with maturities of three months or less at date of purchase.

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**Inventories** Inventories are stated at the lower of cost (on a weighted average basis) or market. Our inventories consisted of the following:

| *(DOLLARS IN THOUSANDS)* | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Raw materials | $ 256,728 | $ 248,050 |
| Work in process | 7,804 | 6,992 |
| Finished goods | 276,126 | 289,397 |
| Total | $ 540,658 | $ 544,439 |

**Property, Plant and Equipment** Property, plant and equipment are recorded at cost. Depreciation is calculated on a straight-line basis, principally over the following estimated useful lives: buildings and improvements, 10 to 40 years; machinery and equipment, 3 to 10 years; information technology hardware and software, 3 to 7 years; and leasehold improvements which are included in buildings and improvements, the estimated life of the improvements or the remaining term of the lease, whichever is shorter.

The Company reviews long-lived assets for impairment when events or changes in business conditions indicate that their full carrying value may not be recovered. An estimate of undiscounted future cash flows produced by an asset or group of assets is compared to the carrying value to determine whether impairment exists. If assets are determined to be impaired, the loss is measured based on an estimate of fair value using various valuation techniques, including a discounted estimate of future cash flows.

**Goodwill and Other Intangible Assets** Goodwill represents the difference between the total purchase price and the fair value of identifiable assets and liabilities acquired in business acquisitions.

In 2012, the Company re-evaluated its reporting unit structure and identified three reporting units: (1) Flavors, (2) Fragrance Compounds and (3) Fragrance Ingredients. These reporting units were determined based on the level at which the performance is measured and reviewed by segment management. Prior to 2012, the Company had identified two reporting units, Flavors and Fragrances. As a result, in 2012 the Company reallocated the goodwill previously allocated to its Fragrances reporting unit to its Fragrance Compounds and Fragrance Ingredients reporting units.

The Company performed the annual goodwill impairment test, utilizing the two-step approach for the Fragrance Compounds and Fragrance Ingredients reporting units, by assessing the fair value of our reporting units based on discounted cash flows, which indicated no impairment of goodwill, as the estimated fair values substantially exceeded the carrying values of each of these reporting units. In the fourth quarter of fiscal 2011, the Company early adopted ASU No. 2011-8 Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment. The Company conducts a goodwill qualitative assessment as of November 30th on an annual basis or more frequently when significant change in circumstances that would be considered a triggering event indicate that the carrying amount of an asset may not be recoverable. The goodwill impairment qualitative assessment requires us to perform an assessment for each reporting unit to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

The Company performed the qualitative assessment for the Flavors reporting unit which considered various factors, including the macroeconomic environment, industry and market specific conditions, financial performance, cost impacts and issues or events specific to the reporting unit. If it is determined that it is more likely than not the carrying amount exceeds the fair value of a reporting unit, the Company performs a step one goodwill impairment test. The Company completed its annual qualitative assessment as of November 30, 2012 for the Flavors reporting unit, which indicated no impairment of goodwill, as it was determined it is more likely than not that the fair value exceeds the carrying value of our reporting unit.

Other intangible assets include patents, trademarks and other intellectual property valued at acquisition, and amortized on a straight-line basis over periods ranging from 6 to 20 years.

**Income Taxes** The Company accounts for taxes under the asset and liability method. Under this method, deferred income taxes are recognized for temporary differences between the financial statement and tax return bases of assets and liabilities, based on enacted tax rates and other provisions of the tax law. The effect of a change in tax laws or rates on deferred tax assets and liabilities is recognized in income in the period in which such change is enacted. Future tax benefits are recognized to the extent that realization of such benefits is more likely than not, and a valuation allowance is established for any portion of a deferred tax asset that management believes may not be realized.

The Company recognizes uncertain tax positions that it has taken or expects to take on a tax return. Pursuant to the accounting requirements, we first determine whether it is more likely than not sustain our tax position if the relevant tax authority were to audit the position with full knowledge of all the relevant facts and other information. For those tax positions that meet this threshold, we measure the amount of tax benefit based on the largest amount of tax benefit that we have a greater than 50% chance of realizing in a final settlement with the relevant authority. Those tax positions failing to qualify for initial recognition are recognized in the first interim period in which they meet the more likely than not standard. We maintain a cumulative risk portfolio relating to all of our uncertainties in income taxes in order to perform this analysis, but the evaluation of our tax positions requires significant judgment and estimation in part because, in certain cases, tax law is subject to varied interpretation, and whether a tax position will ultimately be sustained may be uncertain.

The Company regularly repatriates a portion of current year earnings from select non U.S. subsidiaries. No provision is made for additional taxes on undistributed earnings of subsidiary companies that are intended and planned to be indefinitely invested in such subsidiaries. We intend to, and have plans to, reinvest these earnings indefinitely in our foreign subsidiaries to fund local operations and/or capital projects.

Interest and penalties related to unrecognized tax benefits are recognized as a component of income tax expense.

**Retirement Benefits** Current service costs of retirement plans and postretirement health care and life insurance benefits are accrued. Prior service costs resulting from plan improvements are amortized over periods ranging from 10 to 20 years.

**Financial Instruments** Derivative financial instruments are used to manage interest and foreign currency exposures. The gain or loss on the hedging instrument is recorded in earnings at the same time as the transaction being hedged is recorded in earnings. The associated asset or liability related to the open hedge instrument is recorded in Prepaid expenses and other current assets or Other current liabilities, as applicable.

The Company records all derivative financial instruments on the balance sheet at fair value. Changes in a derivative s fair value are recognized in earnings unless specific hedge criteria are met. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in Net income. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in Accumulated other comprehensive income (AOCI) in the accompanying Consolidated Balance Sheet and are subsequently recognized in Net income when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges, if any, are recognized as a charge or credit to earnings.

**Software Costs** The Company capitalizes direct internal and external development costs for certain significant projects associated with internal-use software and amortizes these costs over 7 years. Neither preliminary evaluation costs nor costs associated with the software after implementation are capitalized. Costs related to projects that are not significant are expensed as incurred.

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**Shipping and Handling Costs** Net sales include shipping and handling charges billed to customers. Cost of goods sold includes all costs incurred in connection with shipping and handling.

**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 computations of basic and diluted net income per share is as follows:

| | Number of Shares | | |
|---|---|---|---|
| *(SHARES IN THOUSANDS)* | **2012** | **2011** | **2010** |
| Basic | 81,108 | 80,456 | 79,495 |
| Assumed dilution under stock plans | 725 | 1,011 | 945 |
| Diluted | 81,833 | 81,467 | 80,440 |

Stock options and stock settled appreciation rights ( SSAR s ) to purchase 132,000, 78,000 and none shares were outstanding at December 31, 2012, 2011 and 2010, respectively, but are not included in the computation of diluted net income per share because to do so would have been anti-dilutive for the periods presented.

The Company has issued shares of Purchased Restricted Stock ( PRS ) which contain nonforfeitable rights to dividends and thus are considered participating securities which are required to be included in the computation of basic and diluted earnings per share pursuant to the two-class method. The two-class method was not presented since the difference between basic and diluted net income per share for both common shareholders and PRS shareholders was approximately $0.01 per share for each year and the number of PRS outstanding as of December 31, 2012, 2011 and 2010 was immaterial (approximately 0.6% of the total number of common shares outstanding). Net income allocated to such PRS during 2012, 2011 and 2010 was approximately $1.6 million, $1.7 million and $1.7 million, respectively.

**Stock-Based Compensation** Compensation cost of all share-based awards is measured at fair value on the date of grant and recognized over the service period for which awards are expected to vest. The cost of such share-based awards is principally recognized on a straight-line attribution basis over their respective vesting periods, net of estimated forfeitures.

**New Accounting Standards**

In May 2011, the Financial Accounting Standards Board ( FASB ) issued authoritative guidance that provides a consistent definition of fair value and ensures that the fair value measurements and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. This guidance enhances the disclosure requirements particularly for level 3 fair value measurements. This guidance was effective as of January 1, 2012 and did not have a material impact on the Company s consolidated financial statements.

In June 2011, the FASB issued revised guidance on the presentation of comprehensive income. This revised guidance eliminates the option to present the components of Other comprehensive income ( OCI ) as part of the Consolidated Statement of Shareholders Equity and provides two alternatives for presenting the components of net income and OCI, either: (i) in a single continuous statement of comprehensive income or (ii) in two separate but consecutive financial statements, consisting of an income statement followed by a separate statement of comprehensive income. Additionally, items that are reclassified from OCI to net income must be presented on the face of the financial statements. Although in December 2011, the FASB deferred the reclassification requirement of this guidance indefinitely, the Company has adopted this revised guidance as of January 1, 2012 and it did not have an impact on the Company s consolidated financial statements.

**Reclassifications and Revisions** Certain reclassifications have been made to the prior years financial statements to conform to the 2012 presentation.

The 2011 Consolidated Statement of Cash Flows has been revised to properly eliminate the non-cash effect of accrued capital expenditures of $18.1 million from the Changes in Accounts payable to the Changes in Other

current payables and accrued expenses within Net cash provided by operating activities. In addition, the Company has revised its Consolidated Balance Sheet as of December 31, 2011 to properly reflect $2.1 million of allowance for doubtful accounts which had previously been netted against gross trade receivables. As a result, both gross trade accounts receivable and the related allowance for doubtful accounts increased by $2.1 million, resulting in no change to Trade receivables, net of allowances. These revisions are not considered material to the previously issued financial statements.

**NOTE 2. RESTRUCTURING AND OTHER CHARGES**

Restructuring and other charges primarily consist of separation costs for employees including severance, outplacement and other benefit costs.

**European Rationalization Plan**

In 2009, as part of the rationalization of our European Fragrance manufacturing footprint, the Company decided to close its Fragrances compounding facility in Drogheda, Ireland as well as the partial closure of its Fragrance Ingredients plant in Haverhill, United Kingdom. The Company recorded $12.2 million of severance costs and $1.0 million of accelerated depreciation on certain related assets and other restructuring related costs. In addition, as part of the continued focus to optimize our European operations, the Flavors segment recorded a provision for severance costs of $1.0 million.

The Company completed its negotiations with the Drogheda, Ireland employee representatives regarding separation benefits related to the closure of the Company s compounding facility at that location during the third quarter 2010. Based upon the period-end estimates regarding the separation agreements, the Company increased its provision for severance costs by $4.4 million in 2010. The remaining $5.7 million of the restructuring charges in 2010 was mainly due to accelerated depreciation and other restructuring related costs pertaining to the rationalization of our Fragrances and Ingredients operations in Europe. The Company ceased its operations at the Drogheda plant as of September 30, 2010.

During the second quarter 2011, the Company executed a partial settlement of its pension obligations with the former employees of the Drogheda facility. As a result, we recorded a charge of $3.9 million related to the European rationalization plan to cover settlements and special termination benefits. This settlement was funded primarily through pension plan investment trust assets.

The Company also reversed $1.2 million of employee-related liabilities in 2011 due to certain employees accepting other roles within the Company, offset by $0.6 million of additional costs incurred.

**Strategic Initiative**

In December 2011, the Company recorded a charge to cover a restructuring initiative which involved a reduction in workforce primarily related to a realignment of responsibilities in our Fragrances business unit. It entailed the redeployment of creative resources in emerging markets and resulted in the elimination of 72 positions, across Fragrances, Flavors and Corporate functions. As a result, the Company recorded a provision for severance costs of $9.8 million to Restructuring and other charges, net in our 2011 Consolidated Statement of Income and Comprehensive Income. The Company recorded an additional net charge of $1.7 million during the twelve months ended December 31, 2012, principally attributable to adjustments based on the final separation terms with affected employees.

In the aggregate for 2012, we have recorded expenses of $34.1 million relating to the European Rationalization Plan and $11.5 million for the Strategic Initiative, of which $39.3 million was recorded to Restructuring and other charges, net and $6.3 million recorded to Cost of goods sold, R&D expenses and Selling and administrative expenses. We do not anticipate any further expenses related to the European Rationalization Plan.

**Reorganization Plan**

Movements in related accruals during 2010, 2011 and 2012 are as follows:

| *(DOLLARS IN THOUSANDS)* | Employee-Related | Pension | Asset - Related and Other | Total |
|---|---|---|---|---|
| Balance January 1, 2010 | $ 18,914 | $ | $ | $ 18,914 |
| Additional charges (reversals), net | 4,370 | | 5,707 | 10,077 |
| Non-cash charges | | | (4,409) | (4,409) |
| Payments and other costs | (19,307) | | (1,298) | (20,605) |
| Balance December 31, 2010 | 3,977 | | | 3,977 |
| Additional charges (reversals), net | 8,677 | 3,877 | 618 | 13,172 |
| Non-cash charges | | (3,139) | | (3,139) |
| Payments and other costs | (1,880) | (738) | (618) | (3,236) |
| Balance December 31, 2011[1] | 10,774 | | | 10,774 |
| Additional charges (reversals), net | 1,376 | 292 | | 1,668 |
| Non-cash charges | | (292) | | (292) |
| Payments and other costs | (9,001) | | | (9,001) |
| Balance December 31, 2012 | $ 3,149 | $ | $ | $ 3,149 |

(1) $0.6 million of the remaining employee-related liability is classified in Other liabilities as of December 31, 2011 in the Consolidated Balance Sheet.

**NOTE 3. PROPERTY, PLANT AND EQUIPMENT, NET**

PP&E consists of the following amounts:

| | December 31, | |
|---|---|---|
| *(DOLLARS IN THOUSANDS)* | 2012 | 2011 |
| *Asset Type* | | |
| Land | $ 24,183 | $ 26,468 |
| Buildings and improvements | 328,724 | 305,766 |
| Machinery and equipment | 790,445 | 717,626 |
| Information technology | 247,298 | 242,501 |
| Construction in process | 141,667 | 139,733 |
| | 1,532,317 | 1,432,094 |
| Accumulated depreciation | (877,676) | (824,029) |
| | $ 654,641 | $ 608,065 |

**NOTE 4. GOODWILL AND OTHER INTANGIBLE ASSETS, NET**

Goodwill by segment is as follows:

| *(DOLLARS IN THOUSANDS)* | **December 31, 2012 and 2011** |
|---|---|
| Flavors | $ 319,479 |
| Fragrances | 346,103 |
| Total | $ 665,582 |

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Trademark and other intangible assets consist of the following amounts:

| (DOLLARS IN THOUSANDS) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Gross carrying value[1] | $ 165,406 | $ 165,406 |
| Accumulated amortization | (128,718) | (122,643) |
| Total | $ 36,688 | $ 42,763 |

(1) Includes patents, trademarks and other intellectual property, valued at acquisition.

Amortization expense for the years ended December 31, 2012, 2011 and 2010 was $6.1 million. Estimated annual amortization is $6.1 million for years 2013 and $4.7 million for 2014 through 2017.

**NOTE 5. OTHER ASSETS**

Other assets consist of the following amounts:

| (DOLLARS IN THOUSANDS) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Overfunded pension plans | $ 33,345 | $ 67,518 |
| Cash surrender value of life insurance contracts | 51,391 | 56,177 |
| Other | 74,784 | 56,138 |
| Total | $ 159,520 | $ 179,833 |

**NOTE 6. OTHER CURRENT LIABILITIES**

Other current liabilities consist of the following amounts:

| (DOLLARS IN THOUSANDS) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Accrued payrolls and bonuses | $ 80,027 | $ 42,229 |
| VAT payable | 30,129 | 21,744 |
| Interest payable | 14,788 | 14,822 |
| Current pension and other postretirement benefit obligation | 2,949 | 12,852 |
| Accrued insurance (including workers compensation) | 11,016 | 7,806 |
| Other | 131,331 | 104,382 |
| Total | $ 270,240 | $ 203,835 |

**NOTE 7. SALE AND LEASEBACK TRANSACTIONS**

In connection with the disposition of certain real estate in prior years, we entered into long-term operating leases. The leases are classified as operating leases and the gains realized on these leases have been deferred and are being credited to income over the initial lease term. Such deferred gains totaled $48 million and $51 million at December 31, 2012 and 2011, respectively, of which $45 million and $48 million, respectively, are reflected in the accompanying Consolidated Balance Sheet under the caption Deferred gains, with the remainder included as a

component of Other current liabilities.

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**NOTE 8. BORROWINGS**

Debt consists of the following at December 31:

| *(DOLLARS IN THOUSANDS)* | **Rate** | **Maturities** | **2012** | **2011** |
|---|---|---|---|---|
| Senior notes 2007 | 6.40% | 2017-27 | $ 500,000 | $ 500,000 |
| Senior notes 2006 | 6.10% | 2013-16 | 225,000 | 225,000 |
| Credit facilities | 1.41% | 2016 | 296,748 | 157,483 |
| Bank overdrafts and other | 1.20% | 2012 | 399 | 1,488 |
| Deferred realized gains on interest rate swaps | | | 9,028 | 10,965 |
| | | | 1,031,175 | 894,936 |
| Less: Current portion of long-term debt | | | (150,071) | (116,688) |
| | | | $ 881,104 | $ 778,248 |

Commercial paper issued by the Company generally has terms of 30 days or less. There were no outstanding commercial paper borrowings at December 31, 2012 or 2011.

In 2005, IFF, including certain subsidiaries, entered into a revolving credit agreement (the Facility ) with certain banks. The Facility provided for a five-year U.S. $350 million ( Tranche A ) and Euro 400 million ( Tranche B ) multi-currency revolving credit facility. As permitted by the Facility, in 2007, the termination dates were extended until November 23, 2012. As the Facility was a multi-year revolving credit agreement, we classified the portion we expected to have outstanding longer than 12 months as long-term debt.

On November 9, 2011, IFF, including certain subsidiaries, entered into a revolving credit agreement with Citibank, N.A., as administrative agent and the other lenders, agents, arrangers and bookrunners to replace the Facility. The Credit Agreement which was amended and restated on March 9, 2012 provides for a revolving loan facility in an aggregate amount up to an equivalent of $942 million (the New Facility ). There are three tranches under the New Facility. The Tranche A facility is available to all of the borrowers other than IFF Spain in U.S. dollars, euros, Swiss francs, Japanese yen and British sterling in an aggregate amount up to an equivalent of $458 million and contains sublimits of $50 million for swing line borrowings. The Tranche B facility is available to all of the borrowers in euros, Swiss francs, Japanese yen and British sterling in an aggregate amount up to an equivalent of $354 million and contains sublimits of 50 million for swing line borrowings. The Tranche C facility is available to all of the borrowers in euros only in an aggregate amount up to 100,505,400. The New Facility will be available for general corporate purposes of each borrower and its subsidiaries. The obligations under the New Facility are unsecured and the Company has guaranteed the obligations of each other borrower under the New Facility. The New Facility will mature on November 9, 2016, but may be extended for up to two additional one-year periods at the Company s request, subject to the agreement of the lenders having commitments representing more than 50% of the aggregate commitments of all lenders under the New Facility. Borrowings under the New Facility bear interest at an annual rate of LIBOR plus a margin, currently 125 bps, linked to our credit rating. We pay a commitment fee on the aggregate unused commitments; such fee is not material. The New Facility contains various affirmative and negative covenants, including the requirement for us to maintain, at the end of each fiscal quarter, a ratio of net debt for borrowed money to adjusted EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) in respect of the previous 12-month period of not more than 3.25 to 1. As of December 31, 2012, we were in compliance with all covenants under this New Facility. We had $296.7 million outstanding under New Facility as of December 31, 2012, with $648.2 million still available for additional borrowings. As the New Facility is a multi-year revolving credit agreement, we classify as long-term debt the portion that we have the intent and ability to maintain outstanding longer than 12 months. At December 31, 2012, $247 million of revolver borrowings was classified as long-term debt, and the remaining $50 million was classified as current portion of long-term debt.

Credit facility borrowings and bank overdrafts were outstanding in several countries and averaged $143 million in 2012 and $90 million in 2011. The highest levels were $297 million in 2012, $163 million in 2011, and

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$81 million in 2010. The 2012 weighted average interest rate of these borrowings, based on balances outstanding at the end of each month, was 1.5% and the average rate on balances outstanding at December 31, 2012 was 1.6%. These rates compare with 0.8% and 0.7%, respectively, in 2011, and 0.5% and 0.4%, respectively, in 2010.

On September 27, 2007, the Company issued $500 million of Senior Unsecured Notes ( Senior Notes 2007 ) in four series under the Note Purchase Agreement ( NPA ): (i) $250 million in aggregate principal amount of 6.25% Series A Senior Notes due September 27, 2017, (ii) $100 million in aggregate principal amount of 6.35% Series B Notes due September 27, 2019, (iii) $50 million in aggregate principal amount of 6.50% Series C Notes due September 27, 2022, and (iv) $100 million in aggregate principal amount of 6.79% Series D Notes due September 27, 2027. Proceeds of the offering were used primarily to fund an accelerated repurchase of IFF stock.

In 2006, the Company issued $375 million of Senior Unsecured Notes ( Senior Notes 2006 ) in four series under another NPA: (i) $50 million in aggregate principal amount of 5.89% Series A Senior Notes due July 12, 2009, (ii) $100 million in aggregate principal amount of 5.96% Series B Notes due July 12, 2011, (iii) $100 million in aggregate principal amount of 6.05% Series C Notes due July 12, 2013, and (iv) $125 million in aggregate principal amount of 6.14% Series D Notes due July 12, 2016. Proceeds of the offering were used primarily to repay commercial paper borrowings used to fund our maturing debt. In July 2009 we repaid $50 million in principal in the first series under the Senior Notes 2006 that became due. On July 12, 2011, the Company made a $100 million debt repayment related to the maturity of our Senior Notes 2006, which was funded primarily through existing cash balances with the remainder coming from our existing credit facility.

On November 21, 2011 the Company repaid the remaining balance of our ¥1.8 billion Japanese Yen Note for $23.7 million, financed primarily from the New Facility.

Maturities on debt outstanding at December 31, 2012 are: 2013, $150 million; 2016, $372 million; 2017, $250 million and 2018 and thereafter, $250 million. There is no debt maturing in 2014 and 2015.

The estimated fair value at December 31, 2012 of our Senior Notes 2007 and Senior Notes 2006 was approximately $634 million and $248 million, respectively, and is discussed in further detail in Note 14.

During the third quarter of 2010, the Company entered into two new interest rate swap agreements effectively converting the fixed rate on a portion of our long-term Senior note borrowings to a variable short-term rate based on the LIBOR plus an interest markup.

In March 2008, the Company realized an $18 million gain on the termination of an interest rate swap, which has been deferred and is being amortized as a reduction to interest expense over the remaining term of the related debt. The balance of this deferred gain was $9 million at December 31, 2012.

**NOTE 9. INCOME TAXES**

Earnings before income taxes consisted of the following:

| | December 31, | | |
|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** | **2010** |
| U.S. loss before taxes | $ (21,308) | $ (5,854) | $ (82,112) |
| Foreign income before taxes | 464,723 | 379,400 | 441,705 |
| Total income before taxes | $ 443,415 | $ 373,546 | $ 359,593 |

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The income tax provision consisted of the following:

| *(DOLLARS IN THOUSANDS)* | December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| Current | | | |
| Federal | $ 8,280 | $ 2,386 | $ 5,379 |
| State and local | (456) | 15 | 507 |
| Foreign[(1)] | 197,335 | 78,922 | 103,451 |
| | 205,159 | 81,323 | 109,337 |
| Deferred | | | |
| Federal | (4,650) | 11,088 | (22,423) |
| State and local | (74) | 5,996 | 2,868 |
| Foreign[(1)] | (11,154) | 8,273 | 6,254 |
| | (15,878) | 25,357 | (13,301) |
| Total income taxes | $ 189,281 | $ 106,680 | $ 96,036 |

(1) For year ended December 31, 2012, the foreign current income tax provision includes $72 million of Spanish tax charges and $12 million of charges related to the Spanish dividend withholding cases. The foreign deferred income tax provision includes a $11 million tax benefit from the corporate restructuring of certain foreign subsidiaries.

A reconciliation between the U.S. federal statutory income tax rate to our actual effective tax rate is as follows:

| | December 31, 2012 | 2011 | 2010 |
|---|---|---|---|
| Statutory tax rate | 35.0% | 35.0% | 35.0% |
| Difference in effective tax rate on foreign earnings and remittances | (10.6) | (10.0) | (9.5) |
| Unrecognized tax benefit, net of reversals | 0.9 | 1.8 | 1.4 |
| Corporate restructuring of certain foreign subsidiaries | (2.4) | | |
| Spanish tax charges | 16.3 | | |
| Spanish dividend withholdings | 2.6 | | |
| State and local taxes | (0.1) | 1.5 | 0.8 |
| Other, net | 1.0 | 0.3 | (1.0) |
| Effective tax rate | 42.7% | 28.6% | 26.7% |

Our effective tax rate reflects the benefit from having significant operations outside the U.S. that are taxed at rates that are lower than the U.S. federal rate of 35%. Included in the 2012 effective tax rate is $72.4 million of tax charges pursuant to the Spanish tax settlement. The 2012, 2011 and 2010 effective tax rates were also favorably impacted by the reversals of liabilities for uncertain tax positions of $1 million, $5 million and $6 million, respectively, principally due to statutory expiry and effective settlement.

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The deferred tax assets consist of the following amounts:

| *(DOLLARS IN THOUSANDS)* | December 31, 2012 | 2011 |
|---|---|---|
| **ASSETS** | | |
| Employee and retiree benefits | $ 156,399 | $ 132,210 |
| Credit and net operating loss carryforwards[(1)] | 308,900 | 210,886 |
| Property, plant and equipment, net | 2,643 | 5,015 |
| Trademarks and other[(1)] | 141,248 | 87,911 |
| Amortizable R&D expenses | 30,590 | 23,571 |
| Other, net | 25,148 | 18,729 |
| Gross deferred tax assets | 664,928 | 478,322 |
| Valuation allowance[(1)] | (450,733) | (290,879) |
| Total net deferred tax assets | $ 214,195 | $ 187,443 |

(1) During 2012, the Company increased its deferred tax assets by $129 million. The 2012 amount includes a revision to the 2011 foreign net operating loss carryforwards in the amount of $74 million and a $55 million increase related to current year internally generated intangible assets. The revision is not considered material to the previously issued financial statements. This entire increase of $129 million was offset by a corresponding increase in valuation allowances.

Net operating loss carryforwards were $273 million and $175 million at December 31, 2012 and 2011, respectively. If unused, $6 million will expire between 2013 and 2032. The remainder, totaling $267 million, may be carried forward indefinitely. Tax credit carryforwards were $36 million at December 31, 2012 and 2011. If unused, the credit carryforwards will expire between 2013 and 2031.

The U.S. consolidated group has historically generated taxable income after the inclusion of foreign dividends. As such, the Company is not in a federal net operating loss position. This allows IFF and its U.S. subsidiaries to realize tax benefits from the reversal of temporary differences and the utilization of its federal tax credits before the expiration of the applicable carryforward periods. The Company has not factored any future trends, other than inflation, in its U.S. taxable income projections. The corresponding U.S. federal taxable income is sufficient to realize $187.2 million in deferred tax assets as of December 31, 2012.

The majority of states in the U.S. where IFF and its subsidiaries file income tax returns allow a 100% foreign dividend exclusion, effectively converting the domestic companies reversing temporary differences into net operating losses. As there is significant doubt with respect to realizability of these net operating losses, we have established a full valuation allowance against these deferred tax assets.

Of the $309 million deferred tax asset for net operating loss carryforwards and credits at December 31, 2012, we consider it unlikely that a portion of the tax benefit will be realized. Accordingly, a valuation allowance of $268 million of net operating loss carryforwards and $9 million of tax credits has been established against these deferred tax assets, respectively. In addition, due to realizability concerns, we established a valuation allowance against certain other net deferred tax assets of $174 million.

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A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| *(DOLLARS IN THOUSANDS)* | **2012** | **December 31, 2011** | **2010** |
|---|---|---|---|
| Balance of unrecognized tax benefits at beginning of year | $ 67,615 | $ 63,928 | $ 64,673 |
| Gross amount of increases in unrecognized tax benefits as a result of positions taken during a prior year | 22,031 | 118 | 2 |
| Gross amount of decreases in unrecognized tax benefits as a result of positions taken during a prior year | (1,853) | (50) | |
| Gross amount of increases in unrecognized tax benefits as a result of positions taken during the current year | 3,854 | 8,300 | 4,706 |
| The amounts of decreases in unrecognized benefits relating to settlements with taxing authorities | (48,355) | (2,960) | (4,945) |
| Reduction in unrecognized tax benefits due to the lapse of applicable statute of limitation | (2,139) | (1,721) | (508) |
| Balance of unrecognized tax benefits at end of year | $ 41,153 | $ 67,615 | $ 63,928 |

At December 31, 2012, 2011 and 2010, there are $36.4 million, $65.9 million, and $63.9 million, respectively, of unrecognized tax benefits recorded to Other liabilities and $4.8 million and $1.7 million in 2012 and 2011, respectively, recorded to Other current liabilities. If these unrecognized tax benefits were recognized, all the benefits and related interest would be recorded as a benefit to income tax expense.

For the year ended December 31, 2012, the Company reduced its liabilities for interest and penalties by $5.3 million, net, principally due to payments made pursuant to the Spanish tax settlement, as discussed below. For the years ended December 31, 2011 and 2010 the Company recognized $2.0 million and $1.0 million, respectively, in interest and penalties. At December 31, 2012, 2011 and 2010, we had accrued $7.4 million, $12.8 million and $11.0 million, respectively, of interest and penalties classified as Other liabilities and $0.1 million in 2012 recorded to Other current liabilities.

Tax benefits credited to Shareholders equity totaled $0.4 million, $2.0 million and $3.0 million for 2012, 2011 and 2010, respectively, associated with stock option exercises and PRS dividends.

U.S. income taxes and foreign withholding taxes associated with the repatriation of earnings of its foreign subsidiaries were not provided on a cumulative total of $1,146 million of undistributed earnings of foreign subsidiaries. We intend to, and have plans to, reinvest these earnings indefinitely in our foreign subsidiaries to fund local operations and/or capital projects. It is not practicable to estimate the unrecognized deferred tax liability on these undistributed earnings.

The Company has ongoing income tax audits and legal proceedings which are at various stages of administrative or judicial review, of which the material items are discussed below. In addition, the Company has other ongoing tax audits and legal proceedings that relate to indirect taxes, such as value-added taxes, capital tax, sales and use and property taxes, which are discussed in Note 16.

As of December 31, 2012, the most significant income tax disputes in which the Company was involved related to certain tax positions taken by the Company s Spanish subsidiaries for the 2002-2003 fiscal years which positions have been challenged by the Spanish tax authorities. As a result of the audits of 2002-2003 fiscal years, the Spanish tax authorities imposed assessments aggregating Euro 22.2 million ($29.3 million), including aggregate estimated interest through December 31, 2012. In order to proceed with its appeals of the tax assessments for the 2002-2003 fiscal years, the Company was required to post bank guarantees. As of December 31, 2012, the Company had posted bank guarantees of Euro 21.6 million ($28.5 million) associated with the 2002-2003 appeals. The Company appealed these assessments with the Appellate Court. On February 7,

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2013, the Appellate Court upheld the lower court s ruling with respect to the 2003 tax assessment and the related tax avoidance claims. We have filed a notice of intent to appeal this ruling. The Appellate Court has not yet ruled on our appeal of the 2002 tax assessment and related claims. We recorded an additional tax provision in the first quarter of 2013 of $6 million after-tax associated with the 2002-2003 cases. The Company s Spanish subsidiaries have not yet received an assessment with respect to the 2011 fiscal year.

During the third quarter of 2012 the Company and the Spanish tax authorities entered into an overall settlement with respect to assessments imposed in connection with audits for the 2004-2010 fiscal years. In connection with this settlement, the Company paid Euro 84.0 million ($105.5 million based on exchange rates at the respective payment dates) during 2012 and will pay the remainder of Euro 1.5 million ($1.9 million) in the first quarter of 2013. This settlement did not address either the 2002-2003 fiscal years or the 2011 fiscal year. In connection with the overall settlement, the Company recorded after-tax charges of $72.4 million during the third quarter 2012, which included $56.0 million related to the tax settlement of the 2004-2010 period and the increased liabilities for uncertain tax positions of $16.4 million for years not settled. During the fourth quarter the Company and the Spanish tax authorities also finalized a multi-year agreement that established the tax basis for the Company s activities in Spain for 2012 through 2014 consistent with the key principles preliminarily agreed upon as part of the overall settlement.

In addition to the above, the Company has also been a party to four dividend withholding tax controversies in Spain in which the Spanish tax authorities alleged that the Company s Spanish subsidiaries underpaid withholding taxes during the 1995-2001 fiscal years. The Company had previously appealed each of these controversies. During 2012, the Company received unfavorable decisions on the first three cases. As a result of these rulings, the Company (i) recorded charges (including estimated interest) of approximately $12 million after-tax during 2012, and (ii) made payments of Euro 9.8 million ($12.8 million based on exchange rates at the respective payment date) during 2012. At December 31, 2012, the Company had Euro 4.3 million ($5.7 million) reflected in income taxes payable in connection with these three cases. The fourth and final remaining appeal has not yet been heard by the Spanish Supreme Court. At December 31, 2012, the aggregate amount of the remaining dividend withholding controversy was Euro 8.2 million ($10.8 million), including estimated interest. As of December 31, 2012, the Company had posted bank guarantees of Euro 7.9 million ($10.5 million) in order to proceed with the appeal in this controversy.

As of December 31, 2012, the Company s aggregate provisions for uncertain tax positions, including interest and penalties, was $48.7 million, which includes $25.9 million associated with the tax positions taken by our Spanish subsidiaries for the 2002-2003 and the 2011 fiscal years, $3.7 million associated with our Spanish dividend withholding tax controversies and the remainder associated with various other tax positions asserted in foreign jurisdictions, none of which is individually material.

In addition, the Company has several other tax audits in process and has open tax years with various taxing jurisdictions that range primarily from 2002 to 2011. Based on currently available information, we do not believe the ultimate outcome of any of these tax audits and other tax positions related to open tax years, when finalized, will have a material impact on our financial position.

**NOTE 10. SHAREHOLDERS EQUITY**

Cash dividends declared per share were $1.30, $1.16 and $1.04 in 2012, 2011 and 2010, respectively. In December 2012, the Company declared and paid a cash dividend of $0.34 per share. There are no dividends payable as of December 31, 2012. Dividends declared, but not paid at December 31, 2011 and 2010 were $25.1 million ($0.31 per share) and $21.7 million ($0.27 per share), respectively. The increase in the dividends paid from 2011 to 2012 reflects both a higher level of dividends declared in 2012 as well as the accelerated payment in December 2012 of our fourth quarter dividend.

In December 2012, the Board of Directors authorized a $250 million share repurchase program, which commenced in the first quarter of 2013 and is expected to be completed by the end of 2014. Based on the total

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authorized amount of $250 million available under the repurchase program, approximately 3.8 million shares, or 4.7% of shares outstanding (based on the market price and shares outstanding as of December 31, 2012) could be repurchased under the program. The purchases 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 placed into treasury stock. No repurchases were made during the fourth quarter of 2012. This plan expires on December 31, 2014.

**NOTE 11. STOCK COMPENSATION PLANS**

We have various equity plans under which our officers, senior management, other key employees and directors may be granted options to purchase IFF common stock or other forms of stock-based awards. Beginning in 2004, we granted Restricted Stock Units ( RSU s ) as the principal element of our equity compensation for all eligible U.S. based employees and a majority of eligible overseas employees. Vesting of the RSU s is solely time based; the vesting period is primarily three years from date of grant. For a small group of employees, primarily overseas, we granted stock options prior to 2008.

The cost of all employee stock-based awards are principally recognized on a straight-line attribution basis over their respective vesting periods, net of estimated forfeitures. Total stock-based compensation expense included in our Consolidated Statement of Income and Comprehensive Income was as follows:

| | | December 31, | |
|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** | **2010** |
| Equity-based awards | $ 19,716 | $ 20,547 | $ 18,382 |
| Liability-based awards | 3,294 | 3,044 | 3,619 |
| Total stock-based compensation | 23,010 | 23,591 | 22,001 |
| Less tax benefit | (7,228) | (7,730) | (8,028) |
| Total stock-based compensation, net of tax | $ 15,782 | $ 15,861 | $ 13,973 |

The shareholders of the Company approved the Company s 2010 Stock Award and Incentive Plan (the 2010 Plan ) at the Annual Meeting of Shareholders held on April 27, 2010. The 2010 Plan replaced the Company s 2000 Stock Award and Incentive Plan and the 2000 Supplemental Stock Award Plan (the 2000 Plans ) and provides the source for future deferrals of cash into deferred stock under the Company s Deferred Compensation Plan (with the Deferred Compensation Plan being deemed a subplan under the 2010 Plan for the sole purpose of funding deferrals under the IFF Share Fund).

Under the 2010 Plan, a total of 2,749,669 shares are authorized for issuance, including 749,669 shares remaining available under a previous plan that were rolled into the 2010 Plan. At December 31, 2012, 1,866,473 shares were subject to outstanding awards and 1,814,093 shares remained available for future awards under all of the Company s equity award plans, including the 2010 Plan (excluding shares not yet issued under open cycles of the Company s Long-Term Incentive Plan).

The Company offers a Long-Term Incentive Plan ( LTIP ) for senior management. The targeted payout is 50% cash and 50% IFF stock at the end of the three-year cycle and provides for segmentation in which one-fourth of the award vests during each twelve-month period, with the final one-fourth segment vesting over the full three-year period. Grants prior to 2012, were earned based on the achievement of defined EPS targets and our performance ranking of total shareholder return as a percentile of the S&P 500. Commencing with the 2012-2014 LTIP cycle, the Company used Economic Profit ( EP ) rather than EPS, as one of the two financial metrics of Company performance. EP measures operating profitability after considering (i) all our operating costs, (ii) income taxes and (iii) a charge for the capital employed in the business. When the award is granted, 50% of the target dollar value of the award is converted to a number of notional shares based on the closing price at the beginning of the cycle. For those shares whose payout is based on shareholder return as a percentile of the S&P 500, compensation expense is recognized using a graded-vesting attribution method, while compensation expense for the remainder of the performance shares (e.g., EPS targets) is recognized on a straight-line basis over

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the vesting period based on the probable outcome of the performance condition. The 2008-2010 cycle concluded at the end of 2010 and an aggregate 78,072 shares of our common stock were issued in March 2011.

On February 1, 2010, the Compensation Committee of the Company s Board of Directors approved a one-year supplemental performance metric for the Company s LTIP 2008-2010 cycle which was based on improvement in operating profit margin measured over the fiscal year 2010 period as compared to 2009. The 2009-2011 cycle concluded at the end of 2011 and an aggregate 128,293 shares of our common stock were issued in March 2012. The 2010-2012 cycle concluded at the end of 2012 and an aggregate 119,561 shares of our common stock will be issued in March 2013.

In 2006, our Board approved the Equity Choice Program (the Program ) for senior management. This program continues under the 2010 Plan. 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) SSAR s, (2) RSU s or (3) PRS.

***SSAR s***

SSAR s granted become exercisable on the third anniversary of the grant date and have a maximum term of seven years. We granted 54,307, 77,864 and 196,652 SSAR s during 2012, 2011 and 2010, respectively. No stock options were granted in 2012, 2011 and 2010.

We use the Binomial lattice-pricing model as our valuation model for estimating the fair value of SSAR s granted. In applying the Binomial model, we utilize historical information to estimate expected term and post-vesting terminations within the model. The expected term of a SSAR is based on historical employee exercise behavior, vesting terms and a contractual life of primarily seven years. The risk-free interest rate for periods within the expected term 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 our common stock over the calculated expected term. We anticipate paying cash dividends in the future and therefore use an expected dividend yield in the valuation model; the cash dividend in effect at the time of grant was employed in this calculation.

Principal assumptions used in applying the Binomial model in 2012, 2011 and 2010 were:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Weighted average fair value of SSAR s granted during the period | $ 10.39 | $ 11.47 | $ 10.41 |
| Assumptions: | | | |
| Risk-free interest rate | 0.9% | 1.7% | 2.2% |
| Expected volatility | 22.5% | 23.2% | 29.8% |
| Expected dividend yield | 2.1% | 2.1% | 2.2% |
| Expected life, in years | 5 | 5 | 5 |
| Termination rate | 1.05% | 0.99% | 1.09% |
| Exercise multiple | 1.44 | 1.43 | 1.38 |

SSAR s and Stock options activity were as follows:

| *(SHARE AMOUNTS IN THOUSANDS)* | Shares Subject to SSAR s/Options | Weighted Average Exercise Price | SSAR s/ Options Exercisable |
|---|---|---|---|
| Balance at December 31, 2011 | 1,090 | $ 39.16 | 627 |
| Granted | 54 | $ 60.39 | |
| Exercised | (443) | $ 34.87 | |
| Cancelled | (95) | $ 36.75 | |
| Balance at December 31, 2012 | 606 | $ 44.68 | 320 |

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The weighted average exercise price of our SSAR s and options exercisable at December 31, 2012, 2011 and 2010 were $37.64, $36.86 and $36.14, respectively. The following tables summarize information concerning currently outstanding and exercisable SSAR s and options.

SSAR s and options outstanding at December 31, 2012 were as follows:

| Price Range | Number Outstanding (in thousands) | Weighted Average Remaining Contractual Life (in years) | Weighted Average Exercise Price | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| $26 $30 | 78 | 3.4 | $ 30.19 | |
| $31 $35 | 72 | 1.4 | $ 33.78 | |
| $36 $40 | 74 | 2.8 | $ 36.87 | |
| $41 $50 | 199 | 4.0 | $ 44.30 | |
| $51 $55 | 51 | 3.9 | $ 51.44 | |
| $56 $65 | 132 | 5.8 | $ 61.42 | |
| | 606 | | $ 44.68 | $ 12,888 |

SSAR s and stock options exercisable as of December 31, 2012 were as follows:

| Price Range | Number Exercisable (in thousands) | Weighted Average Remaining Contractual Life (in years) | Weighted Average Exercise Price | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| $26 $30 | 78 | 3.4 | $ 30.19 | |
| $31 $35 | 72 | 1.4 | $ 33.78 | |
| $36 $40 | 74 | 2.8 | $ 36.87 | |
| $41 $50 | 45 | 2.3 | $ 42.18 | |
| $51 $55 | 51 | 3.9 | $ 51.44 | |
| | 320 | | $ 37.64 | $ 9,051 |

The total intrinsic value of options/SSAR s exercised during 2012, 2011 and 2010 totaled $11 million, $10 million and $14 million, respectively.

As of December 31, 2012, there was $0.9 million of total unrecognized compensation cost related to non-vested SSAR awards granted; such cost is expected to be recognized over a weighted average period of 1.6 years.

***Restricted Stock Units***

We have granted RSU s to eligible employees and directors. Such RSU s are subject to forfeiture if certain employment conditions are not met. RSU s principally vest 100% at the end of three years and contain no performance criteria provisions. An RSU s fair value is calculated based on the market price of our stock at date of grant, with an adjustment to reflect the fact that such awards do not participate in dividend rights. The aggregate fair value is amortized to expense ratably over the vesting period.

RSU activity was as follows:

| *(SHARE AMOUNTS IN THOUSANDS)* | Number of Shares | Weighted Average Grant Date Fair |
|---|---|---|

| | | | Value Per Share |
|---|---|---|---|
| Balance at December 31, 2011 | 782 | $ | 44.91 |
| Granted | 211 | $ | 56.43 |
| Vested | (333) | $ | 30.24 |
| Forfeited | (41) | $ | 47.30 |
| Balance at December 31, 2012 | 619 | $ | 54.09 |

The total fair value of RSU s which vested during the year ended December 31, 2012 was $20.0 million.

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As of December 31, 2012, there was $11.2 million of total unrecognized compensation cost related to non-vested RSU awards granted under the equity incentive plans; such cost is expected to be recognized over a weighted average period of 1.7 years.

***Purchased Restricted Stock***

For awards issued in 2012 and prior, PRS provides for eligible employees to purchase restricted shares of IFF stock at 50% of the fair market value on the grant date of the award. The shares generally vest on the third anniversary of the grant date, are subject to continued employment and other specified conditions and pay dividends if and when paid by us. Holders of PRS have, in most instances, all of the rights of stockholders, except that they may not sell, assign, pledge or otherwise encumber such shares. RSU s provide no such rights. We issued 228,750 shares of PRS in 2012 for an aggregate purchase price of $6.9 million covering 114,375 purchased shares, 174,212 shares of PRS in 2011 for $5.4 million covering 87,106 purchased shares and 213,714 shares in 2010 for $4.8 million covering 106,857 purchased shares.

PRS activity was as follows:

| *(SHARE AMOUNTS IN THOUSANDS)* | **Number of Shares** | **Weighted Average Grant Date Fair Value Per Share** | |
|---|---|---|---|
| Balance at December 31, 2011 | 497 | $ | 23.03 |
| Granted | 229 | $ | 30.20 |
| Vested | (159) | $ | 15.51 |
| Forfeited | (30) | $ | 23.35 |
| Balance at December 31, 2012 | 537 | $ | 28.30 |

The total fair value of PRS s which vested during the year ended December 31, 2012 was $7.1 million.

As of December 31, 2012, there was $4.7 million of total unrecognized compensation cost related to non-vested PRS awards granted under the equity incentive plans; such cost is expected to be recognized over a weighted average period of 1.8 years.

***Liability Awards***

We have granted Cash RSU s to eligible employees that are paid out 100% in cash upon vesting. Such RSU s are subject to forfeiture if certain employment conditions are not met. Cash RSU s principally vest 100% at the end of three years and contain no performance criteria provisions. A Cash RSU s fair value is calculated based on the market price of our stock at date of our closing period and is accounted for as a liability award. The aggregate fair value is amortized to expense ratably over the vesting period.

Cash RSU activity was as follows:

| *(SHARE AMOUNTS IN THOUSANDS)* | **Cash RSUs** | **Weighted Average Fair Value Per Share** | |
|---|---|---|---|
| Balance at December 31, 2011 | 154 | $ | 52.42 |
| Granted | 42 | $ | 65.96 |
| Vested | (64) | $ | 60.21 |
| Cancelled | (12) | $ | 57.79 |
| Balance at December 31, 2012 | 120 | $ | 65.96 |

The total fair value of Cash RSU s which vested during the year ended December 31, 2012 was $3.9 million.

As of December 31, 2012, there was $2.9 million of total unrecognized compensation cost related to non-vested Cash RSU awards granted under the equity incentive plans; such cost is expected to be recognized over a weighted average period of 1.8 years. The aggregate compensation cost will be adjusted based on changes in the Company s stock price.

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**NOTE 12. SEGMENT INFORMATION**

We are organized into two operating segments, Flavors and Fragrances; these segments align with the internal structure used to manage these businesses. Flavor compounds are sold to the food and beverage industries for use in consumer products such as prepared foods, beverages, dairy, food and sweet products. Fragrances is comprised of Fragrance Compounds, which are ultimately used by our customers in two broad categories: functional fragrances, including fragrance compounds for personal care (e.g., soaps) and household products (e.g., detergents and cleaning agents) and fine fragrance and beauty care, including perfumes, colognes and toiletries; and Fragrance Ingredients, consisting of synthetic and natural ingredients that can be combined with other materials to create unique functional and fine fragrance compounds. Major fragrance customers include the cosmetics industry, including perfume and toiletries manufacturers, and the household products industry, including manufacturers of soaps, detergents, fabric care, household cleaners and air fresheners.

We evaluate the performance of these operating segments based on segment profit which is defined as operating profit before Restructuring and certain non-recurring adjustments, Interest expense, Other expense, net and Taxes on income. The Global expenses caption represents corporate and headquarters-related expenses which include legal, finance, human resources and other administrative expenses that are not allocated to individual business units. Unallocated assets are principally cash and cash equivalents and other corporate and headquarters-related assets.

Our reportable segment information is as follows:

| | | December 31, | |
|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** | **2010** |
| **Net sales** | | | |
| Flavors | $ 1,378,377 | $ 1,347,340 | $ 1,203,274 |
| Fragrances | 1,443,069 | 1,440,678 | 1,419,588 |
| Consolidated | $ 2,821,446 | $ 2,788,018 | $ 2,622,862 |

| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** |
|---|---|---|
| **Segment assets** | | |
| Flavors | $ 1,422,762 | $ 1,327,279 |
| Fragrances | 1,519,219 | 1,512,511 |
| Global assets | 307,619 | 125,791 |
| Consolidated | $ 3,249,600 | $ 2,965,581 |

| | | December 31, | |
|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** | **2010** |
| **Segment profit:** | | | |
| Flavors | $ 298,326 | $ 284,246 | $ 242,528 |
| Fragrances | 238,379 | 226,560 | 244,966 |
| Global expenses | (48,419) | (36,410) | (61,056) |
| Restructuring and other charges, net | (1,668) | (13,172) | (10,077) |
| Mane patent litigation settlement | | (33,495) | |
| Operating Profit | 486,618 | 427,729 | 416,361 |
| Interest expense | (41,753) | (44,639) | (48,709) |
| Other expense, net | (1,450) | (9,544) | (8,059) |
| Income before taxes | $ 443,415 | $ 373,546 | $ 359,593 |
| Profit margin | | | |
| Flavors | 21.6% | 21.1% | 20.2% |

| | | | |
|---|---|---|---|
| Fragrances | 16.5% | 15.7% | 17.3% |
| Consolidated | 17.2% | 15.3% | 15.9% |

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We have not disclosed revenues at a lower level than provided herein, such as revenues from external customers by product, as it is impracticable for us to do so.

We had one customer that accounted for more than 10% of our consolidated net sales in each year for all periods presented and related net sales were $320 million, $297 million and $273 million in 2012, 2011 and 2010, respectively. The majority of these sales were in the Fragrances operating segment.

Total long-lived assets consist of net property, plant and equipment and amounted to $655 million and $608 million at December 31, 2012 and 2011, respectively. Of this total $162 million and $163 million was located in the United States at December 31, 2012 and 2011, respectively, and $97 million and $89 million were located in the Netherlands at December 31, 2012 and 2011, respectively.

| | Capital Expenditures | | | Depreciation and Amortization | | |
|---|---|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | 2012 | 2011 | 2010 | 2012 | 2011 | 2010 |
| Flavors | $ 90,309 | $ 69,675 | $ 46,776 | $ 39,565 | $ 31,140 | $ 31,634 |
| Fragrances | 26,069 | 50,454 | 53,969 | 34,238 | 41,941 | 45,713 |
| Unallocated assets | 9,762 | 7,328 | 5,556 | 2,864 | 2,246 | 1,895 |
| Consolidated | $ 126,140 | $ 127,457 | $ 106,301 | $ 76,667 | $ 75,327 | $ 79,242 |

| | Net Sales by Geographic Area | | |
|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | 2012 | 2011 | 2010 |
| Europe, Africa and Middle East | $ 912,768 | $ 956,977 | $ 896,647 |
| Greater Asia | 771,877 | 744,810 | 676,838 |
| North America | 694,430 | 678,763 | 651,057 |
| Latin America | 442,371 | 407,468 | 398,320 |
| Consolidated | $ 2,821,446 | $ 2,788,018 | $ 2,622,862 |

Net sales are attributed to individual regions based upon the destination of product delivery. Net sales related to the U.S. for the years ended December 31, 2012, 2011 and 2010 were $662 million, $644 million and $618 million, respectively. Net sales attributed to all foreign countries in total for the years ended December 31, 2012, 2011 and 2010 were $2,159 million, $2,144 million and $2,005 million, respectively. No non-U.S. country had net sales in any period presented greater than 7% of total consolidated net sales.

**NOTE 13. EMPLOYEE BENEFITS**

We have pension and/or other retirement benefit plans covering approximately one-third of active employees. In 2007 the Company amended its U.S. qualified and non-qualified pension plans under which accrual of future benefits was suspended for all participants that did not meet the rule of 70 (age plus years of service equal to at least 70 at December 31, 2007). Pension benefits are generally based on years of service and on compensation during the final years of employment. Plan assets consist primarily of equity securities and corporate and government fixed income securities. Substantially all pension benefit costs are funded as accrued; such funding is limited, where applicable, to amounts deductible for income tax purposes. Certain other retirement benefits are provided by general corporate assets.

We sponsor a qualified defined contribution plan covering substantially all U.S. employees. Under this plan, we match 100% of participants contributions up to 4% of compensation and 75% of participants contributions from over 4% to 8%. Employees that are still eligible to accrue benefits under the defined benefit plan are limited to a 50% match up to 6% of the participants compensation.

In addition to pension benefits, certain health care and life insurance benefits are provided to qualifying United States employees upon retirement from IFF. Such coverage is provided through insurance plans with

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premiums based on benefits paid. We do not generally provide health care or life insurance coverage for retired employees of foreign subsidiaries; such benefits are provided in most foreign countries by government-sponsored plans, and the cost of these programs is not significant to us.

We offer a non-qualified Deferred Compensation Plan (DCP) for certain key employees and non-employee directors. Eligible employees and non-employee directors may elect to defer receipt of salary, incentive payments and Board of Directors fees into participant directed investments, which are generally invested by the Company in individual variable life insurance contracts we own that are designed to informally fund savings plans of this nature. The cash surrender value of life insurance is based on the net asset values of the underlying funds available to plan participants. At December 31, 2012 and December 31, 2011, the Consolidated Balance Sheet reflects liabilities of $27.0 million, for both years, related to the DCP in Other liabilities and $12.3 million and $12.0 million, respectively, included in Capital in excess of par value related to the portion of the DCP that will be paid out in IFF shares.

The total cash surrender value of life insurance contracts the Company owns in relation to the DCP and post-retirement life insurance benefits amounted to $51.3 million and $56.2 million at December 31, 2012 and 2011, respectively, and are recorded in Other assets in the Consolidated Balance Sheet.

The plan assets and benefit obligations of our defined benefit pension plans are measured at December 31 of each year.

| | | **U.S. Plans** | | | **Non-U.S. Plans** | |
|---|---|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** | **2010** | **2012** | **2011** | **2010** |
| **Components of net periodic benefit cost** | | | | | | |
| Service cost for benefits earned | $ 3,121 | $ 3,602 | $ 3,781 | $ 12,585 | $ 10,560 | $ 9,804 |
| Interest cost on projected benefit obligation | 24,314 | 24,373 | 24,191 | 30,944 | 34,033 | 32,954 |
| Expected return on plan assets | (24,329) | (25,070) | (24,146) | (43,728) | (45,386) | (41,569) |
| Net amortization and deferrals | 20,180 | 11,888 | 7,441 | 6,443 | 5,360 | 5,214 |
| Settlement and curtailment | | 444 | | 873 | 3,139 | 182 |
| Special termination benefits | | | | | 738 | 178 |
| Net periodic benefit cost | 23,286 | 15,237 | 11,267 | 7,117 | 8,444 | 6,763 |
| Defined contribution and other retirement plans | 7,039 | 6,550 | 7,169 | 4,837 | 4,113 | 4,459 |
| Total expense | $ 30,325 | $ 21,787 | $ 18,436 | $ 11,954 | $ 12,557 | $ 11,222 |
| **Changes in plan assets and benefit obligations recognized in OCI** | | | | | | |
| Net actuarial loss | $ 32,569 | $ 77,924 | | $ 53,469 | $ 32,218 | |
| Recognized actuarial loss | (19,810) | (11,441) | | (7,181) | (8,352) | |
| Prior service cost | (370) | (891) | | | (191) | |
| Recognized prior service cost | | | | (135) | (147) | |
| Currency translation adjustment | | | | 6,068 | 355 | |
| Total recognized in OCI (before tax effects) | $ 12,389 | $ 65,592 | | $ 52,221 | $ 23,883 | |

During the second quarter 2011, we settled a portion of the Ireland pension plan as discussed in Note 2. As a result, we recorded a settlement charge and a special termination benefit charge of $3.9 million to recognize a portion of the unrecognized loss related to those employees who have accepted the settlement and for additional benefits credited to those participants accepting a settlement. This settlement was funded primarily through pension plan investment trust assets.

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In connection with negotiations completed during the second quarter 2011, we have amended the pension plan for one of our North American Ingredients plants. We recorded a curtailment charge of $0.4 million during the second quarter 2011 to recognize a portion of the unrecognized prior service costs associated with the years of service no longer expected to be rendered and credited as service under the plan.

| | Postretirement Benefits | | |
|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** | **2010** |
| **Components of net periodic benefit cost** | | | |
| Service cost for benefits earned | $ 1,357 | $ 1,178 | $ 1,378 |
| Interest cost on projected benefit obligation | 5,656 | 5,861 | 6,468 |
| Net amortization and deferrals | (1,770) | (2,552) | (2,232) |
| Expense | $ 5,243 | $ 4,487 | $ 5,614 |
| **Changes in plan assets and benefit obligations recognized in OCI** | | | |
| Net actuarial loss (gain) | $ (10,921) | $ 16,909 | |
| Recognized actuarial loss | (2,951) | (2,167) | |
| Recognized prior service credit | 4,721 | 4,719 | |
| Total recognized in OCI (before tax effects) | $ (9,151) | $ 19,461 | |

The amounts expected to be recognized in net periodic cost in 2013 are:

| *(DOLLARS IN THOUSANDS)* | U.S. Plans | Non-U.S. Plans | Postretirement Benefits |
|---|---|---|---|
| Actuarial loss recognition | $ 23,171 | $ 9,765 | $ 2,060 |
| Prior service cost recognition | 308 | 15 | (4,712) |

| **Weighted-average actuarial** | **U.S. Plans** | | | **Non-U.S. Plans** | | |
|---|---|---|---|---|---|---|
| **assumption used to determine expense** | **2012** | **2011** | **2010** | **2012** | **2011** | **2010** |
| Discount rate | 4.70% | 5.60% | 6.10% | 4.71% | 5.37% | 5.66% |
| Expected return on plan assets | 7.30% | 7.75% | 7.75% | 6.27% | 6.55% | 6.63% |
| Rate of compensation increase | 3.25% | 3.25% | 3.25% | 2.88% | 2.66% | 3.00% |

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Changes in the postretirement benefit obligation and plan assets, as applicable, are detailed in the following table:

| | U.S. Plans | | Non-U.S. Plans | | Postretirement Benefits | |
|---|---|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** | **2012** | **2011** | **2012** | **2011** |
| Benefit obligation at beginning of year | $ 523,298 | $ 440,646 | $ 670,231 | $ 625,052 | $ 128,719 | $ 108,710 |
| Service cost for benefits earned | 3,121 | 3,602 | 12,585 | 10,560 | 1,357 | 1,178 |
| Interest cost on projected benefit obligation | 24,314 | 24,373 | 30,944 | 34,033 | 5,656 | 5,861 |
| Actuarial loss (gain) | 47,547 | 78,026 | 76,786 | 43,067 | (10,921) | 16,909 |
| Plan amendments | | | | (191) | | |
| Adjustments for expense/tax contained in service cost | | | (2,282) | (2,382) | | |
| Plan participants contributions | | | 2,492 | 2,523 | 979 | 1,015 |
| Benefits paid | (24,574) | (23,349) | (27,234) | (28,923) | (6,482) | (4,954) |
| Curtailments / settlements | | | (2,641) | (11,290) | | |
| Special termination benefits | | | | 738 | | |
| Translation adjustments | | | 19,283 | (2,956) | | |
| Benefit obligation at end of year | $ 573,706 | $ 523,298 | $ 780,164 | $ 670,231 | $ 119,308 | $ 128,719 |
| Fair value of plan assets at beginning of year | $ 372,142 | $ 347,084 | $ 702,366 | $ 671,559 | | |
| Actual return on plan assets | 39,306 | 25,172 | 64,765 | 53,853 | | |
| Employer contributions | 18,415 | 23,235 | 16,767 | 18,817 | | |
| Participants contributions | | | 2,492 | 2,523 | | |
| Benefits paid | (24,574) | (23,349) | (27,234) | (28,923) | | |
| Settlements | | | (2,641) | (11,290) | | |
| Translation adjustments | | | 19,673 | (4,173) | | |
| Fair value of plan assets at end of year | $ 405,289 | $ 372,142 | $ 776,188 | $ 702,366 | | |
| Funded status at end of year | $ (168,417) | $ (151,156) | $ (3,976) | $ 32,135 | | |

| | U.S. Plans | | Non-U.S. Plans | |
|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** | **2012** | **2011** |
| **Amounts recognized in the balance sheet:** | | | | |
| Other assets | $ | $ | $ 33,345 | $ 67,518 |
| Other current liabilities | (3,855) | (3,615) | (621) | (631) |
| Retirement liabilities | (164,562) | (147,541) | (36,700) | (34,752) |
| Net amount recognized | $ (168,417) | $ (151,156) | $ (3,976) | $ 32,135 |

| | U.S. Plans | | Non-U.S. Plans | | Postretirement Benefits | |
|---|---|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **2012** | **2011** | **2012** | **2011** | **2012** | **2011** |
| **Amounts recognized in AOCI consist of:** | | | | | | |
| Net actuarial loss | $ 209,156 | $ 196,398 | $ 231,857 | $ 179,512 | $ 31,087 | $ 44,959 |
| Prior service cost (credit) | 786 | 1,156 | (431) | (307) | (19,719) | (24,440) |
| Total AOCI (before tax effects) | $ 209,942 | $ 197,554 | $ 231,426 | $ 179,205 | $ 11,368 | $ 20,519 |

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| *(DOLLARS IN THOUSANDS)* | U.S. Plans 2012 | U.S. Plans 2011 | Non-U.S. Plans 2012 | Non-U.S. Plans 2011 |
|---|---|---|---|---|
| **Accumulated Benefit Obligation end of year** | $ 570,655 | $ 516,747 | $ 745,828 | $ 644,548 |
| **Information for Pension Plans with an ABO in excess of Plan Assets:** | | | | |
| Projected benefit obligation | $ 573,706 | $ 523,298 | $ 43,403 | $ 39,664 |
| Accumulated benefit obligation | 570,655 | 516,747 | 41,720 | 38,470 |
| Fair value of plan assets | 405,289 | 372,142 | 16,776 | 16,520 |
| **Weighted-average assumptions used to determine obligations at December 31** | | | | |
| Discount rate | 4.10% | 4.70% | 4.14% | 4.71% |
| Rate of compensation increase | 3.25% | 3.25% | 2.73% | 2.88% |

| *(DOLLARS IN THOUSANDS)* | U.S. Plans | Non-U.S. Plans | Postretirement Benefits |
|---|---|---|---|
| **Estimated Future Benefit Payments** | | | |
| 2013 | 27,565 | 28,597 | 5,050 |
| 2014 | 28,916 | 28,488 | 5,493 |
| 2015 | 30,338 | 29,627 | 5,888 |
| 2016 | 31,466 | 30,172 | 6,294 |
| 2017 | 32,702 | 31,708 | 6,725 |
| 2018-2022 | 179,188 | 174,217 | 38,443 |
| **Contributions** | | | |
| Required Company Contributions in the Following Year (2013) | $ 3,933 | $ 18,142 | $ 5,050 |

We consider a number of factors in determining and selecting assumptions for the overall expected long-term rate of return on plan assets. We consider the historical long-term return experience of our assets, the current and expected allocation of our plan assets and expected long-term rates of return. We derive these expected long-term rates of return with the assistance of our investment advisors. We base our expected allocation of plan assets on a diversified portfolio consisting of domestic and international equity securities, fixed income, real estate and alternative asset classes. The asset allocation is monitored on an ongoing basis.

We consider a variety of factors in determining and selecting our assumptions for the discount rate at December 31. For the U.S. plans, the discount rate was based on the internal rate of return for a portfolio of Moody s Aaa, Aa and Merrill Lynch AAA-AA high quality bonds with maturities that are consistent with the projected future benefit payment obligations of the plan. The rate of compensation increase for all plans and the medical cost trend rate for the applicable U.S. plans are based on plan experience.

| | U.S. Plans 2012 | U.S. Plans 2011 | Non-U.S. Plans 2012 | Non-U.S. Plans 2011 |
|---|---|---|---|---|
| **Percentage of assets invested in:** | | | | |
| Cash and cash equivalents | 1% | 2% | 2% | 1% |
| Equities | 50% | 50% | 22% | 22% |
| Fixed income | 49% | 48% | 59% | 59% |
| Property | 0% | 0% | 9% | 10% |
| Alternative and other investments | 0% | 0% | 8% | 8% |

With respect to the U.S. plans, the expected return on plan assets was determined based on an asset allocation model using the current target allocation, real rates of return by asset class and an anticipated inflation rate. In late 2011 the Company changed its target investment allocation to 50% equity securities and 50% fixed income securities from 60% 65% in equity securities and 35% 40% in fixed income securities in order to reduce funded status volatility.

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The expected annual rate of return for the non-U.S. plans employs a similar set of criteria adapted for local investments, inflation rates and in certain cases specific government requirements. The target asset allocation, for the non-U.S. plans, consists of approximately: 55% 60% in fixed income securities; 20% 25% in equity securities; 5% 10% in real estate; and 5% 10% in alternative investments.

The following tables present our plan assets for the U.S. and non-U.S. plans using the fair value hierarchy as of December 31, 2012 and 2011. Our plans assets were accounted for at fair value and are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and their placement within the fair value hierarchy levels. For more information on a description of the fair value hierarchy, see Note 14.

| | U.S. Plans for the year ended December 31, 2012 | | | |
|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **Level 1** | **Level 2** | **Level 3** | **Total** |
| ***Cash Equivalents*** | $ | $ 1,976 | $ | $ 1,976 |
| ***Equity Securities*** | | | | |
| U.S. Common Stock | 43,338 | | | 43,338 |
| Non-U.S. Common Stock | 700 | | | 700 |
| Balanced Funds | | 8,077 | | 8,077 |
| Pooled Funds | | 150,372 | | 150,372 |
| ***Fixed Income Securities*** | | | | |
| Government & Government Agency Bonds | | 6,662 | | 6,662 |
| Mutual Funds | | 123,447 | | 123,447 |
| Corporate Bonds | | 61,382 | | 61,382 |
| Municipal Bonds | | 8,696 | | 8,696 |
| Asset Backed Securities | | | | |
| **Total** | $ 44,038 | $ 360,612 | $ | $ 404,650 |
| Receivables | | | | $ 639 |
| **Total** | | | | $ 405,289 |

| | U.S. Plans for the year ended December 31, 2011 | | | |
|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **Level 1** | **Level 2** | **Level 3** | **Total** |
| ***Cash Equivalents*** | $ | $ 6,125 | $ | $ 6,125 |
| ***Equity Securities*** | | | | |
| U.S. Common Stock | 40,045 | | | 40,045 |
| Balanced Funds | | 7,631 | | 7,631 |
| Pooled Funds | | 136,634 | | 136,634 |
| ***Fixed Income Securities*** | | | | |
| Government & Government Agency Bonds | | 76,095 | | 76,095 |
| Corporate Bonds | | 93,062 | | 93,062 |
| Municipal Bonds | | 8,283 | | 8,283 |
| Asset Backed Securities | | 1,982 | | 1,982 |
| **Total** | $ 40,045 | $ 329,812 | $ | $ 369,857 |
| Receivables | | | | $ 2,285 |
| **Total** | | | | $ 372,142 |

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| | Non-U.S. Plans for the year ended December 31, 2012 | | | |
|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **Level 1** | **Level 2** | **Level 3** | **Total** |
| ***Cash*** | $ 14,075 | $ | $ | $ 14,075 |
| ***Equity Securities*** | | | | |
| U.S. Large Cap | 28,009 | | | 28,009 |
| Non-U.S. Large Cap | 116,473 | | | 116,473 |
| Non-U.S. Mid Cap | 132 | | | 132 |
| Non-U.S. Small Cap | 35 | | | 35 |
| Emerging Markets | 25,876 | | | 25,876 |
| ***Fixed Income Securities*** | | | | |
| U.S. Treasuries/Government Bonds | 52 | | | 52 |
| U.S. Corporate Bonds | | | | |
| Non-U.S. Treasuries/Government Bonds | 131,764 | 68,453 | | 200,217 |
| Non-U.S. Corporate Bonds | 64,583 | 182,068 | | 246,651 |
| Non-U.S. Mortgage-Backed Securities | | | | |
| Non-U.S. Asset-Backed Securities | | | | |
| Non-U.S. Other Fixed Income | 1,460 | 9,944 | | 11,404 |
| ***Alternative Types of Investments*** | | | | |
| Insurance Contracts | 945 | | | 945 |
| Hedge Funds | | | 14,436 | 14,436 |
| Private Equity | | | 7 | 7 |
| Absolute Return Funds | | 51,156 | | 51,156 |
| ***Real Estate*** | | | | |
| Non-U.S. Real Estate | | 65,468 | 1,252 | 66,720 |
| **Total** | $ 383,404 | $ 377,089 | $ 15,695 | $ 776,188 |

| | Non-U.S. Plans for the year ended December 31, 2011 | | | |
|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **Level 1** | **Level 2** | **Level 3** | **Total** |
| ***Cash*** | $ 8,479 | $ | $ | $ 8,479 |
| ***Equity Securities*** | | | | |
| U.S. Large Cap | 26,683 | | | 26,683 |
| Non-U.S. Large Cap | 107,964 | | | 107,964 |
| Non-U.S. Mid Cap | 3,116 | | | 3,116 |
| Non-U.S. Small Cap | 455 | | | 455 |
| Emerging Markets | 14,265 | | | 14,265 |
| ***Fixed Income Securities*** | | | | |
| U.S. Treasuries/Government Bonds | 74 | | | 74 |
| U.S. Corporate Bonds | 5 | | | 5 |
| Non-U.S. Treasuries/Government Bonds | 199,266 | 35,308 | | 234,574 |
| Non-U.S. Corporate Bonds | 52,174 | 109,013 | | 161,187 |
| Non-U.S. Mortgage-Backed Securities | | | | |
| Non-U.S. Asset-Backed Securities | | 11,734 | | 11,734 |
| Non-U.S. Other Fixed Income | | 8,664 | | 8,664 |
| ***Alternative Types of Investments*** | | | | |
| Insurance Contracts | | 320 | | 320 |
| Hedge Funds | | | 54,036 | 54,036 |
| Private Equity | | | 1 | 1 |
| ***Real Estate*** | | | | |
| Non-U.S. Real Estate | | 69,284 | 1,525 | 70,809 |
| **Total** | $ 412,481 | $ 234,323 | $ 55,562 | $ 702,366 |

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Cash and cash equivalents are primarily held in registered money market funds which are valued using a market approach based on the quoted market prices of identical instruments. Other cash and cash equivalents are valued daily by the fund using a market approach with inputs that include quoted market prices for similar instruments.

Equity securities are primarily valued using a market approach based on the quoted market prices of identical instruments. Pooled funds are typically common or collective trusts valued at their net asset values (NAVs).

Fixed income securities are primarily valued using a market approach with inputs that include broker quotes and benchmark yields.

Derivative instruments are valued by the custodian using closing market swap curves and market derived inputs.

Real estate values are primarily based on valuation of the underlying investments, which include inputs such as cost, discounted future cash flows, independent appraisals and market comparable data.

Hedge funds are valued based on valuation of the underlying securities and instruments within the funds. Quoted market prices are used when available and NAVs are used for unquoted securities within the funds.

Absolute return funds are actively managed funds mainly invested in debt and equity securities and are valued at their NAVs.

The following table presents a reconciliation of Level 3 non-U.S. plan assets held during the year ended December 31, 2012:

| | Non-U.S. Plans | | | |
|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **Real Estate** | **Private Equity** | **Hedge Funds** | **Total** |
| Ending balance as of December 31, 2011 | $ 1,525 | $ 1 | $ 54,036 | $ 55,562 |
| Actual return on plan assets | (273) | | 446 | 173 |
| Purchases, sales and settlements | | 6 | (40,046) | (40,040) |
| Ending balance as of December 31, 2012 | $ 1,252 | $ 7 | $ 14,436 | $ 15,695 |

The following weighted average assumptions were used to determine our postretirement benefit expense and obligation for the years ended December 31:

| | Expense | | Liability | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Discount rate | 4.60% | 5.50% | 4.00% | 4.60% |
| Current medical cost trend rate | 7.00% | 8.00% | 6.75% | 7.00% |
| Ultimate medical cost trend rate | 4.75% | 4.75% | 4.75% | 4.75% |
| Medical cost trend rate decreases to ultimate rate in year | 2021 | 2016 | 2021 | 2021 |

| | Sensitivity of Disclosures to Changes in Selected Assumptions | | | |
|---|---|---|---|---|
| | **25 BP Decrease in Discount Rate** | | **25 BP Decrease in Discount Rate** | **25 BP Decrease in Long-Term Rate of Return** |
| *(DOLLARS IN THOUSANDS)* | **Change in PBO** | **Change in ABO** | **Change in pension expense** | **Change in pension expense** |
| U.S. Pension Plans | $ 17,816 | $ 17,687 | $ 1,181 | $ 843 |
| Non-U.S. Pension Plans | $ 33,889 | $ 31,185 | $ 2,733 | $ 1,929 |
| Postretirement Benefit Plan | N/A | $ 3,677 | $ 236 | N/A |

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The effect of a 1% increase in the medical cost trend rate would increase the accumulated postretirement benefit obligation and the annual postretirement expense by approximately $7.3 million and $0.4 million, respectively; a 1% decrease in the rate would decrease the obligation and expense by approximately $6.9 million and $0.4 million, respectively.

We contributed $18.4 million and $16.8 million to our qualified U.S. pension plans and non-U.S. pension plans in 2012. We made $3.4 million in benefit payments with respect to our non-qualified U.S. pension plan. In addition, $6.5 million of contributions were made with respect to our other postretirement plans.

**NOTE 14. FINANCIAL INSTRUMENTS**

**Fair Value**

Accounting guidance on fair value measurements specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. These two types of inputs create the following fair value hierarchy:

Level 1 Quoted prices for *identical* instruments in active markets.

Level 2 Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires us to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. We determine the fair value of structured liabilities (where performance is linked to structured interest rates, inflation or currency risks) using the London InterBank Offer Rate ( LIBOR ) swap curve and forward interest and exchange rates at period end. Such instruments are classified as Level 2 based on the observability of significant inputs to the model. We do not have any instruments classified as Level 1 or Level 3, other than those included in pension asset trusts included in Note 13.

These valuations take into consideration our credit risk and our counterparties credit risk. The estimated change in the fair value of these instruments due to such changes in our own credit risk (or instrument-specific credit risk) was immaterial as of December 31, 2012.

The amounts recorded in the balance sheet (carrying amount) and the estimated fair values of financial instruments at December 31 consisted of the following:

| | 2012 | | 2011 | |
|---|---|---|---|---|
| *(DOLLARS IN THOUSANDS)* | **Carrying Amount** | **Fair Value** | **Carrying Amount** | **Fair Value** |
| Cash and cash equivalents[(1)] | $ 324,422 | $ 324,422 | $ 88,279 | $ 88,279 |
| Credit facilities and bank overdrafts[(2)] | 297,147 | 297,147 | 158,971 | 158,971 |
| Long-term debt:[(3)] | | | | |
| Senior notes 2007 | 500,000 | 634,000 | 500,000 | 617,000 |
| Senior notes 2006 | 225,000 | 248,000 | 225,000 | 250,000 |

(1) The carrying amount of cash and cash equivalents approximates fair value due to the short maturity of those instruments.

(2) The carrying amount of our credit facilities and bank overdrafts approximates fair value as the interest rate is reset frequently based on current market rates as well as the short maturity of those instruments.

(3) The fair value of our long-term debt was calculated using discounted cash flows applying current interest rates and current credit spreads based on our own credit risk.

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**Derivatives**

We periodically enter into foreign currency forward contracts with the objective of reducing exposure to cash flow volatility associated with our intercompany loans, foreign currency receivables and payables and anticipated purchases of certain raw materials used in operations. These contracts generally involve the exchange of one currency for a second currency at a future date, have maturities not exceeding twelve months and are with counterparties which are major international financial institutions.

In 2003, we executed a 10-year Yen U.S. dollar currency swap related to the monthly sale and purchase of products between the U.S. and Japan which has been designated as a cash flow hedge. This swap matured in January 2013.

During the third quarter of 2010, we entered into two interest rate swap agreements effectively converting the fixed rate on a portion of our long-term borrowings to a variable short-term rate based on the LIBOR plus an interest markup. These swaps are designated as fair value hedges and will mature in the third quarter of 2013. Any amounts recognized in Interest expense have been immaterial for the year ended December 31, 2012.

During the year ended December 31, 2012, we entered into multiple forward currency contracts which qualified as net investment hedges, in order to mitigate a portion of our net European investments from foreign currency risk. The effective portions of net investment hedges are recorded in OCI as a component of Foreign currency translation adjustments in the accompanying Consolidated Statement of Income and Comprehensive Income. Realized gains/(losses) are deferred in AOCI where they will remain until the net investments in our European subsidiaries are divested. Four of these forward currency contracts matured during the year ended December 31, 2012. The outstanding forward currency contacts have remaining maturities of less than one year.

During the year ended December 31, 2012, we continued to enter into several forward currency contracts which qualified as cash flow hedges. The objective of these hedges is to protect against the currency risk associated with forecasted U.S. dollar (USD) denominated raw material purchases made by Euro (EUR) functional currency entities which result from changes in the EUR/USD exchange rate. The effective portions of cash flow hedges are recorded in OCI as a component of (Losses)/gains on derivatives qualifying as hedges in the accompanying Consolidated Statement of Income and Comprehensive Income. Realized gains/(losses) in AOCI related to cash flow hedges of raw material purchases are recognized as a component of Cost of goods sold in the accompanying Consolidated Statement of Income and Comprehensive Income in the same period as the related costs are recognized.

The following table shows the notional amount of the Company s derivative instruments outstanding as of December 31, 2012 and December 31, 2011:

| *(DOLLARS IN THOUSANDS)* | **December 31, 2012** | **December 31, 2011** |
|---|---|---|
| Forward currency contracts | $ 143,483 | $ 147,078 |
| Interest rate swaps | $ 100,000 | $ 100,000 |

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The following tables show the Company s derivative instruments measured at fair value (Level 2 of the fair value hierarchy) as reflected in the Consolidated Balance Sheets as of December 31, 2012 and December 31, 2011 (in thousands):

| | December 31, 2012 | | |
|---|---|---|---|
| | Fair Value of Derivatives Designated as Hedging Instruments | Fair Value of Derivatives Not Designated as Hedging Instruments | Total Fair Value |
| Derivative assets[a] | | | |
| Foreign currency contracts | $ 676 | $ 2,535 | $ 3,211 |
| Interest rate swaps | 328 | | 328 |
| | $ 1,004 | $ 2,535 | $ 3,539 |
| Derivative liabilities[b] | | | |
| Foreign currency contracts | $ 5,251 | $ 278 | $ 5,529 |

| | December 31, 2011 | | |
|---|---|---|---|
| | Fair Value of Derivatives Designated as Hedging Instruments | Fair Value of Derivatives Not Designated as Hedging Instruments | Total Fair Value |
| Derivative assets[a] | | | |
| Foreign currency contracts | $ 9,333 | $ 5,473 | $ 14,806 |
| Interest rate swaps | 286 | | 286 |
| | $ 9,619 | $ 5,473 | $ 15,092 |
| Derivative liabilities[b] | | | |
| Foreign currency contracts | $ 3,368 | $ 2,054 | $ 5,422 |

(a) Derivative assets are recorded to Prepaid expenses and other current assets in the Consolidated Balance Sheet.

(b) Derivative liabilities are recorded as Other current liabilities in the Consolidated Balance Sheet.

The following table shows the effect of the Company s derivative instruments which were not designated as hedging instruments in the Consolidated Statement of Income and Comprehensive Income for the years ended December 31, 2012 and December 31, 2011 (in thousands):

| Derivatives Not Designated as Hedging Instruments under ASC 815 | Amount of Gain or (Loss) For the years ended December 31, 2012 | 2011 | Location of Gain or (Loss) Recognized in Income on Derivative |
|---|---|---|---|
| Foreign currency contract | $ 17,847 | $ (2,451) | Other expense, net |

Most of these net gains (losses) offset any recognized gains (losses) arising from the revaluation of the related intercompany loans during the same respective periods.

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The following table shows the effect of the Company s derivative instruments designated as cash flow and net investment hedging instruments in the Consolidated Statement of Income and Comprehensive Income for the years ended December 31, 2012 and December 31, 2011 (in thousands):

| | Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) For the years ended December 31, | | Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) For the years ended December 31, | |
|---|---|---|---|---|---|
| | 2012 | 2011 | | 2012 | 2011 |
| **Derivatives in Cash Flow Hedging Relationships:** | | | | | |
| Cross currency swap[1] | $ 1,975 | $ 1,206 | Other expense, net | $ (2,787) | $ (2,467) |
| Forward currency contract | (6,523) | 7,179 | Other expense, net | 4,206 | (5,156) |
| **Derivatives in Net Investment Hedging Relationships:** | | | | | |
| Forward currency contract | (395) | 265 | N/A | | |
| **Total** | $ (4,943) | $ 8,650 | | $ 1,419 | $ (7,623) |

(1) Ten year swap executed in 2003.

The ineffective portion of the above noted cash flow hedges and net investment hedges was not material for the years ended December 31, 2012 and 2011.

The Company expects approximately $1.2 million (net of tax), of derivative gains included in AOCI at December 31, 2012, based on current market rates, will be reclassified into earnings within the next 12 months. The majority of this amount will vary due to fluctuations in foreign currency exchange rates.

**NOTE 15. CONCENTRATIONS OF CREDIT RISK**

The Company does not have significant concentrations of risk in financial instruments. Temporary investments are made in a well-diversified portfolio of high-quality, liquid obligations of government, corporate and financial institutions. There are also limited concentrations of credit risk with respect to trade receivables because the Company has a large number of customers who are spread across many industries and geographic regions. The Company s larger customers are each spread across many sub-categories of its segments and geographical regions. We had one customer that accounted for more than 10% of our consolidated net sales in each year for all periods presented.

**NOTE 16. COMMITMENTS AND CONTINGENCIES**

**Lease Commitments**

Minimum rental payments under non-cancelable operating leases are $28.8 million in 2013, $25.7 million in 2014, $23.4 million in 2015 and from 2016 and thereafter through 2030, the aggregate lease obligations are $191.1 million. The corresponding rental expense amounted to $31.5 million, $30.8 million and $29.0 million for the years ended December 31, 2012, 2011 and 2010, respectively. None of our leases contain escalation clauses and they do not require capital improvement funding.

**Guarantees and Letters of Credit**

The Company has various bank guarantees and letters of credit which are available for use regarding governmental requirements associated with pending litigation in various jurisdictions and to support its ongoing business operations.

At December 31, 2012, we had total bank guarantees and standby letters of credit of approximately $92.4 million with various financial institutions. Of this amount, Euro 30.9 million ($40.9 million) in bank guarantees are related to governmental requirements on income tax disputes in Spain, as discussed in further detail in Note 9. Also included in the above aggregate amount is a total of $12.0 million in bank guarantees which the Company has posted to appeal a Spanish capital tax assessment and $26.2 million for certain other assessments in Brazil for other diverse income tax and indirect tax disputes related to fiscal years 1998-2011. There were no material amounts utilized under the standby letters of credit as of December 31, 2012.

In order to challenge the assessments in these cases in Brazil, the Company has been required to and has separately pledged assets, principally property, plant and equipment to cover assessments in the amount of approximately $17.7 million as of December 31, 2012.

**Lines of Credit**

The Company has various lines of credit which are available to support its ongoing business operations. At December 31, 2012, we had available lines of credit (in addition to the New Facility as discussed in Note 8) of approximately $70.3 million with various financial institutions. There were no material amounts drawn down pursuant to these lines of credit as of December 31, 2012.

**Litigation**

The Company assesses contingencies related to litigation and/or other matters to determine the degree of probability and range of possible loss. A loss contingency is accrued in the Company s consolidated financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable resolutions could occur, assessing contingencies is highly sensitive and requires judgments about future events. On at least a quarterly basis, the Company reviews contingencies related to litigation to determine the adequacy of accruals. The amount of ultimate loss may differ from these estimates and further events may require the Company to increase or decrease the amounts it has accrued on any matter.

Periodically, we assess our insurance coverage for all known claims, where applicable, taking into account aggregate coverage by occurrence, limits of coverage, self-insured retentions and deductibles, historical claims experience and claims experience with our insurance carriers. The liabilities are recorded at management s best estimate of the probable outcome of the lawsuits and claims, taking into consideration the facts and circumstances of the individual matters as well as past experience on similar matters. At each balance sheet date, the key issues that management assesses are whether it is probable that a loss as to asserted or unasserted claims has been incurred and if so, whether the amount of loss can be reasonably estimated. We record the expected liability with respect to claims in Other liabilities and expected recoveries from our insurance carriers in Other assets. We recognize a receivable when we believe that realization of the insurance receivable is probable under the terms of the insurance policies and our payment experience to date.

***Environmental***

Over the past 20 years, various federal and state authorities and private parties have claimed that we are a Potentially Responsible Party ( PRP ) as a generator of waste materials for alleged pollution at a number of waste sites operated by third parties located principally in New Jersey and have sought to recover costs incurred and to be incurred to clean up the sites.

We have been identified as a PRP at nine facilities operated by third parties at which investigation and/or remediation activities may be ongoing. We analyze our potential liability on at least a quarterly basis. We accrue for environmental liabilities when they are probable and estimable. We estimate our share of the total future cost for these sites to be less than $5 million.

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While joint and several liability is authorized under federal and state environmental laws, we believe the amounts we have paid and anticipate paying in the future for clean-up costs and damages at all sites are not and will not have a material adverse effect on our financial condition, results of operations or liquidity. This assessment is based upon, among other things, the involvement of other PRPs at most of the sites, the status of the proceedings, including various settlement agreements and consent decrees and the extended time period over which payments will likely be made. There can be no assurance, however, that future events will not require us to materially increase the amounts we anticipate paying for clean-up costs and damages at these sites, and that such increased amounts will not have a material adverse effect on our financial condition, results of operations or cash flows.

**Other Contingencies**

The Company has contingencies, including litigation, in various jurisdictions in which it operates pertaining to such items as value-added taxes, capital and other indirect taxes, customs and duties and sales and use taxes, the most significant existing in Brazil and Spain. It is possible that cash flows or results of operations, in any period, could be materially affected by the unfavorable resolution of one or more of these contingencies.

With regard to the Brazilian matters, we believe we have valid defenses for the underlying positions under dispute; however, in order to pursue its defenses, we are required to, and have provided, bank guarantees and pledged assets in the amount of $44 million. We have recorded provisions only in those cases where the loss is both probable and estimable. We cannot reasonably estimate a range of possible loss for a majority of the Brazilian matters due to the extended period of time to proceed through the judicial process given the fact that the majority of the underlying positions under dispute had either no or favorable rulings to date.

The Spanish tax authorities are alleging claims for a capital tax in a case arising from similar facts as the income tax cases (discussed in further detail in Note 9). We have determined the loss is neither probable nor estimable. We estimate a range of reasonably possible loss in this case of zero to $12 million. We intend to vigorously defend, and believe we have valid defenses for, our underlying position with regard to this matter.

(a)(3) EXHIBITS

| Exhibit Number | Description |
|---|---|
| 3(i) | Restated Certificate of Incorporation of the Company, incorporated by reference to Exhibit 10(g) to Registrant s Report on Form 10-Q filed on August 12, 2002 (SEC file number reference 001-04858). |
| 3(ii) | By-laws of the Registrant, effective as of March 6, 2012, incorporated by reference to Exhibit 3.3 to Registrant s Report on Form 8-K filed on March 12, 2012. |
| 4.1 | Note Purchase Agreement, dated as of July 12, 2006, by and among International Flavors & Fragrances Inc. and the various purchasers named therein, incorporated by reference to Exhibit 4.7 to Registrant s Report on Form 8-K filed on July 13, 2006 (SEC File No. 001-04858). |
| 4.2 | Form of Series A, Series B, Series C and Series D Senior Notes incorporated by reference to Exhibit 4.8 to Registrant s Report on Form 8-K filed on July 13, 2006 (SEC File No. 001-04858). |
| 4.3 | Note Purchase Agreement, dated as of September 27, 2007, by and among International Flavors & Fragrances Inc. and the various purchasers named therein, incorporated by reference to Exhibit 4.7 to Registrant s Report on Form 8-K filed on October 1, 2007. |
| 4.4 | Form of Series A, Series B, Series C and Series D Senior Notes incorporated by reference to Exhibit 4.8 of Registrant s Report on Form 8-K filed on October 1, 2007. |
| *10.1 | Separation Agreement between International Flavors & Fragrances Inc. and Robert M. Amen dated October 14, 2009, incorporated by reference to Exhibit 10.1 to Registrant s Report on Form 8-K filed on October 19, 2009. |
| *10.2 | Letter Agreement between International Flavors & Fragrances Inc. and Douglas D. Tough, dated September 8, 2009, incorporated by reference to Exhibit 10.1 to the Registrant s Report on Form 8-K filed on September 14, 2009. |
| *10.3 | Supplemental Retirement Plan, adopted by the Registrant s Board of Directors on October 29, 1986 as amended and restated through October 9, 2007, incorporated by reference to Exhibit 10.5 to Registrant s Report on Form 10-K filed on February 27, 2008. |
| *10.4 | 2000 Stock Award and Incentive Plan, adopted by the Registrant s Board of Directors on March 9, 2000 as amended and restated through October 9, 2007, incorporated by reference to Exhibit 10.6 to Registrant s Report on Form 10-K filed on February 27, 2008. |
| *10.5 | 2010 Stock Award and Incentive Plan, as Amended and Restated December 14, 2010, incorporated by reference to Exhibit 10.8 to Registrant s Report on Form 10-K filed on February 24, 2011. |
| *10.6 | 2000 Supplemental Stock Award Plan, adopted by the Registrant s Board of Directors on November 14, 2000 as amended and restated through October 9, 2007, incorporated by reference to Exhibit 10.7 to Registrant s Report on Form 10-K filed on February 27, 2008. |
| *10.7 | Performance Criteria for the Registrant s Equity Choice Program relating to Senior Executives incorporated by reference to Exhibit 10.1 to Registrant s Report on Form 10-Q filed on May 6, 2010. |
| *10.8 | Form of Non-Employee Director s Restricted Stock Units Agreement under International Flavors & Fragrances Inc. 2000 Stock Award and Incentive Plan, incorporated by reference to Exhibit 10.7 to Registrant s Report on Form 10-Q filed on October 31, 2007. |
| *10.9 | Form of U.S. Restricted Stock Units Agreement under International Flavors & Fragrances Inc. 2000 Stock Award and Incentive Plan incorporated by reference to Exhibit 10.5 to Registrant s Report on Form 10-Q filed on October 31, 2007. |

| Exhibit Number | Description |
|---|---|
| *10.10 | Form of U.S. Stock Settled Appreciation Rights Agreement under International Flavors & Fragrances Inc. 2000 Stock Award and Incentive Plan, incorporated by reference to Exhibit 10.6 to Registrant s Report on Form 10-Q filed on October 31, 2007. |
| *10.11 | Form of Restricted Stock Units Agreement under International Flavors & Fragrances Inc. 2000 Stock Award and Incentive Plan incorporated by reference to Exhibit 10.2 to Registrant s Report on Form 10-Q filed on August 5, 2009. |
| *10.12 | Form of Purchased Restricted Stock Agreement under International Flavors & Fragrances Inc. 2000 Stock Award and Incentive Plan incorporated by reference to Exhibit 10.1 to Registrant s Report on Form 10-Q filed on August 5, 2009. |
| *10.13 | Form of Employee Stock Option Agreement under International Flavors & Fragrances Inc. 2000 Stock Award and Incentive Plan, incorporated by reference to Exhibit 10.1 to Registrant s Report on Form 10-Q filed on November 9, 2004 (SEC file number reference 001-04858). |
| *10.14 | Form of International Flavors & Fragrances Inc. Stock Option Agreement under 2000 Stock Option Plan for Non-Employee Directors, incorporated by reference to Exhibit 10.2 to Registrant s Report on Form 10-Q filed on November 9, 2004 (SEC file number reference 001-04858). |
| *10.15 | Restated and Amended Executive Separation Policy Document, as Amended through and including December 14, 2010, incorporated by reference to Exhibit 10.29 to Registrant s Report on Form 10-K filed on February 24, 2011. |
| *10.16 | Trust Agreement dated October 4, 2000 among Registrant, First Union National Bank and Buck Consultants Inc. approved by Registrant s Board of Directors on September 12, 2000, incorporated by reference to Exhibit 10.21 to Registrant s Report on Form 10-K filed on March 13, 2006 (SEC File No. 001-04858). |
| *10.17 | Amendment dated August 2, 2005 to the Trust Agreement dated October 4, 2000 among Registrant, Wachovia Bank, N.A. (formerly First Union National Bank) and Buck Consultants LLC (formerly Buck Consultants Inc.), incorporated by reference to Exhibit 10.1 to Registrant s Report on Form 10-Q filed on August 5, 2005 (SEC file number reference 001-04858). |
| *10.18 | 2000 Stock Option Plan for Non-Employee Directors as amended and restated as of December 15, 2004, incorporated by reference to Exhibit 10.2 to Registrant s Report on Form 8-K filed on December 20, 2004 (SEC file number reference 001-04858). |
| *10.19 | Amendment No. 1, dated as of March 6, 2012, to the 2000 Stock Option Plan for Non-Employee Directors as amended and restated as of December 15, 2004, incorporated by reference to Exhibit 10.20(a) to Registrants Report on Form 10-Q filed on May 8, 2012. |
| *10.20 | Director Charitable Contribution Program, adopted by the Board of Directors on December 8, 2009, incorporated by reference to Exhibit 10.38 to Registrant s Report on Form 10-K filed on February 25, 2010. |
| 10.21 | Form of Director/Officer Indemnification Agreement incorporated by reference to Exhibit 10.1 to Registrant s Report on Form 8-K filed on July 28, 2008. |
| 10.22 | Credit Agreement, dated as of November 9, 2011, among International Flavors & Fragrances Inc., International Flavors & Fragrances (Luxembourg) S.à r.l., International Flavors & Fragrances (Nederland) Holding B.V., International Flavors & Fragrances I.F.F. (Nederland) B.V. and IFF Latin American Holdings (España) S.L., as borrowers, the banks, financial institutions and other institutional lenders and issuers of letters of credit party thereto, and Citibank, N.A. as administrative agent, incorporated by reference to Exhibit 10.1 to Registrant s Report on Form 8-K filed on November 16, 2011. |

| Exhibit Number | Description |
|---|---|
| 10.23 | Amendment No. 1, dated as of March 9, 2012, to the Credit Agreement, dated as of November 9, 2011, among International Flavors & Fragrances Inc., International Flavors & Fragrances (Luxembourg) S.à r.l., International Flavors & Fragrances (Nederland) Holding B.V., International Flavors & Fragrances I.F.F. (Nederland) B.V. and IFF Latin American Holdings (España) S.L., as borrowers, the banks, financial institutions and other institutional lenders and issuers of letters of credit party thereto, and Citibank, N.A. as administrative agent, incorporated by reference to Exhibit 10.26(a) to Registrants Report on Form 10-Q filed on May 8, 2012. |
| *10.24 | Form of Executive Death Benefit Plan Agreement incorporated by reference to Exhibit 10.27 to Registrant s Report on Form 10-K filed on February 28, 2012. |
| *10.25 | Deferred Compensation Plan, as amended and restated December 12, 2011 incorporated by reference to Exhibit 10.28 to Registrant s Report on Form 10-K filed on February 28, 2012. |
| *10.26 | Form of U.S. Stock Settled Appreciation Rights Agreement under International Flavors & Fragrances Inc. 2010 Stock Award and Incentive Plan incorporated by reference to Exhibit 10.29 to Registrant s Report on Form 10-K filed on February 28, 2012. |
| *10.27 | Form of Restricted Stock Units Agreement under International Flavors & Fragrances Inc. 2010 Stock Award and Incentive Plan incorporated by reference to Exhibit 10.30 to Registrant s Report on Form 10-K filed on February 28, 2012. |
| *10.28 | Form of Purchased Restricted Stock Agreement under International Flavors & Fragrances Inc. 2010 Stock Award and Incentive Plan incorporated by reference to Exhibit 10.31 to Registrant s Report on Form 10-K filed on February 28, 2012. |
| *10.29 | Form of Non-Employee Director s Restricted Stock Units Agreement under International Flavors & Fragrances Inc. 2010 Stock Award and Incentive Plan incorporated by reference to Exhibit 10.32 to Registrant s Report on Form 10-K filed on February 28, 2012. |
| 21 | List of Principal Subsidiaries. |
| 23 | Consent of PricewaterhouseCoopers LLP. |
| 31.1 | Certification of Douglas D. Tough pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Kevin C. Berryman pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification of Douglas D. Tough and Kevin C. Berryman pursuant to 18 U.S.C. Section 1350 as adopted pursuant to the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extensions Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

* Management contract or compensatory plan or arrangement

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Pursuant to the requirements of Section 13 or 15(d) 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.**

| | |
|---|---|
| By: | /s/ KEVIN C. BERRYMAN |
| Name: | **Kevin C. Berryman** |
| Title: | ***Executive Vice President and Chief Financial Officer*** |

Dated: February 26, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

| Signature | Title | Date |
|---|---|---|
| /s/ DOUGLAS D. TOUGH<br>**Douglas D. Tough** | Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer) | February 26, 2013 |
| /s/ KEVIN C. BERRYMAN<br>**Kevin C. Berryman** | Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer) | February 26, 2013 |
| /s/ MARCELLO V. BOTTOLI<br>**Marcello V. Bottoli** | Director | February 26, 2013 |
| /s/ LINDA B. BUCK<br>**Linda B. Buck** | Director | February 26, 2013 |
| /s/ J. MICHAEL COOK<br>**J. Michael Cook** | Director | February 26, 2013 |
| /s/ ROGER W. FERGUSON, JR.<br>**Roger W. Ferguson, Jr.** | Director | February 26, 2013 |
| /s/ ANDREAS FIBIG<br>**Andreas Fibig** | Director | February 26, 2013 |
| /s/ ALEXANDRA A. HERZAN<br>**Alexandra A. Herzan** | Director | February 26, 2013 |

| | | |
|---|---|---|
| /s/ Henry W. Howell, Jr. | Director | February 26, 2013 |
| **Henry W. Howell, Jr.** | | |
| /s/ Katherine M. Hudson | Director | February 26, 2013 |
| **Katherine M. Hudson** | | |
| /s/ Arthur C. Martinez | Director | February 26, 2013 |
| **Arthur C. Martinez** | | |
| /s/ Dale F. Morrison | Director | February 26, 2013 |
| **Dale F. Morrison** | | |

**INTERNATIONAL FLAVORS & FRAGRANCES INC. AND SUBSIDIARIES**

**SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS AND RESERVES**

**(IN THOUSANDS)**

| | For the Year Ended December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Balance at beginning of period | Additions (deductions) charged to costs and expenses | Accounts written off | Translation adjustments | Balance at end of period |
| Allowance for doubtful accounts[1] | $ 5,831 | $ 3,639 | $ (824) | $ 647 | $ 9,293 |
| Valuation allowance on credit and operating loss carryforwards and other net deferred tax assets | 290,879 | 153,718[2] | | 6,136 | 450,733 |

| | For the Year Ended December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Balance at beginning of period | Additions (deductions) charged to costs and expenses | Accounts written off | Translation adjustments | Balance at end of period |
| Allowance for doubtful accounts[1] | $ 8,470 | $ (518) | $ (1,219) | $ (902) | $ 5,831 |
| Valuation allowance on credit and operating loss carryforwards and other net deferred tax assets | 288,182 | 8,743 | | (6,046) | 290,879 |

| | For the Year Ended December 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Balance at beginning of period | Additions (deductions) charged to costs and expenses | Accounts written off | Translation adjustments | Balance at end of period |
| Allowance for doubtful accounts[1] | $ 12,409 | $ (1,352) | $ (2,716) | $ 129 | $ 8,470 |
| Valuation allowance on credit and operating loss carryforwards and other net deferred tax assets | 212,705 | 91,632 | | (16,155) | 288,182 |

(1) Amounts have been revised to properly reflect a $2.1 million increase discussed in Note 1 of the Consolidated Financial Statements.
(2) The 2012 amount includes a revision to the 2011 foreign net operating loss carryforwards in the amount of $74 million.

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**INTERNATIONAL FLAVORS & FRAGRANCES INC.**

**INVESTOR INFORMATION**

**ANNUAL MEETING**

The Annual Meeting of Shareholders will be held at the offices of the Company, 521 West 57th Street, New York, New York, on April 30, 2013 at 10:00 a.m., EDT.

IFF will be furnishing proxy materials to shareholders on the internet, rather than mailing printed copies of those materials to each shareholder. A Notice of Internet Availability of Proxy Materials will be mailed to each shareholder on or about March 14, 2013, which will provide instructions as to how shareholders may access and review the proxy materials for the 2013 Annual Meeting on the website referred to in the Notice or, alternatively, how to request a printed copy of the proxy materials be sent to them by mail.

**TRANSFER AGENT AND REGISTRAR**

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PricewaterhouseCoopers LLP

**WEBSITE**

www.iff.com