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INGR.N - Q2 2022 Ingredion Inc Earnings Call

EVENT DATE/TIME: AUGUST 09, 2022 / 1:00PM GMT

**OVERVIEW:**

Co. reported 2Q22 net sales of $2.044b, reported operating income of $213m and reported EPS of $2.12. Expects full-year 2022 net sales to be up mid-double digits and adjusted EPS to be $6.90-7.45. Expects 3Q22 net sales to increase in the high teens.

## CORPORATE PARTICIPANTS

**James Derek Gray** *Ingredion Incorporated - Executive VP & CFO*

**James P. Zallie** *Ingredion Incorporated - President, CEO & Director*

**Jason Payant** *Ingredion Incorporated - VP of Corporate Finance & Interim VP of IR*

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## PRESENTATION

**Operator**

Thank you for standing by, and welcome to the Ingredion Incorporated Second Quarter 2022 Earnings Conference Call. (Operator Instructions) As a reminder, today's program may be recorded. And now I'd like to introduce your host for today's program, Jason Payant, Vice President of Corporate Finance and Interim Vice President of Investor Relations. Please go ahead, sir.

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**Jason Payant** - *Ingredion Incorporated - VP of Corporate Finance & Interim VP of IR*

Good morning, and welcome to Ingredion's Second Quarter 2022 Earnings Call. I'm Jason Payant, Vice President of Corporate Finance and Interim Vice President of Investor Relations. On today's call are Jim Zallie, our President and CEO; and Jim Gray, our Executive Vice President and CFO. We issued our results today in a press release that can be found on our website, ingredion.com, in the Investors section.

The slides accompanying this presentation can also be found on the website and were posted today for your convenience. As a reminder, our comments within this presentation may contain forward-looking statements. These statements are subject to various risks and uncertainties and include expectations and assumptions regarding the company's future operations and financial performance. Actual results could differ materially from those estimated in the forward-looking statements, and Ingredion assumes no obligation to update them in the future as, or if, circumstances change.

Additional information concerning factors that could cause actual results to differ materially from those discussed during today's conference call or in this morning's press release can be found in the company's most recently filed annual report on Form 10-K and subsequent reports on Forms 10-Q and 8-K. During this call, we also refer to certain non-GAAP financial measures, including adjusted earnings per share, adjusted operating income and adjusted effective tax rate, which are reconciled to U.S. GAAP measures in Note 2 non-GAAP information included in our press release and in today's presentation's appendix.

Now I'm pleased to turn the call over to Jim Zallie.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Thank you, Jason, and good morning, everyone. We are pleased to discuss Ingredion's second quarter performance and continued business momentum.

We delivered outstanding top line performance of 16% net sales growth for the second quarter. Our pricing centers of excellence continued to offset higher corn and other input costs, including foreign exchange impacts. Combined with a better product mix, our second quarter adjusted operating income grew 3% over last year's very strong second quarter. And just to note, this year's second quarter performance is now the strongest quarter we've delivered since 2017.

Looking more closely at our top line performance, across all 4 regions, comparable net sales grew double digits in the second quarter. As I mentioned, our commercial teams continue to successfully manage the terms of our customer contracts to address higher corn and input costs and continued to take actions to offset foreign exchange impacts as the U.S. dollar continued to strengthen. Of note, we offset more than $40 million of foreign exchange sales headwinds in EMEA and Asia Pacific combined.

Regarding customer demand, I would like to note that on a comparable basis, our shipped product volumes are now ahead of pre-pandemic levels for the same quarter in 2019. This is an important milestone for us given the impact that the pandemic has had on the industry and our business over the last 2 years. At the same time, net sales have grown significantly and specialty ingredients have increased as a percentage of both volume and net sales, reflecting a higher value mix.

Now moving on to our strategic pillars. We continued to make great progress against each of the 4 pillars that are shaping our growth strategy. Global Specialties once again exhibited strong top line growth, up mid-double digits in the quarter. Specialties performance was robust across all five growth platforms with texturizing ingredients and sugar reduction leading the net sales dollar increase. Additionally, plant-based protein sales were up strongly in the quarter and are now up more than 185% year-to-date.

Moving to commercial excellence. While challenges remain across global supply chains, we've implemented several process improvements to best respond to customer demand.

With regard to cost competitiveness through operational excellence, we have expanded our hedging programs and continue to build our capability to address commodity risks, primarily in North America. As a result, we anticipate significantly less commodity volatility in the second half of the year.

We also maintained momentum against our fourth strategic pillar, accelerating a purpose-driven and people-centric growth culture. We published our 2021 sustainability report, Making Life Better, which details our progress against our 2030 global sustainability goals to address important societal and environmental sustainability challenges.

During the quarter, we advanced several sustainability initiatives to drive positive, lasting impact in the communities where we live and work. One such example that I would like to highlight is a pilot program that Ingredion Brazil is leading. Working with HEINEKEN and several other suppliers, we are teaching and training farmers to adopt regenerative farming practices. This pilot program resulted in a 25% reduction of emissions in scope and increased the amount of carbon captured in the soil by 40%.

Separately, to further reduce our global carbon emissions, we have successfully exited coal usage at our Argo plant in Illinois, which resulted in an 8% reduction in our total Zone 1 and 2 carbon emissions. This change delivered nearly one-third of the reduction needed to meet our 2030 greenhouse gas emissions goal.

Also in the quarter, we published our 2021 diversity, equity and inclusion report, which highlights our broad efforts to increase representation across our employee population. We are committed to creating a growth culture focused on diverse talent, inclusiveness and community partnerships.

As I mentioned, specialty delivered very strong growth this quarter across all 4 regions. And net sales grew double digits over and above the strong growth we experienced in the first half of 2021. While the growth was led by our texturizing portfolio, we also generated strong growth from our sugar reduction and specialty sweetener ingredients and plant-based proteins. Notably, our first half specialty's net sales results are above our expected 4-year net sales growth outlook, which we outlined at our recent Investor Day.

Now let me spend a moment to update you specifically on sugar reduction, which grew 20% in the second quarter led by PureCircle where customer wins drove 28% net sales growth and positive operating income. PureCircle's continued momentum demonstrates its market leadership for high intensity, natural sweeteners in a rapidly growing market for reduced sugar foods and beverages, and we are pleased to share that we have increased our ownership of PureCircle from 75% to 82% in the quarter. We anticipate further increases to our ownership of PureCircle over the next 3 years.

As we look ahead to the second half of the year, we are focused on navigating the challenges in the current business landscape.

First, we continue to remain committed to offsetting inflationary increases through a combination of pricing and productivity improvements from our operations. We have demonstrated an ability to do this well in the first half, and we expect to be able to offset additional cost increases as they arise.

Second, supply chain challenges continue to be impacted by labor availability, COVID restrictions and the Ukraine conflict. Our teams are operating with agility to overcome these challenges to ensure continuity of supply and service to customers.

Third, energy prices remain elevated, and there is increasing concern around the potential natural gas supply disruptions in Europe. We are currently developing contingency plans to mitigate possible impacts in the region.

And lastly, while foreign exchange impacts have been relatively benign over the past 2 years, we are currently experiencing higher foreign currency weakness on the back of a strengthening U.S. dollar. Our pricing centers of excellence have served us well, and we will continue to price through raw material costs increases as well as foreign exchange.

Now let me hand it over to Jim Gray for the financial overview. Jim?

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Thank you, Jim. Good morning to everyone. Starting first with our Q2 regional performance. North America net sales were up 20% when compared to the same period in 2021. The increase was driven by strong price mix, primarily as a result of last fall's contracting season as well as dynamic in-year pricing.

North America operating income was $161 million, up 8% versus the prior year. The increase in operating income was driven by strong price mix that more than offset inflationary input costs, including higher corn.

In South America, reported net sales were up 8% versus prior year, which includes the impact of the Argentina JV presentation change. On a comparable basis, net sales would have been up 42% versus prior year, primarily driven by strong price mix and volume across the region. South America operating income was $39 million, up $6 million. Operating income favorability was driven by stronger performance in Andean and Brazil as well as a positive contribution from the Argentina joint venture. Excluding foreign exchange impacts, adjusted operating income was up 15% in the quarter.

Moving to Asia Pacific, net sales were up 11% in the quarter. Absent foreign exchange, sales were up 19%. Asia Pacific operating income was $21 million, down $3 million versus prior year. Strong performance in ASEANI was more than offset by weakness in Korea due to higher input costs and impacts in China related to COVID disruptions. Negative foreign exchange also impacted the region during the quarter.

In EMEA, net sales increased 10% for the quarter. And absent foreign exchange impacts, net sales were up 24%. EMEA operating income was $29 million for the quarter, down $3 million compared to the prior year. EMEA operating income was down as higher corn and input costs in Pakistan, as well as foreign exchange headwinds, more than offset resilient performance in Europe. Excluding $5 million of foreign exchange impacts, EMEA's adjusted operating income was up 6% in the quarter.

Moving to our income statement. Net sales of $2.044 billion were up 16% for the quarter versus prior year. Gross profit dollars were higher year-over-year while gross margin was 19.1%, down 170 basis points, mostly attributable to price mix lagging higher corn and input costs, primarily in Pakistan and Korea. Reported operating income was $213 million and adjusted operating income was $215 million. Reported operating income was lower than adjusted operating income due to restructuring expenses.

Our second quarter reported and adjusted earnings per share were both $2.12 for the period.

Turning to our Q2 net sales bridge. We achieved strong price mix of $328 million, largely attributable to strong contracting and dynamic in-year pricing in each of our 4 regions, with notable increases in North America and South America. The sales volume decrease of $5 million was driven by the impact of the presentation change related to the Argentina joint venture, partially offset by strong volume increases in each of the regions.

On the next slide, we highlight net sales drivers. Of note, foreign exchange was a 2% headwind in the quarter, with significant headwinds in EMEA and Asia Pacific. Reported South America results include the impact of the presentation change of the Argentina joint venture within the volume column. South America net sales grew 42% with volume up 15% on a comparable basis, excluding the impact of the Argentina JV.

Turning to our earnings bridge. On the left side of the page, you can see the reconciliation from reported to adjusted earnings per share. On the right side, operationally, we saw an increase of $0.07 per share for the quarter. The increase was driven primarily by an operating margin increase of $0.24 partially offset by lower volumes of minus $0.11 and unfavorable foreign exchange of minus $0.07. Moving to our nonoperational items. EPS was flat to prior year primarily driven by lower financing costs of $0.02 and favorable outstanding shares benefit of $0.02, mostly offset by a higher adjusted effective tax rate of minus $0.03.

Year-to-date net sales of $3.936 billion were up 17% versus prior year. Gross profit margin was 19.5%, down 180 basis points. Year-to-date reported operating income was $423 million, and adjusted operating income was $428 million. Reported operating income was lower than adjusted operating income, primarily due to restructuring costs. Our year-to-date reported earnings per share was $4.04 and adjusted earnings per share was $4.06.

Turning to our year-to-date net sales bridge. 17% net sales growth has been led by $612 million of price mix improvement, primarily from North America. The sales volume increase of $14 million was driven by volume increases in each of the regions, primarily in North and South America, largely offset by a sales volume decrease of a negative $128 million from the presentation change related to the Argentina joint venture. These sales increases were offset by foreign exchange headwinds of $66 million in the first half.

Turning to our year-to-date earnings bridge. On the left side of the page, you can see the reconciliation from reported to adjusted. On the right side, operationally, we saw an increase of $0.22 per share year-to-date. The increase was driven by margin improvement of $0.44 and other income of $0.02 offset by lower volumes of minus $0.13 and foreign exchange of minus $0.11.

Moving to our nonoperational items. We saw a decrease of minus $0.06 per share year-to-date, driven primarily by a higher tax rate of minus $0.03 and higher financing costs of minus $0.03.

Moving to cash flow. Second quarter cash from operations was essentially breakeven. Cash from operations [decreased](corrected by company after the call) versus prior year, driven by higher working capital usage as a result of higher input costs flowing through inventory values and accounts receivable. Net capital expenditures were $137 million, up $35 million from the prior year due to the timing of spend. We are in line with our 2022 expectations for capital commitments.

In the first half of the year, we paid $86 million of dividends to Ingredion shareholders and repurchased $83 million of outstanding common shares. Finally, we acquired additional shares of PureCircle from minority shareholders for $27 million.

We expect our full year 2022 adjusted EPS to be in the range of $6.90 to $7.45. This excludes the impact of acquisition-related integration and restructuring costs as well as any potential impairment charges.

We expect net sales to be up mid-double digits driven by strong price mix and volume growth on a comparable basis. We expect full year reported operating income to be up significantly as the prior year reflects the impact of the net asset impairment charge related to the contribution of our Argentina operations to the joint venture. We expect adjusted operating income to be up low double digits compared to last year.

2022 financing costs are expected to be in the range of $88 million to $93 million, reflecting primarily higher incremental borrowing costs. Our anticipated adjusted effective annual tax rate is expected to be between 28% and 29%, which reflects a decrease in the top end of the range from prior guidance. Cash flow from operations is now expected to be in the range of $300 million to $360 million, reflecting greater working capital investments, as I noted previously.

Net capital investment commitments are expected to be between $290 million and $320 million, of which approximately $85 million will be invested to drive specialty growth. We expect total diluted weighted average shares outstanding to be in the range of 67 million to 68 million for the year.

In terms of our regional outlook. North America net sales are expected to be up 15% to 20%, driven by favorable price mix and higher volumes. Operating income is expected to be up low to mid-double digits, driven by favorable price and product mix and higher volumes more than offsetting higher corn and input costs.

For South America, we now expect net sales to be up low double digits, reflecting strong favorable price mix, more than offsetting the impact of the presentation change for the Argentina joint venture. South America operating income is also now expected to be up low double digits, driven by favorable price mix.

In Asia Pacific, we anticipate net sales to be up 10% to 15% versus the prior year. We continue to expect operating income to be flat to prior year driven by higher corn costs in Korea related to the Ukraine conflict and the impact of COVID lockdowns in China, offsetting stronger growth from PureCircle.

For EMEA, we expect net sales to be up 10% to 15%, and we expect operating income to be flat to down low single digits, driven by higher corn and energy costs and negative foreign exchange impacts.

For the third quarter 2022, we expect an increase in net sales to be in the high teens and operating income growth to be up high single digits when both are compared to the prior year.

That concludes my comments, and I'll hand it back to Jim.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Thanks, Jim. While there are a number of variables that could impact our expected results in the second half, we believe we have developed a solid pricing playbook and have significant experience in managing inflation. Additionally, our teams are taking actions to mitigate earnings volatility through our expanded risk management program and are working to limit our exposure to corn price movements, all of which is expected to support margin expansion in the second half relative to the prior period.

We are also carefully monitoring potential changes in consumer behaviors and spending, which could impact sales volume amidst a possible recession. We are positioned well since the ingredients we produce are used in a broad range of food and beverage categories and are consumed across many different types of eating occasions. For example, we benefit from resurgent strength in both foodservice and private label sales in the U.S. and Europe.

In closing, our second quarter results were very strong. We grew our top and bottom line in the quarter despite significant inflation and continued supply chain disruptions, [while advancing](corrected by company after the call) progress against our strategic pillars. We exit the first half with solid momentum, and we expect to deliver continued growth in the second half. Now let's open the call for questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) And our first question comes from the line of Adam Samuelson from Goldman Sachs, your question please.

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**Adam L. Samuelson** - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Yes. Good morning everyone.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Good morning Adam.

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**Adam L. Samuelson** - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

So I guess my first question is just trying to make sense of kind of how kind of the forward outlook has changed. In the quarter, your op income performance came in above kind of what you thought the guidance range didn't really budge a couple -- a little bit at the low end.

And so I'm just trying to get a sense of kind of -- is it more caution on currency, on cost layout? Just making sure I'm understanding kind of the moving pieces of kind of how the first half performance doesn't seem to be fully flowing through in the back half of the year, if at all?

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Yes. Adam, this is Jim. I'll take a first shot. I think first, just to remind everybody that as we look at the corn layout, clearly in the beginning of the year, we saw rising corn as we were laying on hedges and getting basically Q2, Q3 and Q4 covered. We will incur a little bit more in terms of corn costs in Q3, Q4. So that is reflected in our assumptions. But I think maybe more to your point, as we're looking at what's kind of changed is that we're really -- we're somewhat cautious about Europe and the kind of the situation there with regard to energy supply.

So as Jim mentioned on the call, we're putting in plans now to kind of mitigate if there is any type of gas curtailment and how we would move product around. And so we're a bit cautious on that. And then also, I think that as we look to Asia Pac, we've had a COVID disruption in China. We seem to be coming out of that quite strongly in the beginning of Q3, but we're also just cautious about the cost of corn as it impacts us in Korea.

And I think that's also kind of reflected in our second.. but overall, EBIT is up -- I mean year-over-year, EBIT will be up both -- obviously, Q3, Q4 EBIT will be very strong relative to last year's relatively weaker laps. And then overall, in total, EBIT for the full year will be up a bit -- slightly higher than what we previously forecasted.

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**Adam L. Samuelson** - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

No. That's helpful. And then maybe zeroing in on North America. I mean volumes up, one. And I guess specialties are growing in that. I guess we're also hearing about parts of kind of some of the more commodity products and core products that are in quite tight supply at the moment. And I'd love to get any thoughts you have about kind of the demand trends in some of those core products in North America and how that frames your view of supply and demand going into contracting for '23?

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Yes. Maybe I'll comment on syrups and then maybe Jim can comment on more kind of dextrose. So what we're seeing for syrups is generally a pull within North America as you've seen really strong food service takeaway, both in Q2, probably continuing all throughout summer. You're seeing strong pull for beverages, and you're also seeing strong pull from brewery.

And then also just to add, Mexico, most throughout last year was still kind of came out of Delta, Omicron kind of hit and I would say that the bounce back in Mexico in '21 was a bit subdued. And what we're just seeing is, I think, a nice recovery, full volume recovery in Mexico as we go through the year. And with regard to kind of more kind of value-added core products, crystalline dextrose has been in strong demand throughout the whole year.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Yes. I think demand continued to be strong in the second quarter, and orders continue to remain robust right now. Our visibility, Adam, at this point, indicates strong demand continuing through quarter 3, which is typically a strong quarter, tied to customers' pipeline filling for holiday offerings. That's not meant to imply that quarter 4 will soften.

We just don't have visibility that far forward just yet. So what we see is still strong demand from food service, private label, strength and strong orders through quarter 3, and it remains to be seen, obviously, how quarter 4 will continue.

And as a reminder, our customer base is broad with sales across all the different categories, whether it be branded grocery, private label, food service as well as we have a very strong distributor network really around the world. And we certainly would say foodservice appears robust through the end of the summer for sure. So that's about as much visibility as we have and that's all positive at this point in time from a demand forecasting standpoint.

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**Adam L. Samuelson** - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Ok, that is all very helpful color. I will pass it on.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Thank you

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Thank you

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**Operator**

(Operator Instructions) And our next question comes from the line of Robert Moskow from Credit Suisse, your question please.

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**Robert Bain Moskow** - *Crédit Suisse AG, Research Division - Research Analyst*

Hi, I was hoping you could be a little more specific on your fill rates for customers because anecdotally, we've heard about some shortages, I think, in the starch complex. Do you expect those -- where are your service issues now? And do you expect them to keep getting stronger? And then a follow-up.

**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Yes. Thanks, Rob. What I would say is that the industry at large has experienced supply disruptions for certain products, which has strained product availability. And demand has continued to be strong for a number of the products we supply, and this has been the case since the rebound from the depths of COVID going back to quarter 3 of 2020.

And as we indicated, during the presentation, sales volumes are now back to 2019 pre-pandemic levels, and we're operating at high levels of capacity utilization. Through this period, we've worked closely with customers to overcome many of the global supply chain issues. And our teams have been really working diligently to meet the increased demand. We've made investments in how to -- digital investments basically from a standpoint of automation of order receiving, product allocation, order confirmation, et cetera to make sure that we're focused on those customers that are the most strategic from a relationship standpoint to us to optimize the timely and efficient delivery of product.

And also what we've done to help address some of the tightness in the supply issues, it's noteworthy that we have very high demand, for example, for our clean label texturizers and we accelerated the capacity expansion of these products at our Indianapolis facility, and that capacity is now online, and we're shipping to customers around the world. And that's in addition to a significant expansion of specialty starch production in China that is commissioning right now in quarter 3. So the industry at large, I would say, has been tight.

There's been a number of issues that have impacted service across the industry, whether it be chemical shortages or some force majeures that have been declared in various chemical supplies as well as just the overall impact of tightness with truck drivers, labor, et cetera, that we all know about. But from a standpoint of the look forward for the remainder of the year, we see the situation steadily improving in the second half as supply chains normalize over the remainder of the year.

**Robert Bain Moskow** - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. And maybe an update on your plant-based protein capacity expansion, customer orders. You gave some very specific detail on profit impact, I think, last quarter. Any update there?

**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Yes. We had actually a very strong quarter, which has us on track at this point in time. We've got a challenging second half comparable from a standpoint of what our internal targets are. But from a standpoint of our portfolio, it remains very well positioned for growth given the breadth of our product portfolio across protein flours, concentrates and isolates and across 4 different types of pulse ingredients. This really doesn't make us dependent on sales into one product category such as alternative meats with, say, just isolates, for example.

We have a very robust project pipeline with many customers across multiple consumer product categories such as alternative dairy, alternative snacks and bakery and we really have strong relationships that we've built with leading players in each of those categories and are focused on delivering the innovation to them. We really strongly believe that the plant-based trend is built on long-term sustainable fundamentals. And what we're focused on is delivering great taste and texture as well as high-quality nutrition along with clean and simple labeling.

We really believe that's the recipe for long-term success in this category and our facilities are running well now. And again, the portfolio of products that we've developed, we think are leading edge products from a taste and protein content standpoint. So the interest in our products is great, and we had a good second quarter, and the team is just running real hard to deliver a solid second half.

**Robert Bain Moskow** - *Crédit Suisse AG, Research Division - Research Analyst*

Jim, just to be more specific. I think it's operating below breakeven this year. Does that mean that there's an opportunity for kind of a rebound year or strong profit growth comparisons in '23?

**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Yes, you're absolutely right. We're running breakeven because we just commissioned the plant towards the end of last year. And what we have as a target to remind everybody, is a $10 million operating year-on-year improvement from a standpoint of our operating income from those facilities. And right now, we're on track to deliver that plus the sales growth that I referred to. So as with any new start-up, you obviously incur operating costs until the plants in this case are fully loaded. Jim, any other comments?

**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Yes. Just I think, Rob, as you look from 2022 and where we'll finish the year to 2023, we anticipate to kind of build even more on the net sales in '23 versus the foundation that we've laid in 2022. That helps us amortize more of the fixed costs in that facility. And we have yet to say what our '23 kind of expected improvement in the operating margin from plant-based proteins will be, but we're heading in the right direction, and we're seeing notable improvement in 2022's operating loss versus 2021.

**Robert Bain Moskow** - *Crédit Suisse AG, Research Division - Research Analyst*

Great, thank you.

**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

You got it Rob.

**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Thanks Rob.

**Operator**

And our next question comes from the line of Ken Zaslow from BMO, your question please.

**Kenneth Bryan Zaslow** - *BMO Capital Markets Equity Research - MD of Food & Agribusiness Research and Food & Beverage Analyst*

Hey, good morning guys.

**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Good morning Ken.

**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Good morning.

**Kenneth Bryan Zaslow** - *BMO Capital Markets Equity Research - MD of Food & Agribusiness Research and Food & Beverage Analyst*

Just curious, as you're starting to set up for 2023, it seems like you have more capacity going online. You have greater demand for -- or you seem very comfortable with the demand outlook and then you also have pretty tight utilization rates. How does that play out for 2023? Are you looking -- how do you think about it? It just seems like your growth algorithm seems to be pretty doable going into 2023, if not even better. Can you just give some parameters to that? I know it's a little early, but how does this year set up for next year?

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Well, let me take a shot first and then I'll turn it over to Jim. What I would say is right now, we're seeing demand strong. And then if you just think about navigating pricing, we've done a very good job, I think, year-to-date being able to navigate pricing, offsetting corn costs and other input cost inflation and foreign exchange.

And we're anticipating continuing to be able to do that going forward. The industry capacity utilization is tight for the ingredients that are starch-based derivative-based. And we see that at this point in time, continuing going forward. So it's really early, Ken, to really put any kind of an outlook on 2023. But I think one thing that I would say that I think everybody is tracking is our corn prices.

And looking at today's corn futures outlook and the 2023 strip pricing, we would anticipate that any required pricing actions would imply an increase versus today's increased level, but those levels would be certainly much less than what was required in 2022. So from a standpoint of that hurdle to be able to get that pricing through, I don't think it's going to be as severe as it has been as required at what it was in '22. Anything else, Jim?

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Hey Ken, I would just add in terms of what the entire team here is working towards is when we look at our specialty ingredients, greater functionality and greater value in a recipe, we highlighted that in our Investor Day. That carries with it higher average prices that customers really value the ingredients and always working towards higher gross margins in our portfolio mix.

And then I think the addition that we've seen is really in some of our core products is that you do have this shift that we've made, looking at high fructose corn syrup, we've really moved more towards kind of glucose and other specialty dextrose. And I think that, that has its own demand as we head into '23.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Yes. And I know, Ken, oftentimes we end up on these calls talking about North America predominantly, but it is also noteworthy to say that we anticipate really steady demand in the second half from Mexico and South America, especially with events such as the World Cup later in the year. Both of those businesses have done extremely well for us over the last few years. And so from that vantage point, volumes look to remain strong in the second half of this year as we head then into 2023.

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**Kenneth Bryan Zaslow** - *BMO Capital Markets Equity Research - MD of Food & Agribusiness Research and Food & Beverage Analyst*

And just my follow-up question here is how much capacity -- additional capacity do you have coming on in 2023? And to what extent do you think you'll get a return on that, and that would be where I'd leave it.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Well, our operations team is very focused on improving on-stream effectiveness, OEE, to squeeze more pounds out of our plants because right now, and the situation has been this way for quite a while, we can sell every pound we make. So we've been very focused on operational excellence. We've made the investment in the FBR in Indianapolis, which has expanded our clean label texturizing portfolio.

That came on in record time, team did a phenomenal job and our expansion in China has really been remarkable from a standpoint of that facility has actually shipped its first product to customers. And so that plant is coming on stream with significant capacity for that local market and potentially some export opportunities as well within that region, which relieves export requirements from other regions into Asia, freeing up some capacity.

So we've taken a number of steps. And we also announced, and I'll just draw you back to an announcement we made at Investor Day of $160 million of capital investments, specifically in texturizers to expand volume growth. And that's across a variety of downstream refining assets for the more highly valued specialty texturizing ingredients. And that's across the pre pregelatinized and/or cold water swelling category. That's across the clean label texturizers that I mentioned as well as different bases as well. So whether it be potato-based or rice-based, we have seen strong growth. So we're expanding capacity there, but in the downstream finishing channels not necessarily in the grind capacity realm. Jim?

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Hey Ken, as we outlined in our 4-year outlook, for us to look at our texturizers, we really need to plan for volume growth that's going to be in the mid-single digits. And so while Jim highlights a number of our areas, we have a pretty comprehensive capital planning to make sure that as we're looking forward to the next year and the year after that, that as we anticipate customer demand in texturizers that we're really planning ahead to accommodate that growth.

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**Kenneth Bryan Zaslow** - *BMO Capital Markets Equity Research - MD of Food & Agribusiness Research and Food & Beverage Analyst*

Ok, I appreciate it. Thank you.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Thank you Ken.

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**Operator**

(Operator Instructions) And our next question comes from the line of Seth Goldstein from Morningstar, your question please.

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**Seth Goldstein** - *Morningstar Inc., Research Division - Equity Analyst*

Hi good morning guys, thanks for taking my question.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Thank you Seth.

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**Seth Goldstein** - *Morningstar Inc., Research Division - Equity Analyst*

How do the new contract structures work in a scenario where commodity prices were to fall and particularly in specialty, would you be able to maintain higher prices? Or would there be some sort of a pass-through to reflect the commodity price declines.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Well, for our more specialty products, those are sold on a value-added basis. And from a standpoint of the performance they're delivering in that application. And prices typically for those ingredients don't necessarily fall or come down associated with say, corn cost inputs to the same degree or if at all, in comparison to more of the core ingredients, the core bulk sweeteners, for example, that doesn't typically happen.

And so those margins, remember, are minimum in GP 2x ,the core ingredient margins. So that's typically how pricing works with those products. And it's different also depending on the region. North America is a little different than Asia Pacific, which is a little different than South America and EMEA, for example.

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**Seth Goldstein** - *Morningstar Inc., Research Division - Equity Analyst*

Okay. That's really helpful. And what percentage of the EMEA sales come from the 2 facilities in Germany? Just trying to size up the potential risk that you're trying to mitigate should there be natural gas shortages?

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

So the 2 facilities. We have one facility of consequence, which is in Hamburg, Germany. We have a smaller facility related to the KaTech operations, which we most recently acquired last year. Out of EMEA's entire sales, half of it approximately or a little more than half is from Europe itself. And from that facility, maybe 25%, 30% of the sales comes from that German facility.

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**Seth Goldstein** - *Morningstar Inc., Research Division - Equity Analyst*

Ok, great. I will pass it on. Thank you very much.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Thank you Seth.

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**Operator**

And our next question comes from the line of Ben Theurer from Barclays, your question please.

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**Benjamin M. Theurer** - *Barclays Bank PLC, Research Division - Head of the Mexico Equity Research & Director*

Good morning and thank you very much for taking questions. Just wanted to follow up a little bit on the outlook into the second half. Obviously, in half one, we've seen very strong pricing momentum and essentially volumes being, call it, plus/minus flat. Have you seen amongst your customers, any elasticity, any pushback? I mean you've talked about the order book into Q3. But how do you feel about the pricing needs and the ability to put through pricing just given the general inflationary environment?

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Yes. I think for this calendar year, we remain confident in the ability to pass through pricing through the remainder of this year based on the visibility we have for the demand outlook. Beyond this year, we really can't at this point, comment because we don't have obviously visibility that far forward.

But we feel pretty confident because we have -- been able to put through not only price increases related to our typical contracting period, which goes back to, say, last fall even into, say, January of this year, which is the typical contracting period, but we have put through multiple across multiple regions, dynamic in-year price increases related to incremental inflationary cost increases we've incurred.

And as we've demonstrated, we've been able to more than offset those through pricing actions this calendar year. And it's not been an insignificant proportion of the pricing that we've obtained for total 2022 and that has come from in-year dynamic 2022 pricing in comparison to what we had to put through related to typical contracting at the time when we had visibility our cost structures as we headed into 2022.

So that's what I would say. But we are monitoring, like everyone else, we're monitoring very closely, consumers' behavior and spending and watching very closely. At this moment in time, we don't see softness for the ingredients we supply, given we believe the diversified usage of those ingredients across multiple channels.

So as I was mentioning, the COVID rebound, everybody is obviously out enjoying summer holidays and foodservice and food away from home, we benefit from foodservice equally as consumers trade down private label increases, we equally benefit there, and that's just the nature of the diversified nature of the products we sell and the reach of those products.

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**Benjamin M. Theurer** - *Barclays Bank PLC, Research Division - Head of the Mexico Equity Research & Director*

Okay. And then just following up, you made some comments about Asia Pacific, obviously being impacted because of some of the lockdowns. Can you share maybe a few anecdotes of how things have started to recover? Because it obviously -- if we take a look at the guidance with operating income to be flat for the year, there needs to be some good acceleration into the back half in terms of growth rates. So just how confident are you? And are you seeing anything on the ground that just confirms that your positive view here to get from what that first half minus 12%, 13% was to flat?

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Yes. So for Asia Pacific operating income, we're expecting operating income to be relatively flat for the full year. And that's -- and we've got a significant year-on-year improvement related to PureCircle in there from a standpoint of the bottom line. Remember, we also are incurring start-up costs for the new China modified starch plant.

So for us, quarter 2 was, I would say, the low watermark for the Asia Pacific business related to the severity of the impact of the COVID lockdowns in the second quarter as well as the incurring of the higher corn and energy costs in Korea. But right now, we are also enduring foreign exchange weakness in a number of those currencies.

But the team is putting through in-year pricing, which is going through significantly right now in the second half, and we see demand strong. Our Tapioca franchise is doing exceptionally well. The ASEANI business is doing extremely well. And believe it or not, China is picking up nicely. And again, we're shipping products from the new plant currently to customers. That plant is ramping up -- and so we have phased our outlook with a brighter outlook for the second half in comparison to what we've endured in the first half and specifically quarter 2 was the low watermark, we think, for the year, and it's just getting -- going to just get it better and improve in the second half.

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

And Ben, I'd only note and add to what Jim said is that while the Ukraine conflict created a corn availability shock for Korea, t took a quarter for the team to secure their corn for the second half and then plan on pricing increases. And so now we'll see the pricing increases impact the second half and offset the higher cost of that corn in Korea. And so that's really -- that's really the anticipated improvement in the second half in Asia Pac, along with the other things that Jim mentioned.

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**Benjamin M. Theurer** - *Barclays Bank PLC, Research Division - Head of the Mexico Equity Research & Director*

Ok, perfect. Thank you very much.

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

You got it.

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**Operator**

(Operator Instructions) And our next question comes from the line of Ben Bienvenu from Stephens, your question please

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**Benjamin Shelton Bienvenu** - *Stephens Inc., Research Division - MD & Analyst*

Thanks, good morning guys.

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Hi, Ben.

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**Benjamin Shelton Bienvenu** - *Stephens Inc., Research Division - MD & Analyst*

I want to ask about capital allocation specific to what is a really strong balance sheet positioning, continued progress on the integration of PureCircle. In your updated guidance today, it looks like, obviously, you'll continue to have your dividend payment, but there's not going to be considerable repurchase activity on the buyback. What is your appetite for incremental M&A, just given the progress that you've made on PureCircle integration and the cash generation of the business?

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Jim, do you want to talk about just the cash in year and how you see that playing out? And then I can maybe take the last question.

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Yes, sure. Ben, and for all. When we look at a kind of a rising corn market or an inflation market, we're going to be paying more for that corn. It's going to wind up in our inventory values as we make sales to customers, it's going to be reflected at higher prices on invoices. And that increases our overall -- the two pieces of our working capital. So we've seen this in the past.

We've actually had a significant reversal of that benefit in 2020. We invested in working capital in '21. We're investing in working capital in '22 as our revenue is well above kind of $8 billion. And so that's somewhat normal for our business. We do expect it to flatten out as we get into '23 and

'24. And therefore, we won't be putting as much investment from cash into working capital, and we do expect kind of cash from operations to be returning to that kind of $700 million kind of run rate level.

And from that then, we prioritize very strong organic capital growth projects. We prioritized the dividend, and that leaves us dollars left over for strategic deployment on M&A.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

I think that's well said, and we obviously continue to work an active M&A pipeline. And we believe that this situation will sort itself out as we go through next year.

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**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Yes.

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**Benjamin Shelton Bienvenu** - *Stephens Inc., Research Division - MD & Analyst*

Okay. My second question is related to the EMEA segments and more specifically, the trends you're seeing in Pakistan, you cited it as a source of cost pressure in the quarter. Obviously, we've seen currency come under considerable pressure there. If you could just talk about what's going on there in the broader economy and the business trends, implications for you guys, that would be helpful.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Yes, thank you for that question. We don't often talk about the Pakistan business, which is a significant business for us in the EMEA region. Pakistan, as you said, is experiencing significant cost inflation like everywhere else, particularly in corn and energy as well as unfavorable foreign exchange.

Summer corn crop prices are continuing to increase, indicating that prices may increase up to an additional 10% on top of increases of over 40% versus the prior year in the first half of 2022. And you mentioned the rupee. The rupee has devalued more than 14% against the dollar this year. So the team is working very hard. We have a very solid market position in [Pakistan](corrected by company after the call). The team in Pakistan, has realized significant price increases in the first half of the year, and we'll continue to adjust pricing to capture higher costs in the second half.

I think like everywhere else, what we're going to have to watch is the magnitude of price increases that are required due to these extraordinary circumstances whether they be agricultural input cost inflation or energy cost inflation and then the impact that has on consumers. And that is an emerging market to a degree, and it's a solid market for us. But we're going to just have to watch that over time, given the magnitude of the price increases that are required to offset those inputs that I just talked about.

But so far so good in the first half. It's having an impact, but it's a muted impact, and the team is working very hard to keep that the same way in the second half.

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**Benjamin Shelton Bienvenu** - *Stephens Inc., Research Division - MD & Analyst*

Ok, great. Good luck with the rest of the year.

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**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

Thank you so much Ben.

**James Derek Gray** - *Ingredion Incorporated - Executive VP & CFO*

Thanks Ben.

**Operator**

Thank you. And this does conclude the question-and-answer session of today's program. I'd like to hand the program back to Jim Zallie for any further remarks.

**James P. Zallie** - *Ingredion Incorporated - President, CEO & Director*

I just would like to thank everyone for joining us this morning. We look forward to seeing many of you at our upcoming investor events this fall. And I just want to conclude by saying thank you to everyone listening for your continued interest in Ingredion.

**Operator**

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Have a good day.