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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Ingredion Second Quarter 2023 Earnings Call. (Operator Instructions). Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Noah Weiss, Vice President of Investor Relations. Please go ahead.

Noah Weiss - *Ingredion Incorporated - VP of IR*

Good morning, and welcome to Ingredion's Second Quarter 2023 Earnings Call. I'm Noah Weiss, Vice President of Investor Relations. Joining me on today's call are Jim Zallie, our President and CEO; and Jim Gray, our Executive Vice President and CFO. The press release we issued today as well as the presentation we will reference on our second quarter results can both be found on our website, ingredion.com, in the Investors section.

As a reminder, our comments within the 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 Form 10-Q and 8-K.

During the call, we will also reference 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.

With that, I will turn the call over to Jim Zallie.

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

Thank you, Noah, and good morning, everyone. As we enter the second half of the year, I am pleased to report that sales and profitability remained strong with net sales up 4% for the second quarter, Absent Foreign Exchange impacts, driven by solid price and customer mix management across all regions. Adjusted operating income was up 17% due to pricing and mix improvements, which helped us overcome inflationary input cost pressures that have been a headwind over the last 2 years.

Additionally, gross margins have recovered nicely due to effective customer contracting and disciplined operational execution. And this quarter's performance is the fourth consecutive quarter of gross margin expansion. Our performance this quarter demonstrates the value of a diversified portfolio, where North America's strength in core ingredients and EMEA's strength in specialties contributed to record second quarter net sales and operating income. These results are particularly noteworthy given the strength of last year's second quarter performance and demonstrate that we maintain our ability to price and pass through significant raw material inflation. Our results also demonstrate our ability to be responsive to shifting market dynamics and deliver continued profit growth.

Turning now to our Specialty Ingredients growth highlights. During the quarter, Specialty Ingredients net sales grew 3% due to better price mix, even as continued inventory rebalancing throughout the entire supply chain led to softer volumes. Increased collaborations with customers seeking to improve the affordability of recipes, help drive new business momentum throughout the quarter. Historically, in times of higher commodity cost inflation, our customers look to Ingredion to leverage the functionality of our solutions capabilities to reduce their formulation and production costs. Our teams are actively engaged with customers to co-create new food products, leveraging our proprietary ATLAS product simulator, which accelerates innovation using digital prototyping, helping our customers reduce their R&D expense and increase their own new product development efficiency.

Recently, our team also created and launched our snacking center of expertise, which seeks to capture additional growth opportunities for Ingredion in the global snacking category, which has been growing 3% to 5% year-over-year for the last 5 years. The snacking category presents an excellent opportunity to leverage our complete solutions capability across specialty starches, plant-based proteins and sweeteners. Our snacking experts have deep technical proficiency that allow them to engage with customers in new ways, providing proprietary insights and market-ready prototypes across a variety of snack applications. This collaboration has helped us develop more projects with larger snack companies globally and has created a multimillion-dollar pipeline tapping into the snacking category's high growth potential.

Lastly, our Stevia solutions continue to gain momentum and subsequent to the close of the quarter, we increased our overall ownership of PureCircle to 88%. Taking a closer look at Specialty Ingredient net sales growth over the past 12 months, South America and EMEA Specialty Ingredient sales have increased as a percentage of their total net sales while North America and Asia Pac held steady. On a consolidated basis, Specialty Ingredients now make up 34% of overall company sales and continue to comprise an increasing proportion of company profits. It is important to note that core ingredients net sales growth over the past few quarters has been significantly higher than historical averages which is indicative of strong industry fundamentals.

Turning now to our Sugar Reduction and Specialty Sweeteners portfolio. Ingredion is the global leader in natural high-intensity sweeteners for Sugar Reduction, an estimated $5 billion market, which is growing at 6% compounded annual growth rate. Our growth in this market is attributable to our acquisition of PureCircle 3 years ago. PureCircle's advanced technology in Stevia leaf breeding and enzyme chemistry is bringing natural sweetener solutions to the market for companies like Coca-Cola, Danone, Nestle and others, who are actively looking to reduce the sugar content in their products.

Since acquiring PureCircle, we have leveraged Ingredion's global go-to-market capabilities to add approximately 185 new customers for high-intensity natural sweeteners. We are proud to say that these advancements have helped consumers remove an estimated 3.3 trillion calories from their diets since 2020. We are very pleased with our strategic investments in sugar reduction and continue to focus on expanding our pipeline of projects and new solutions.

As an example, over the next few months, we will be ramping up a significant expansion of our Stevia bioconversion facility in Kuala Lumpur. Now turning to our strategic pillars. Our teams continue to do an outstanding job executing against our 4 strategic growth pillars. Beginning with Specialty Ingredients. Year-to-date, net sales growth once again grew double digits on a constant currency basis. It is worth noting that these year-over-year increases are being achieved while lapping a strong level of net sales growth in the first half of last year. Additionally, more than half of our specialty ingredients growth platforms increased their net sales by double digits on a year-to-date basis.

Turning to commercial excellence. Our value-based pricing and approach to product and customer mix management continues to drive profit growth and positively impact margins. Our teams around the world leverage our Regional Centers -- Pricing Centers of Excellence to continuously assess the value that our ingredients bring to a recipe and price accordingly. Additionally, the investments we have made to increase the visibility of order tracking for customers and improved warehousing logistics is being reflected in increased Net Promoter and customer satisfaction scores across all regions. We are also actively tracking consumer purchasing channel movements that could impact our customer channel demand, so we can respond to changes in buying behavior to maximize volume opportunities.

Against our cost competitiveness strategic pillar, our operations team continues to do a superb job mitigating the impact of fixed cost absorption by tightly managing fluctuations in production schedules and ensuring we meet service delivery requirements of customers. While input cost inflation continued in the second quarter, the rate of increase has started to moderate. This positive development, combined with Ingredion's productivity initiatives will continue to support margin growth. Additionally, our global operations team is in the early stages of driving a connected factory strategy to increase productivity. As an example, our team in Hamburg is leveraging artificial intelligence capabilities to optimize batch cycle times. These efforts are delivering up to a 5% increase in asset utilization and over time, this capability will be expanded to other facilities.

Finally, acknowledging our purpose-driven and people-centric growth culture. We are pleased to have been named as one of the 2023, 2024 Best Companies to Work For by U.S. News and World Report. And we were named to USA today's inaugural Climate Leaders list, which aims to recognize companies that have reduced emissions intensity over the last few years.

Now let me turn it over to Jim Gray for the financial review. Jim?

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

Thank you, Jim, and good morning to everyone. Moving to our income statement. Net sales of approximately $2.1 billion were up 1% for the quarter versus prior year, but close to 4% absent FX impacts. Gross profit dollars grew 13% versus prior year, driven by a combination of factors. It is encouraging that gross margins are above 20% again this quarter and are beginning to reflect historical averages, especially as corn costs fluctuate globally at high levels.

Reported and adjusted operating income were $251 million. The increases were driven by favorable price mix, partially offset by higher raw material and input costs and lower volumes. Our second quarter reported and adjusted earnings per share were $2.42 and $2.32, respectively, for the period, up 14% and 19% sorry, 9%, respectively, from the prior year. To highlight in this quarter's results, reported EPS benefited from a $0.10 tax rate reduction due to a strengthening in the Mexico peso during the quarter, and the subsequent valuation impact to our U.S. dollar-denominated working capital balances in Mexico. We adjust out this tax benefit for non-GAAP adjusted EPS.

Turning to our Q2 net sales bridge. We achieved strong price mix of $297 million, including the pass-through of higher corn and input costs. This was partially offset by decreased volumes of minus $225 million and foreign exchange impacts of minus $47 million.

Turning to the next slide. We highlight net sales drivers for the second quarter. Foreign exchange was a minus 3% headwind in the quarter, with most of the impact in EMEA, particularly in Pakistan. Sales volume was down minus 11% as customers continue to work through elevated inventory levels. Customers are moving towards just-in-time delivery as supply chains normalize. Contributing to net sales growth, price mix was up 15% due to value-based pricing and customer mix optimization compared to the second quarter of 2022. It is worth underscoring that the second quarter 2023 results are not only surpassing the previous high for second quarter 2022, but also represent a record revenue second quarter from an absolute sales perspective.

Given the breadth of our product and customer base, when we assess the volume declines that we are seeing, we conclude the consumers, retailers, foodservice outlets, distributors and packaged goods manufacturers are all experiencing a demand pullback. We show here a volume index based upon our 2019 quarterly shipment averages, excluding high fructose corn syrup and adjusting for changes in our portfolio since 2019. This plot of quarterly volumes illustrates in 2021 and 2022, the higher shipments and buildup of ingredients inventory in our customer base as consumer demand ran up and supply chains were disrupted. As we exit this quarter, we are already seeing signs that inventory in some segments has started to bottom. While we can't predict the exact slope of the volume recovery, we do know from some conversations with customers that inventory levels are already too low. We anticipate a gradual increase in the rate of orders in the back half of the year.

Turning now to gross margins. On a year-over-year basis, we improved gross margin by 220 bps to 21.3%, driven by a catch-up pricing actions taken during last fall's contracting cycle to offset higher inflation. With regard to our pricing centers of excellence, we continue to pursue price for value, which has led to higher profitability in total, while trading off some volume loss from lower-margin transactions. While our operations experienced under absorption of fixed costs from weaker volumes, we mitigated the impact by flexing production at certain plants and taking other cost reduction actions. Although inflationary input cost increases continued through the second quarter, the rate of increase has started to moderate. We view our productivity initiatives as margin supportive, and we will continue to highlight achievements as we progress.

Let me turn to a recap of our Q2 regional performance. North America net sales were up 5% when compared to prior year. The increase was driven by strong price mix as well as strengthening core ingredient sales. North America operating income was $197 million, up 22% versus last year. In South America, comparable net sales were down 11% versus last year and down 8% on a constant currency basis.

South America's operating income was down 41% to $23 million driven primarily by the impact of higher inventory carrying costs in Brazil from last season's corn costs, some lower volumes and foreign exchange headwinds in the Argentina JV results. Moving to Asia Pacific. Net sales were down minus 3% for the quarter and were flat on a constant currency basis. Asia Pacific operating income was $27 million, up 29% versus prior year, with favorable price mix, partially offset by lower volumes.

Excluding foreign exchange impacts, adjusted operating income was up 33% for the quarter. In EMEA, net sales increased 4% for the quarter, and absent foreign exchange impacts, net sales were up 15%. EMEA operating income was $42 million in the quarter up 42% compared to the prior year, driven by favorable price mix, partially offset by lower volumes, higher input costs and foreign exchange impacts, particularly in Pakistan. Excluding foreign exchange impacts, adjusted operating income was up 59% in the quarter.

Turning to our earnings bridge. On the left side of the slide, you can see the reconciliation from reported to adjusted earnings per share. On the right side, operationally, we saw an increase of $0.40 per share for the quarter. The increase was driven primarily by an operating margin increase of $0.75 partially offset by unfavorable volume of minus $0.21, an unfavorable impact of foreign exchange of minus $0.08 per share.

Moving to our non-operational items. We had a decrease of minus $0.20 per share in the quarter, which was primarily driven by higher financing costs of minus $0.15. Year-to-date net sales of $4.2 billion were up 7% versus prior year. Gross profit margin was 22.1%, up 260 basis points. Year-to-date reported operating income was $542 million and adjusted operating income was $547 million.

Reported operating income was lower than adjusted operating income primarily due to the final costs related to the U.S.-based work stoppage at our Cedar Rapids facility recorded in the first quarter. Our year-to-date reported earnings per share was $5.27 and adjusted earnings per share was $5.12. Reported EPS was higher than adjusted EPS, primarily due to the tax benefits from the valuation of the Mexican peso against the U.S. dollar in the period.

Turning to our 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 $1.28 per share year-to-date. The increase was driven by margin improvement of $2.18, offset primarily by lower volumes of minus $0.57 and foreign exchange of minus $0.20.

Moving to our nonoperational items. We saw a decrease of minus $0.22 per share year-to-date, driven primarily by higher financing costs of minus $0.23 per share. Moving to cash flow. First half cash from operations was $279 million, up significantly from an operating loss of $4 million in the same period last year. As working capital investment has begun to normalize following 2 years of significant raw material inflation. Through the end of Q2, our net working capital investment is $218 million and we expect this investment to remain relatively flat or improve for the balance of the year.

Net capital expenditures were $153 million, in line with our full year expectations. In the first half of the year, we paid $95 million in dividends to shareholders. And as you will have read this morning, we announced a 10% increase in our dividend to $0.78 per share up from $0.71 per share. This is the ninth consecutive year of an increase in our quarterly dividend and reflects the continued strength of our business. Through dividends and growth in the dividend, we are increasingly returning cash to shareholders as we execute our driving growth road map.

Next, I'd like to address our updated '23 outlook. We now expect net sales to be up mid- to high single digits, reflecting softer sales volume and the anticipated layout of corn costs. Additionally, cash from operations for full year '23 is now expected to be in the range of $600 million to $700 million. We have raised our full year 2023 adjusted EPS guidance and now expected to be in the range of $8.80 to $9.40. Lastly, we have increased slightly the diluted weighted average shares outstanding to be between 67 million and 68 million shares.

In terms of our full year regional outlook, North American net sales are expected to be up 5% to 10%, driven by favorable price mix. Operating income is expected to be up 20% to 25% with price mix continuing to outpace lower volumes and increasing costs. For South America, we now expect net sales to be flat to down 5%, reflecting lower volume, partially offset by favorable price mix. South America operating income is expected to be down mid to high single digits with higher input costs being partially offset by favorable price mix. In Asia Pacific, we now anticipate net sales to be flat versus the prior year, and we expect operating income to be up high double digits, driven by favorable price mix.

For EMEA, we continue to expect net sales to be up 10% to 15%. And operating income to be up 40% to 50% due to favorable price mix. Corporate costs are expected to be up high single digits. For the third quarter, we expect Ingredion net sales to be up mid-single digits and operating income to be up high single to low double digits when compared to the third quarter last year.

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

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

Thanks, Jim. Before we go to the Q&A, just a few final thoughts on how we see the business outlook for the remainder of the year. We are seeing softer volume demand across the food and beverage supply chain, driven by inventory rebalancing, which we are describing as a move from Just In Case to Just In Time. We are also seeing consumers economizing in response to price inflation. That said, we expect to see a gradual but bumpy pickup in volumes throughout the second half.

Our full year guidance reflects this volume demand outlook and its impact on fixed cost absorption. After 2 years of historically high supply chain costs, and raw material inflation, we are steadily seeing our gross margins recover to pre-pandemic levels. While we are pleased with this progress, we are actively pursuing additional levers that we can pull to further improve the quality of earnings and reduce earnings volatility, all of which align with our long-term strategic goals.

Now let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Ben Bienvenu of Stephens Inc.

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

Hi thanks. Good morning guys.

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

Good morning.

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

Good morning.

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

I'd like to start kind of where you left off, Jim, on the volume front. Could you talk a little bit about with what you saw in the second quarter, how did that compare to your expectations for volumes in the second quarter? And then, Jim Gray, I think you mentioned that you expect to see the rate of orders to pick up in the back half of the year. Should we interpret that to mean that volumes are still negative across the global footprint and then potentially turn positive in the fourth quarter? Or how should we think about the outlay there?

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

Yes. Do you want me to take the first part. So, what we're seeing is that the lower volumes, we believe, are primarily due to downsizing of inventory as the food supply chain at large moves from a situation where people are operating to build inventories Just In Case. There were supply chain issues or disruptions to now, with interest rates and the holding cost of inventory increasing to more of a Just-in-time approach where perhaps the industry is over indexing on that side and having safety stocks be reduced to, say, dangerously low levels potentially as companies try to manage their working capital. And again, believe that the supply chains are back to normal. We do believe we're seeing demand bottoming and we do believe we'll see a gradual but bumpy pickup in demand over the coming quarters.

It is noteworthy, I guess, to highlight that in contrast to those comments, one source of steady volume demand has been syrup shipments, for example, primarily into beverages as we have seen a very modest falloff there. This is likely driven by relatively steady restaurant traffic, QSRs, fast casual, which has been relatively flat in the first half. We also believe we're seeing a bottom in industrial starch volumes in North America as packaging and paper to a lesser degree, have shown some signs of recovery. So our current view now assumes that volumes remain soft through Q3 and start to gradually recover in quarter 4.

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

Okay. Fair enough. In your guidance update today, you did also raise your cash flow from operations forecast, thinking outside of organic growth investment in the business, you upped your stake in PureCircle. Can you talk about some of the other priorities that you have and what the M&A landscape looks like versus potentially buying back your stock as we move forward given that you'll have nice free cash flow generation?

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

Yes. Maybe I'll take it and maybe Jim can add in terms of the view of the M&A landscape. So our capital allocation priorities are still one around the organic growth opportunities we see. Obviously, if volumes pause, then we have a little bit more head space in front of us, which is great as our teams continue to pursue growth and texture and as well as in nutrition and as well as we look at sugar reduction, we are going to then look at M&A as well as mining the dividend.

As I pointed out, we have raised the dividend again, for the October declaration and really just demonstrating that we believe in the future growth, free cash flow in the company as we look forward to 2024 and 2025, and just as a reminder, Ben and for everybody, we are really targeting a long-term dividend payout ratio in the upper 30s to 40% of our adjusted EPS. So this move gets us there, but we really look at the dividend as a primary means to returning cash to shareholders.

With regard to M&A, we are still -- again, we have a very wide M&A net globally as we have many relationships around the world. And I think we are seeing some opportunities for, again, probably more tuck-in type of M&A, but opportunities where we really think that we can further secure our market share and our market positions and the types of businesses that we want to be in.

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

Yes. I mean what I would just simply add is that what we've been emphasizing for the last few years is that Ingredion is not the same company that it was, say, 5, 6 years ago, we really have transformed from a starch and sweetener company to what we are today and what we will be more of in the future, which is a Texture and Health Solutions Company. And anything from an M&A standpoint that's going to enhance the value propositions for Texture and Health Solutions, I think you can expect to see us pursue.

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

Ok, great. Thanks very much.

Operator

(Operator Instructions) Our next question comes from the line of Andrew Strelzik of BMO Capital Markets.

Andrew Strelzik - *BMO Capital Markets Equity Research - Senior Restaurant Analyst*

Hi Good morning, thanks for taking the questions. My first one.

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

Andrew, welcome.

Andrew Strelzik - *BMO Capital Markets Equity Research - Senior Restaurant Analyst*

Thank you very much. Just wanted to start by digging in on South America first. And I heard some of the reasons that you talked about for some of the pressures in the quarter. But I guess I didn't totally understand why there was such a dramatic fall off in the margins. I mean with the corn costs have been that different. And I'm looking at a price mix where the increases weren't quite as meaningful as they've been? Are you seeing any resistance from a pricing perspective in South America? And then lastly, I guess, on this piece. If my math is correct, the margin -- the guidance implies a pretty quick snapback in margins to kind of that mid-teens level. So I guess the confidence there in the quick recovery, are you already seeing that? Just would love to better upstand that for these.

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

Yes. I'm going to tag team with Jim on this one, Jim, why don't you take the corn piece?

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

Yes, sure. So Andrew, sometimes in our business when we're towards the end of corn inventory that we're holding. And the new crop harvest is about to come to market. And the market participants can see whether or not that was a bountiful crop and what it implies for prices of corn in the marketplace. That all happened in Q2 within Brazil. So really, really strong corn crop prices had come down. We were carrying some corn through Q1 and our pricing had really reflected at a higher level the cost of that higher corn kind of at the end of Q1.

As you start to see the balance of full crop coming through, prices of finished goods start to adjust downward, and we're continuing to adjust those prices, but we're moving through that old corn. So you just had a bit of margin compression. As we look forward now, we're going to enjoy the lower cost of the corn as we go into Q3 and Q4 as well as we've done our job through our pricing centers of excellence to maintain our margins and manage our margins as we continue. I think on top of that, we also had some transitions from our energy complex in Brazil. We moved from natural gas to biomass boilers. And so doing that just had some onetime nat gas costs that were higher that we don't expect to repeat as we go forward.

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

Yes. That last point was not an insignificant impact in the quarter, but it was the right thing to do. It's consistent with our sustainability commitments but it's a big investment from a standpoint of an energy transition, which is hitting quarter 2 and just a little bit of remnants, I guess, in quarter 3, Jim, as well.

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

That was probably like $3 million to $4 million just kind of a one-timer to put out there.

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

Right. And then also, what I would say just more generally related to take our largest market in South America, Brazil, we are seeing a slowdown in brand and product consumption such as beer, for example. And the Brazilian government has pulled back on consumer subsidies and interest rate tightening has also slowed economic growth. And in our second largest market, Colombia, we experienced a shutdown to our plant as the natural gas supply to the surrounding community was temporarily disrupted. So that was another onetime event, I guess, in the quarter. So that's the reason why there's optimism for the forward outlook for South America.

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

I mean we're also coming out of winter going into spring and summer, right? So traditionally, when you look out the layout in the phasing in South America, your largest quarter is always going to be Q4 in the calendar year.

Andrew Strelzik - *BMO Capital Markets Equity Research - Senior Restaurant Analyst*

Got it. Okay. That's all super helpful color. And my second question I was just hoping you could give us kind of a sense for utilization rates in North America, obviously, with the volume softness here that you've been talking about. We've enjoyed a very tight utilization rate environment for a while here. We're going from inflationary corn environment to a deflationary corn environment as we approach kind of contracting season. So just any thoughts around utilization as we head into kind of a key period I guess in North America.

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

Yes. So I mean maybe I'd just remind everybody that we report a change in sales volume, right? And so therefore, when you look at sales volume, it may be impacted by more by higher priced or higher value tons the underlying, particularly in the U.S., as Jim noted, there's been pretty steady demand, at least for sweetener volume throughout at least the first half of the year we're seeing pretty steady foodservice traffic. There's nice pull for HF, very modest, flat, if not maybe down 1%. So I think that's acting as a real stabilizing factor when we look at U.S. utilization, for example, as one instance.

So as we go forward, I still think that we're not seeing kind of, not yet, at least or any type of broad significant recessionary impact that's impacting consumers and how they feel about eating out. I think it's a little bit bumpy, as Jim referenced, but we're still seeing decent QSR traffic, fast casual traffic, and I think that pulls for foodservice, and that's a decent part of our volume.

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

The only exception to that, I would say, is Europe does feel softer than the rest of the world right now. And so that's something that we obviously will watch carefully for the second half of the year. But I would say Q2 volumes in Europe were soft. Less so in North America.

Andrew Strelzik - *BMO Capital Markets Equity Research - Senior Restaurant Analyst*

Got it. Okay. Thank you very much.

Operator

One moment please for our next question. Our next question comes from the line of Cody Ross of UBS.

Cody T. Ross - *UBS Investment Bank, Research Division - Analyst*

Good morning. Thank you for taking our questions.

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

Hi, Cody.

Cody T. Ross - *UBS Investment Bank, Research Division - Analyst*

Hi. I want to zero in on North America for a second. Your profit there is up really nicely so far this year. However, your guidance implies a significant sequential step down in the margin to the tune of about 300 to 400 basis points based on our math. Why is that?

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

I don't know if I'm seeing the same margin decrement that you may be calculating Cody, so we probably could take it offline. I would comment that generally, as we go through the year, we always are going to look at the layout of our corn costs. We're also going to look at now kind of maybe the layout of our hedges. But we should see generally kind of continued profit growth in North America as we definitely move into Q3 and Q4.

Cody T. Ross - *UBS Investment Bank, Research Division - Analyst*

Okay. Maybe we can take that offline. And then I just want to move over to your gross margin, specifically on corn prices right now. They're down about 20% recently. I know you've changed your hedging practices a few years ago. At what point do you expect to receive a benefit from the lower corn prices? And do you expect that to affect your pricing negotiations as they come up in a couple of months?

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

Why don't you take the mechanics and I'll take the outlook?

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

Yes, yes, yes. Well, definitely I mean, so while CBOT prices are decreasing. Our corn costs will remain a bit higher for the balance of the year as we've hedged kind of late in -- late last year or the fall of 2022. And those hedges will show a net loss position, but that is reflected fully in our guidance. So in the second half of last year, while we had rising corn costs, our expanded hedging practice showed a gain to mitigate some of that increase that we had in 2022 from the start of the Russia, Ukraine conflict.

So net-net, we do not see a notable benefit from the decreasing cost of physical corn in the second half of this year, still seeing basis and premiums are a bit elevated. For coproducts, we were anticipating a modest decrease in value in the second half following really lower market costs. And again, that is factored into our full year guidance. So for me, I think it's just important to note, the expanded risk management practices should really limit earnings volatility whether corn or coproducts increase or decrease significantly from quarter-to-quarter.

For next year, I'll let Jim talk about contracting, but generally, as an idea, if we see lower CBOT futures or lower cost of corn, that's going to work into how we quote prices and then also how we place hedges for 2024.

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

Yes. As it relates to contracting for next year, I mean, we'll have a better idea of how 2024 is shaping up as we get more data points in the coming months, say, for volume. But we historically, have transparently communicated with customers regarding rising or falling raw material costs, and we anticipate some pass-through of lower corn costs in 2024 if the markets remain with a similar outlook as they are today.

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

And Cody, I just want to make add as people listen to the call, right? So our dollar profit per ton that we make on products, we believe that, that is sufficient for us to earn the return that we need to invest capital and to continue covering all of our operating costs. And so we really look at if there's a change in the cost of the raw material or the corn, we're going to be transparent with customers about that, but we firmly believe that in the dollar profit that we earn per ton is paying us for the value add that our ingredient solutions bring as well as incenting us to continue to invest in assets in the business.

Cody T. Ross - *UBS Investment Bank, Research Division - Analyst*

Thank you. I appreciate it. I'll pass it on.

Operator

One moment please for our next question. Our next question comes from the line of Adam Samuelson of Goldman Sachs.

Guillermo Huerta - *Goldman Sachs Group, Inc. - Analyst*

Yes. Hello. Good morning, everybody. This is actually Guillermo speaking in for Adam. I'm just wondering if you could provide some additional color on fixed cost absorption during the quarter and your expectations for the balance of the year?

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

Fixed cost absorption and impact in the quarter and for the year. So Guillermo, as we said, when we had volumes decline in Q2, and we had actually talked about this in Q1 as well. That what we were anticipating is that we would be able to reduce some of our semi variable costs maybe such as the amount of hours of overtime, or the amount of expediting freight costs. Those costs disappear and those costs have been prevalent in our P&L in both '21 as well as in 2022.

So while we've had some higher fixed costs due to kind of lower absorption, but we've also been able to run the plants kind of with costs less at the French. And so we've been able to reduce some of those extra costs that always come at a marginally higher rate. And so we really, I think, have done a nice job mitigating costs as we go forward. When we anticipate Q3 volumes being soft as well as in some recovery in Q4, that unabsorbed fixed cost is in our guidance for the balance of the year.

Guillermo Huerta - *Goldman Sachs Group, Inc. - Analyst*

Okay. That's super helpful. And just as a follow-up, if you could describe a little bit into more detail its scenario under which you would hit out the guidance for the remainder of the year? What do you need to see over the vast of the year to hit each of the guidance? Thanks

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

Yes, yes, sure. I think on the risk side, we're just -- obviously, we're a little bit cautious on what the volume mix is, as Jim pointed out, the -- I think the shape of the European economic growth or recession is still a little bit to be forming. On the -- I think on the positive side, though, we really think that there are potentially some even stronger volume recoveries as we see into Q4 as well as we're looking at some of the costs of the spring corn may be beneficial to us as we think about the second half of the year.

Guillermo Huerta - *Goldman Sachs Group, Inc. - Analyst*

That's super helpful. Thank you very much.

Operator

Thank you. One moment please for our next question. Our next question comes from the line of Ben Theurer of Barclays.

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

Good morning, Jim and Jim. Congrats on the results. Wanted to dig into what you're seeing on the plant-based site and your venture there. I know that that's been one of the topics we've talked a lot about in the past, but didn't come up that much and the more recent ones, also in light of some of the comments we've heard from some of your peers and softness and saw our company's results. Maybe what are you seeing on the demand for the ingredient side? And how do you feel about plant-based in general? That would be my first question.

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

So we believe the plant-based trend is a long-term enduring trend. The market right now continues to be soft. In the U.S., quarter 2 IRI plant-based milk and alt meat sales were down 10% and 18% year-on-year, respectively. And we simply remain focused on building our customer pipeline and meeting new specification requirements for customers that's where we think the opportunity is going to be for us because the consumers are going to be very discerning with these products related to the perception of their clean label status as well as the price points.

So as we can help the leading companies in that space, in those spaces, to deliver on high degrees of protein fortification, great texture, great taste, along with the clean label aspects, which we believe our products can help enable and it's not just the plant-based proteins piece, but it is the other texturizers that typically are part of those formulations. It's more of a solutions approach to the plant-based sector that we expect to grow revenue and optimize our cost structure and be a significant player in that space. But right now, the market does continue to be soft.

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

Ok, thanks for that. And then my second question is really about the ability around pricing and what you're seeing with your customers in regards to potential pushback or sensitivities around pricing? Because obviously, we saw a very good momentum still on pricing, but at the same time, volume in each region somewhat -- some more and some a little less, but meaningfully impacted. So what are your customers saying to you as you look into the back half and maybe into the, call it, next 12 months or so as it relates to pricing and some of the input costs coming down, are you seeing like first request for discounts, et cetera. So how should we think about the price mix in light of the volume weakness?

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

Yes. I think it's really too early to tell about how all of the factors that are going to impact market pricing for 2024 take shape. And why do I say that is because the -- while some commodity cost deflation is subsiding, you have food inflation still sticky in other areas. And people are trying to determine what's going to be the outlook for food inflation and energy inflation, especially as it relates to, say, oil prices now going back up. So it's quite cloudy and murky in relationship to the input cost side of the equation.

And I think it's one of the reasons why the markets are somewhat jittery in relationship to weather inflation may resurface. And that's why I think the next few months are going to be very important to see how volume and demand manifest itself because if the total food supply chain network has over shifted from, again, a Just in Case to Just in Time and inventories do have to be replenished, that, along with what we're seeing right now with an uptick in oil prices and some aspects of food inflation increasing that could tighten things. And so I just think it's too early right now to give a clear picture on that outlook.

For us, we certainly want to retain the benefits that we have achieved from our pricing centers of excellence and the great job our go-to-market teams have done in delivering value through pricing. So that will be our focus, but we want to do that in a very thoughtful, considerate way. But regardless, we are developing levers that we can pull to, again, focus on quality of earnings and drive growth in the business. And that's why on the cost competitiveness side of the house, we're also driving a lot of productivity initiatives.

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

Thank you very much Jim.

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

Thank you.

Operator

(Operator Instructions)

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

Operator, I don't know if there's any other questions coming.

Operator

All right. So at the moment, yes, we do not see any other questions at this point. I would now like to turn the conference back to Jim Zallie for closing remarks.

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

Thank you. And to everyone, I just wanted to thank you for joining us this morning. We look forward to seeing many of you at our upcoming investor events, and I want to thank everyone for your continued interest in Ingredion.

Operator

That concludes today's conference call. Thank you for participating. You may now disconnect.