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INGR - Q2 2016 Ingredion Inc Earnings Call

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OVERVIEW:

INGR reported 1H16 net sales of $2.81b and reported EPS of $3.36. 2Q16 net sales were $1.46b and reported EPS was $1.58. Co. expects 2016 net sales to be in line with 2015 and adjusted EPS to be $6.70-6.90.

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PRESENTATION

Operator

Welcome to the Ingredion second-quarter 2016 earnings call. (Operator Instructions). As a reminder today's call is being recorded. I will now turn the conference over to Miss Heather Kos. Please go ahead.

Heather Kos - *Ingredion Incorporated - Manager of Corp. Communications*

Good morning and welcome to Ingredion's second-quarter 2016 earnings call. Joining me on the call this morning are Ilene Gordon, our Chairman, President and CEO, and Jack Fortnum, our Executive Vice President and Chief Financial Officer.

Our results were issued this morning in a press release that can be found on our website, Ingredion.com. The slides accompanying this presentation can also be found on the website and were posted a few hours ago 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. Actual results could differ materially from those predicted in the forward-looking statements. And Ingredion is under 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 will 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 US gap up measures in Note 3 non-GAAP information included in our press release. Now I am pleased to turn the call over to Ilene.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

Thanks, Heather, and let me add my welcome to everyone joining us today. We appreciate your time and interest. I am pleased to announce Ingredion ended the quarter with strong operating income and earnings per share.

North America, APAC and EMEA had record high operating income and, as expected, South America was down due to macroeconomic and foreign exchange headwinds in the region. Overall volumes declined 1% driven by macroeconomic headwinds in South America and the sale of our Port Colborne, Canada facility, partially offset by the Kerr acquisition volumes.

Like last quarter, our price/product mix was favorable driven by specialty sales and a favorable trade up of our core ingredient sales. Our focus on continuous improvement and optimizing our global footprint has supported our margin expansion. Overall I am pleased that our business model and strategic blueprint continue to deliver shareholder value.

For our Company overall our ongoing cash flow from operations and strong balance sheet continue to enable us to deploy cash to advance our strategic blueprint. In fact, we recently began operating manufacturing assets that we added using the capital expenditure we announced in September 2014.

These assets increase our manufacturing capacity for specialty ingredients in the US. And the additional capacity in Asia is expected to come online in the third quarter. The expansion is driven by the growing demand for these higher value ingredients used by food and beverage manufacturers to address consumer trends including wholesome foods, simple ingredients and health and wellness.

Now let's spend a moment on each region's performance in the quarter. Operating income in North America was $160 million for the quarter, up $33 million from last year. Overall volumes were down 1% driven by the sale of our Port Colborne facility.

Price/product mix was up driven by specialty sales and core ingredients. Continuous improvement initiatives, network optimization and lower input costs continue to drive good operational efficiencies throughout the region. Jack will spend more time on that a little later.

In South America operating income was $14 million, down $6 million from last year. The macroeconomic conditions continue to be challenging. Pricing actions, good cost discipline and continuous improvement projects unfortunately were more than offset by foreign exchange, higher corn, energy and other input costs and softer volumes.

We continue to right size the business as evidenced by the $3 million restructuring charge we took in the region during the quarter and we are on track with our planned closures of two facilities in Brazil this year.

Brazil's economy continued to feel the effects of negative growth. Given the macroeconomic environment, our local leadership team continued their ongoing focus on specialty ingredient growth, price/mix management and network optimization.

The southern [core] economy became more challenging as economic measures lower to consumer disposable income and affected our volume. For example, the removal of utility subsidies is impacting consumer disposable income and our business. We continue our focus on all executable activities of the business.

The Andean countries continue to perform well as cost discipline expanded margin. We expect 2016 to be challenging for South America and we will maintain a tight focus on cost and network optimization. In the longer term we believe the underlying business demographics are positive for the future and we believe we are well-positioned to take advantage of an economic recovery when it materializes.

Moving along to Asia-Pacific, the region delivered $30 million of operating income, up $2 million from last year. Overall volume was up 2% versus last year and specialty sales were particularly strong in Japan, China and Southeast Asia. Our continued focus on margin expansion also helped offset currency headwinds.

Finally, the EMEA region reported operating income of $29 million, up $6 million from last year. Higher volumes and margin expansion offset currency headwinds. In Europe our broad specialty portfolio continues to perform well and grow. And the Pakistan economy continues to grow given the improved reliability of energy supply to us and our customers.

I am pleased to now turn the call over to Jack who will spend time on our financials. Jack?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Thank you, Ilene. Good morning, everyone. Let me start by covering the highlights of the income statement.

Net sales were up $6 million for the quarter, the majority of the increase is attributable to a more favorable product mix in both our specialty and core ingredients as well as favorable pricing in South and North America. These factors were partially offset by unfavorable foreign exchange and lower volumes from the sale of our Port Colborne, Canada facility.

Gross profit was higher by $36 million as a result of favorable price mix in both specialty -- our specialty and core ingredients and margin expansion as a result of our optimization efforts.

Reported operating income was $25 million higher versus last year while adjusted operating income was $31 million higher. Reported operating income was lower than adjusted operating income by $13 million. $8 million is related to employee-related severance and other costs associated with the execution of information technology outsourcing contracts; $3 million of employee-related severance costs associated with the South American restructuring; and $2 million is restructuring charges related to the prior year sale of our plant in Port Colborne, Canada.

Given that this is the first time we have talked about our global IT outsourcing, I want to explain in a bit more detail what we are doing. The purpose is to advance our IT capabilities supporting our strategic blueprint as technology continues to evolve while maintaining an effective cost structure.

Our reported and adjusted earnings per share were $1.58 and $1.73 respectively. For the quarter our reported and adjusted earnings per share were $0.11 and $0.20 higher than last year's respectively.

Moving on to the net sales bridge. Our sales of $1.46 billion were higher than last year by $6 million. Favorable price/product mix contributed $84 million. This was partially offset by $69 million of foreign exchange headwinds and a volume decrease of $9 million.

If you recall, we explained last quarter that with the sale of Port Colborne we expected our organic volumes to be down as we shed sales of low margin ingredients.

As we look more closely by region, you can see unfavorable foreign exchange affected us across all four regions though to varying degrees.

In North America FX and volume were down under 1% and volume grew in APAC and EMEA. Price mix was favorable by 24% in South America as we continue to price to recover currency devaluations and rapid increases in Brazilian corn costs. And as a result of the pass-through of lower corn costs, price mix was negative in Asia-Pacific and flat in EMEA.

Operating income increased $25 million and adjusted operating income increased $31 million in the quarter. North America posted strong results due to a more favorable price/product mix in both specialty and core ingredients; lower operating cost due to both Penford and Port Colborne cost savings, as well as energy and logistic savings.

South America operating income decreased by $6 million. Headwinds included foreign-exchange, lower volumes due to macroeconomic environment in Southern Cone, and higher corn costs -- higher costs for corn, energy and other inputs. These were partially offset by favorable price mix due to pricing to recover currency devaluations and higher input costs as well as disciplined cost management.

APAC was up $2 million while EMEA was up $6 million versus last year. In APAC volume growth and margin expansion offset the effect of the strong US dollar while in EMEA volume and margin expansion offset foreign-exchange headwind. Corporate costs were [off] due to variable compensation, continued investments in our administrative processes and other small items.

We will wrap up the discussion of the quarter with earnings per share. On the left side of the page you can see the reconciliation from reported to adjusted.

As I mentioned earlier, the drivers of the $0.14 differential between 2016 reported and adjusted EPS include employee-related severance and other costs associated with the execution of information technology outsourcing contracts; employee-related severance costs associated with South American restructuring; and restructuring charges related to the prior year sale of our plant in Port Colborne, Canada.

On the right side operationally, we saw an improvement of $0.30 per share, primarily the result of margin improvement and a minor amount of other income, partially offset by volume and foreign-exchange headwinds.

I do want to take a moment and talk through the margin improvements in more details given the magnitude.

For the quarter both our specialty and core ingredients had a more favorable price/product mix. If you recall, we shed some of our lower margin production with the sale of our Port Colborne facility at the end of last year. And as we mentioned last quarter, we continue to optimize our network.

Our total Penford acquisition cost savings run rate is expected to exceed $25 million. Additionally, we had cost savings from the Port Colborne sale. Lastly, we had lower energy rates and some favorability in our logistics area.

Moving to our non-operational charges. We recognized a $0.10 per share decrease for the quarter. Our tax rate was higher contributing a $0.04 per share headwind, and financing costs were also higher by $0.02 per share.

The higher tax rate was primarily driven by greater earnings in higher tax rate jurisdictions as well as the devaluation of the Mexican peso during the quarter, partially offset by the adoption of a new accounting standard for share-based compensation versus the year ago quarter. Additionally, non-controlling interest was a negative $0.01 per share.

I am going to move fairly quickly through the year-to-date figures. Year-to-date net sales were up $36 million. The majority of the increase is attributable to the addition of the acquisition-related ingredients, a more favorable mix in both our specialty and core ingredients, as well as favorable pricing in South and North America. These factors were partially offset by unfavorable foreign exchange.

Gross profit was higher by $95 million as a result of the addition of acquisition-related volumes, favorable price/product mix in both our specialty and core ingredients, and margin expansion as a result of our optimization efforts.

Reported and adjusted operating income were $86 million and $76 million higher versus last year respectively. The increase in gross profit were partially offset by higher operating expense driven by the inclusion of Penford and Kerr.

Reported operating income was lower than adjusted operating income by $14 million. Our year-to-date reported and adjusted earnings per share were $3.36 and $3.51 respectively. Our reported and adjusted earnings per share were $0.74 and $0.68 higher than last year's respectively.

Moving on to net sales bridge. Our net sales of $2.81 billion were higher than last year's net sales of $2.78 billion. Volume growth contributed $46 million driven predominantly by Q1's Penford and Kerr sales offset by some of the volume associated with the sale of our Port Colborne, Canada facility. Favorable price/product mix contributed $173 million. These impacts were partially offset by $183 million of foreign exchange headwind.

As we look more closely by region, you can see unfavorable foreign exchange affected us across all four regions. Volume grew in North America, APAC and EMEA and price mix was favorable by 23% in South America as we continue to price to recover currency devaluations and rapid increases in corn costs in Brazil. Price mix in Asia Pacific and EMEA was negative as a result of the pass-through of lower corn costs.

Year to date operating income and adjusted operating income increased $86 million and $76 million respectively. North America posted strong results due to acquisition-related volumes, a more favorable price/product mix in both specialty and core ingredients, lower operating costs due to the timing of both Penford and Port Colborne cost savings, and a milder winter than last year combined with lower energy rates and logistic savings.

South America operating income decreased by $13 million, headwinds included foreign-exchange, lower volumes due to the macroeconomic environment in Brazil and Southern Cone and higher costs for corn, energy and other inputs. These were partially offset by favorable price mix due to pricing to recover currency devaluations and higher input costs as well as disciplined cost management.

APAC was up $4 million, but EMEA -- while EMEA was up $10 million versus last year. In APAC volume and margin expansion offset the effect of the strong US dollar while in EMEA volume and margin expansion offset foreign-exchange headwind. Corporate costs were up for the same reason I mentioned for the quarter.

Moving to the earnings per share bridge, on the left side of the page you can see the reconciliation from reported to adjusted that I spoke to earlier. On the right side, operationally we saw an improvement of $0.71 per share, primarily the result of margin improvement partially offset by foreign-exchange and volume.

On margin improvement, as in the case of the second quarter, both our specialty and core ingredients had more favorable price/product mix. The work on our global network optimization, including our Penford cost synergies and cost savings from our Port Colborne sale, also contributed.

Lastly, we had a milder winter combined with lower energy rates and logistic savings.

Our non-operational charges were $0.04 negative year to date. Our tax rate was lower contributing a $0.05 per share benefit and financing costs were higher by $0.02. The lower tax rate was driven by lapping the income tax impact of the devaluation of the Mexican peso during the year ago period as well as the adoption of the new accounting standards for share-based compensation.

The impact of the shares outstanding was negative $0.05 driven by the new accounting standards and variable compensation dilution. Additionally, non-controlling interest was a negative $0.02.

Turning to our guidance. We now anticipate 2016 adjusted earnings per share of $6.70 to $6.90. This guidance excludes acquisition-related integration and restructuring costs as well as any potential impairment costs.

We expect net sales to be in line with last year. We also anticipate volumes to be slightly down from 2015 given the sale of our Port Colborne plant at the end of last year and consumer weakness in South America. However, we expect continued growth in specialty volume.

We anticipate that unfavorable foreign-exchange will have a negative impact of $0.25 to $0.35 per share. We expect that this impact will be partially offset by incremental pricing. As we have explained in our business model, these pricing actions typically require three to six months to take full effect.

We expect corporate expenses to be up year over year due to variable compensation, continued investments in our administrative processes and costs to obtain other further efficiencies and our business.

For the year our financing costs are expected to be slightly higher due to higher interest rates on our floating rate debt and our plan to refinance our 2017 maturities during 2016. Our effective annual tax rate is expected to be approximately 30% to 32% versus an adjusted rate of 31.8% in 2015.

Total diluted weighted average shares outstanding for the quarter were 74 million and we expect that number to be between 74 million and 74.5 million for the year given the adoption of a new accounting standard for share-based compensation.

In North America we expect net sales to be up but volumes to be down from 2015 given the sale of the Port Colborne facility. It is important to keep in mind that a large portion of our sales and cost are based in US dollars which helps mitigate some of the foreign-exchange headwind.

For the full year we expect operating income to increase with improved product mix and margin. South American net sales are expected to be down versus the prior year. We anticipate slow economic growth and foreign-exchange headwinds to continue in South America.

Throughout the region we continue to actively manage our costs to drive efficiencies and offset inflationary pressures. And we continue to look at optimization opportunity. We are on track to close and consolidate two of our Brazilian facilities this year from which we expect net savings of $7 million annually starting in 2017. Overall we expect operating income in South America to be down relative to 2015.

Asia-Pacific and EMEA should continue to deliver operating income growth. We expect the APAC business to be negatively impacted by the currency headwinds associated with a stronger US dollar relative to last year. But we expect to overcome these headwinds with continued growth in specialty ingredients and good cost management.

We expect our EMEA region to have higher net sales compared to the prior year as we expect specialty volume growth to offset anticipated foreign-exchange headwinds and lower prices resulting from the pass-through of anticipated lower input costs.

We anticipate continued growth in the underlying European business fueled by our specialty ingredients portfolio. However, we expect currency headwinds to partially offset the improvement. [Pakistan] is expected to continue its core product growth and drive continued efficiency gains.

Moving on to cash flow. Our cash provided by operations for the first half was $266 million. Our capital expenditures of $125 million were in line with last year as well as our expectations.

We expect cash from operations in 2016 to be in the range of $725 million to $775 million. Additionally, we expect to allocate approximately $300 million around the world to capital investments in 2016 for growth as well as cost and process improvements.

Importantly, we have a proven track record of both reinvesting and returning capital to shareholders and we expect to continue this in the future as we concurrently explore M&A opportunity.

Our expectation for strong cash flows allows us to target a dividend payout ratio of 25% to 30% and it is our intention to evaluate annual dividend increases.

That brings my section of the presentation to a close. So now I will turn the time back over to Ilene.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

I am pleased with our results this quarter. From a strategic perspective our business model and blueprint for growth are working and our momentum continues on a positive trajectory.

I am also pleased that our global footprint and our innovation capabilities with our 25 Ingredion Idea Labs allow us to meet the needs of our customers who demand on trend products customized to local tastes. We continue to take actions to optimize our cost structure for the future while investing for growth in our specialty business.

Regionally, North America is expected to continue its positive trajectory. Asia-Pacific and EMEA are projecting operating income growth and South America is expected to be down versus last year given the macroeconomic headwinds.

With our strong balance sheet we expect to continue deploying our capital to fuel organic growth, network optimization, acquisitions and other shareholder friendly action. And now we are glad to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). David Driscoll, Citi.

Cornell Burnette - *Citigroup - Analyst*

Good morning, this is Cornell Burnette in with a few questions for David. Just want to start off with the two plants that you mentioned are closing in South America. Just so I am clear, this is related to announcements that you previously made last year, so it is not necessarily anything incremental?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

That is correct, Cornell. It is the same two plants that we are talking about and we are moving some of the capacity to other facilities. And so, essentially it is taking us the year to execute on that strategy.

Cornell Burnette - *Citigroup - Analyst*

Okay. And does this represent though a net capacity reduction in Brazil? If so how much?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

We don't talk specifically about all the capacity or anything. But I think what it does is it removes fixed costs from our system. Because essentially what you are doing is as the economies are slow there you can absorb different products into your other facility.

Cornell Burnette - *Citigroup - Analyst*

And just given kind of the continued weakness in the economies, assuming things don't turn around here in the near to medium term, do you see the need for or opportunities to maybe reduce capacity further to kind of adjust to maybe the new realities of the markets down there in South America and particularly in Brazil?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

No, Cornell, I think we look around our entire network, not just Brazil, but everyplace including -- and all through South America to say what is the right network, where does our demand and supply balance equal out. And I think we will do to look at network optimization programs going into the future.

At this point in time we don't have anything that we are announcing or anything like that. So I think that we will continue to monitor and reflect the demand for those economies based off our own capacity.

I would like to highlight a few things though in terms of on the positive side in South America you have to understand that the demographics are still very strong, we still believe in the longer term demand prospects there.

And so, we do have a very strong position throughout South America. And we think about these things very cautiously in terms of as we move forward with looking at how we invest in that region.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

This is Ilene. The other thing I would add is that in Brazil we still will have four very good facilities. So we are really going from six to four, but the two that we're closing were very small.

Cornell Burnette - *Citigroup - Analyst*

This is very good. And then if I can just move it along to North America as we -- kind of into the backstretch of this year and going to another contracting season. Are you seeing utilization rates in the North American industry kind of similar to where they were last year?

And then kind of going forward with kind of profitability moving up within the industry, what is your outlook for capacity? Do you think that there is kind of a [sensation] for new capacity to come online? Or will the market kind of remain disciplined given the dynamics that we have here?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Cornell, as you know, we don't really give 2017 forecast. I think that if you think about the utilization rates, for the first half I think they were very solid in those high 80s, low 90s type of range, which is kind of where we anticipated them to be running at.

In terms of -- like I haven't heard any announcements or anything like that about different capacity increases in the industry. I don't anticipate anything like that. But I haven't picked up anything from that category at all.

Cornell Burnette - *Citigroup - Analyst*

Okay, thanks a lot.

Operator

Robert Moskow, Credit Suisse.

Robert Moskow - *Credit Suisse - Analyst*

Jack and Ilene, North America has had an outstanding year; thus far it looks like it is going to be a strong second half also, beyond certainly our expectations and I think yours too.

So I think the question is like is this a new base, a higher base of earnings that you can keep building from given all the expansion of your specialty division? And -- or is there any thinking internally that, gee, maybe this went beyond what is a normal year for the region?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

This is Jack speaking. I think where I was looking at the North American business, it started out very good from the perspective that we had a mild winter; we had operational efficiencies from our logistics and things like that.

So the first half was very -- it turned out very well. And as you know, we were going through that whole I will say reconfiguration of our network a little bit after the shutdown of our Port Colborne facility in Canada. And so, I think the results came in very strong for us.

In terms of looking into the future, as I indicated, we are not going to give 2017 guidance, but I think we continue to see that strong specialty growth. And I think Mexico continues to perform extremely well for us in terms of growth of core and specialty. So I think that that is kind of how we are looking at North America. And Ilene, did you have (multiple speakers)?

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

Yes, the only thing I would add is I do think that in the North American consumer environment the drive has increased for these healthier ingredients by millennials and all parts of the population. And so we are very well positioned with our R&D and product development to develop those particular solutions.

So I think what you find in a mature economy, the ability to really grow in the specialty products is increasing. I mean even the desire for non-GMO products is increasing. And so, we are one of the few companies that is able to supply those type of ingredients. We have been supplying non-GMO type starches for over 10 years.

So again, I think you have both the base dynamics as well as the specialty growth in this North American environment.

Robert Moskow - *Credit Suisse - Analyst*

Okay, then a follow-up, Ilene, for you. I think you mentioned $300 million of CapEx that is going to get deployed around the world. Do you have any specifics as to where that money is going and is it continuing to expand your specialty starch capabilities internationally as well as domestically?

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

What we had announced a little over a year ago was the $100 million of capital towards specialty. And what I was referring to was the startup of some of the capacity in Indianapolis most recently and then in Asia in Thailand during the third quarter.

So we continue to look at where those opportunities are in the specialty. The $300 million is a round number, it includes maintenance, it includes cost reduction and it includes other specialty investments.

So, we continue to look at where there's opportunities to invest with features, and especially in finishing channels with our wonderful footprint of 40 type facilities in 40 countries to really grow.

And we also, as you recall, announced capacity additions in Mexico which we announced in January, $30 million, which was for both the core and the specialty growth in Mexico.

So, we are always looking at where the dynamics are growing for specialty growth and what kind of features and capacity we need to address those needs. And so that $300 million is part of that.

Robert Moskow - *Credit Suisse - Analyst*

Okay. All right, well, thank you.

Operator

Farha Aslam, Stephens.

Farha Aslam - *Stephens Inc. - Analyst*

So, when we look at your North American business and that footprint, Ilene, that you discussed, clearly this year you are getting incremental synergies from the Penford acquisition. As you look further are there more opportunities for you to optimize North America going into next year and perhaps beyond?

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

Well, I will start and then turn it over to Jack. We are always looking for those opportunities. And as you know, when we bought National Starch and even with Penford, the look for acquisitions that primarily add features to help us address the changing demand of consumers with specialty products.

But at the same time as we optimize the network we look at moving specs around. And so, that has given us opportunities from both National Starch and from Penford that we refer to as cost reduction that gives us opportunities to optimize the network by moving those around to different facilities. And so, we continue to look at that. I don't know, Jack, you have been involved.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I think the opportunities are endless to a certain extent when you look at your configuration of plants and how you can deploy them effectively. And like we had the -- I would like to highlight too that the Penford acquisition had potato facilities as well which were a little unique and drove some of our good growth from a revenue perspective.

But the primary portion was they had a facility down in Cedar Rapids which was the corn refining facility and we were able to optimize that looking at the configuration of all of our facilities in North America, moving around where we are producing product, where the freight rates were. It's a fairly complex exercise but it is one that we continue to look at.

And I would say that there will be continued synergies. We probably won't talk to them as much going into the future or anything like that since we are kind of getting to the end of that two-year period. But I continue to expect always doing optimization of our manufacturing network.

Farha Aslam - *Stephens Inc. - Analyst*

Just as a follow-up on South America. Could you share with us some deeper dynamics in Argentina? Kind of how you are seeing that market, particularly as it relates to sugar, going into the second half of the year? And kind of how you expect it to (technical difficulty) going into next year as perhaps the economy begins to, quote/unquote, normalize a little bit?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I will start and then Ilene may have something to add. But fundamentally it is a challenging environment in Argentina right now. I think what we have seen is inflation is still there even after the devaluation that took place late in December last year and the continued devaluation, sugar moving through the market.

But the real thing that kind of impacted us more than we anticipated, I would call it, that is one of the reasons we are calling South America down now, is the consumer disposable income seemed to shrink considerably within Argentina as they took some of the subsidies away from whether it be their fuel bills and things.

And this is traditionally our slowest period, don't forget, during the winter months right now. And what we have seen is this contraction of demand, which being in the food and beverage segment you don't usually see as much contraction in demand as we are seeing there. And so, that whole consumer disposable income.

And so, the real question will become one of when will it come back. And I can't -- I'm not going to predict 2017 or anything else at this point in time because it seems like it is a little bit elongated. I think Macri has done the right things in general. He has taken some of the subsidies off and getting back to a more I will say [free] market economy type of basis.

But it has been a little bit delayed in terms of how we anticipated. In the second half we have got it kind of running a little bit better because the seasonality of our business. But, we are still looking at soft volume in Argentina. Maybe I can ask Ilene if she has another comment.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

Well, the only thing I would add as I look at the whole region, the South America region is I continue to be very excited about Colombia. I mean with their GDP rate of 2.5%. I was recently in [Medellin], very exciting environment with opportunities to grow specialty.

So while it is smaller than let's say Brazil or Southern Cone, both Colombia and Peru, that whole Pacific Coast continues to have opportunity.

So, there are parts of South America that continue to do very well. And as Jack said, we believe strongly in the region and at some point both Brazil and Southern Cone we believe will join the Northwest with some of the demanded that is coming out of Colombia.

Farha Aslam - *Stephens Inc. - Analyst*

Great, thank you for the added color.

Operator

Adam Kendrick, Morningstar.

Adam Kendrick - *Morningstar - Analyst*

I would like to ask a question about the mix impact on the percentage of your business, specialty and the percentage of this core. Because I get the feeling that must have moved a lot particularly since you have closed some of the low margin business, Port Colborne has been closed and you have expanded capacity and are continuing to expand in specialty.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Yes, I think every year we kind of wrap up our percentages. As you know, we are trying to drive to that 30% category. Last year we moved by 1% to 24% to 25%. And so it is a combination of many things. But our specialty business, we are very pleased with the growth rates that we are seeing there.

And as Ilene indicated, we have capacity coming on stream now in North America to meet some of the demand of those products as well as in Asia we have some incremental capacity which will be coming on later in the year.

So, I think from a supply perspective we are in pretty good shape in terms of the growth projections we are seeing in that. And so, I think we are still tracking fairly well in terms of our specialty growth and, as we anticipated, getting to the 30% level by 2019.

Adam Kendrick - *Morningstar - Analyst*

Good. And I was going to ask you a follow-up question on the price mix. How much of the 6% in the quarter was actually price and how much is mix? If you can maybe cast some light on that even if you maybe can't give us precise figures.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Well, if you look at the price mix, we have got that continual trade up. And what we had commented on in our earnings algorithm is if you held corn and all the inputs content including exchange that the price mix would improve our margins by about 2% -- 2 percentage points over the period of five years.

And what we have seen though is -- you have to understand is that we did have some of the devaluations that took place last year as well that we say that it takes three to six months to price that through. And some of it is recovering some of the devaluations from last year that took place.

And so, we are tracking fairly well and getting our margins back in line with what we anticipated them to be at that point.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

The other thing I would add is -- and we talked about this last quarter, that we also, with the optimization of our networks, have been able to trade up in both the core and the specialty. So you are getting a combination of growth in the specialty that we continually talk about, but also a trade up within the different categories.

Adam Kendrick - *Morningstar - Analyst*

Good, that is fine. Thanks.

Operator

Kenneth Zaslow, BMO Capital Markets.

Patrick Chen - *BMO Capital Markets - Analyst*

Good morning, this is Patrick filling in for Ken. You guys talked a little bit about the Argentinean operating outlook earlier. I wanted to follow up on the legislative environment.

It seems like [farmer] supply increased corn planting in light of the favorable tariff environment. On the other hand I think Macri re-launched the price controls early on this quarter. So, I'm just wondering how you guys kind of net the two together.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Well, it is interesting because as they have taken off the subsidies on the corn and it becomes maybe a slightly beneficial crop compared to the soybeans from an export perspective. So there will be more planting. It depends on how much is exported.

So that is always a tough call for us in terms of how much goes out of the domestic markets if we're looking at the domestic market for our consumption.

And the netting of the two, I think that really it is really from our vantage point much more because of the fact that Argentina is principally a core ingredients play with us as from HFCS. It is really what happens to sugar in that domestic market.

And we anticipate that sugar should start to move up to those normalized type of world sugar prices. We haven't seen that at this point in time. I don't really think that the price controls are the limiting factor there, it is the supply/demand balance, consumption being low right now.

But I do think it will get into a more normalized environment where you have relatively cost-effective corn, which Argentina always has. And then if the domestic market goes closer to the world sugar market it should bode well in terms of getting at least margin -- some margin improvement going into the future.

But I still think the big issue there is this supply and demand in terms of consumer demand is just [stopped] right now as they go through this transition.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

And I think the other thing I would add is, as you know, on the utilities, for many of the consumers as these subsidies were removed utilities went very high for the consumer.

And the recent legislation in July where the government promised to cap it at 400% and even to go retroactive for consumers back to April will right size that and give the consumer a little bit of confidence that at least they won't see it to be any worse than it has been -- and maybe even matter for some people.

So, that is a piece of legislation that I think was very positive for the consumer at least. And as they come out of the winter it will certainly improve.

Patrick Chen - *BMO Capital Markets - Analyst*

Yes. Sticking with legislation (inaudible), but changing the geographies. You talk a little bit about non-GMO growth helping specialty in North America. I am just wondering if the US does pass the GMO labeling law how will that kind of accelerate your specialty growth. Will that structurally improve your North American margins? Any color would be appreciated.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

Yes, I mean I would say that I think that having the US rule on a labeling law will help the overall -- our overall customers rather than having to deal with different states. And certainly it helps them from the supply chain and the packaging side.

But I think the trend and the demand for -- consumers really want to know that their food is healthy, healthy ingredients, and so it plays very well in terms of our specialty portfolio. So the demands, we are seeing everything from people wanting simple foods, simple labels, non-GMO.

They look at that as a proxy for healthy -- there is no definition of natural. So in a way non-GMO I think helps the consumer feel better, they pay more for it.

So, I think certainly we just supply what our customers want and don't particularly have a view on whether labeling is good or bad so to speak. But we are there to supply what our customers want. And I think that the certainty for the consumer helps our customers and in terms of their supply chain.

Patrick Chen - *BMO Capital Markets - Analyst*

Great, I will pass it along. Thank you.

Operator

Akshay Jagdale, Jefferies.

Akshay Jagdale - *Jefferies LLC - Analyst*

Congratulations on another solid quarter. I wanted to ask about the specialty business, maybe you can give us a little bit more color by region.

The reason I am asking this is when you look at top-line trends in regions like EMEA, your organic growth slowed down sequentially a little bit. And an Asia-Pacific it is negative, those are two regions where the mix of specialty is higher.

So it looks like on the surface just the top line -- looking at top-line trends that maybe the specialty portfolio is slowing or not growing as fast. But I think you have to peel the onion and look at the EBIT trends to really understand what is going on.

So, can you help us peel the onion a little bit on your specialty portfolio and give us by region a little bit more color on what the growth looks like? I mean North America we can talk about separately after that, if I may.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

Yes, I will start off and then turn it to Jack and I will deal with it from a very high level in terms of how I see the consumer trends in each of the regions. Certainly in North America, as I said earlier, that the consumer is demanding these healthy solutions. And certainly Mexico is an engine to that in terms of the consumer wanting to eat more healthy.

We supply ingredients very much focused on the food industry. And as I mentioned, some of the non-GMO. And certainly in Mexico the affordability is very important and that demand provides us an opportunity for some great recipes that we deliver to our customers in terms of gluten-free and non-GMO and substituting starch for oil.

So that continues to go well and we have had that ability to grow specialty and even trade up in our different categories. South America of course you have macroeconomics that are challenging. At the same time our team there is really growing our specialty product from a very low base.

But even I look at the dairy sector, some of the tastes and desires in South America, even demand for Stevia-based products continues to grow.

And then if you go to EMEA certainly in Europe which is very largely a specialty segment, the consumer is demanding our NOVATION type products that, as you know, modify starch with heat rather than enzymes, very focused on the clean label aspects -- continue to grow and the capacity we have added in Europe continues to run very well and even run above design capacity. So that continues to go well.

And then in Asia-Pacific I think -- Jack will talk about the dynamics of the P&L. But we have been able to grow our specialty in a place like Korea where there is demand for specialty sweeteners, people want to eat more healthy, China we continue to grow.

And even in Thailand where we are adding some specialty capacity for both the region and for export based on tapioca, which also is -- the cassava is gluten-free and non-GMO. So we see the opportunities continue in all the different regions, but certainly different dynamics. So, I know, Jack, do you want to talk more specifically about the quarter or --?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Maybe just add a little bit of color in terms of let's start with Asia-Pacific for example. And as you know, our business is kind of -- you have some mature economies and some developing and I will call it developing economies where mostly specialties are there.

And if you look specifically in the countries like China, the volume continues to grow very well. We have seen very strong -- and that is all specialty sales. You see Japan the volume of specialty sales moved very -- relatively slow moving economy -- actually grew very well.

And Southeast Asia was another one that really highlighted our growth in specialty throughout the region. So you might see a little bit of tempering in the region when you look at the total volume number, but that is primarily on the core side of the business. And so, I am fairly confident that we are moving forward.

Ilene mentioned Korea, but that is principally a core ingredient type of market and is kind of moving along fairly slowly with population growth. And so, it kind of pushes down the absolute growth volume.

And then when you talk about EMEA, you have to understand there are a couple things there. We have Pakistan which is core and then you have got your specialties which is really the European continent there.

And particularly in Europe, we have seen -- Europe is almost all specialty from our viewpoint. And so, what we have seen is that particularly continental Europe growing very nicely at this point in time. It is coming forward with very strong growth.

And so, we are actually -- we were actually very pleased with some of the growth and the projections for growth going into the rest of this year as well.

So, I think Europe and APAC have both done a nice job. And you have seen it through the GP because both of them had record quarters this quarter as well from an operating income perspective.

And so, it is kind of translating -- you may not see it totally in volume because of some of the trade up strategy that we are deploying, but you are seeing it in terms of profitability. And so I think that that is kind of how we are looking at the quarter as well as the year.

Akshay Jagdale - *Jefferies LLC - Analyst*

Okay. And then just on North America, first a question for the back half of the year. Is there anything specific to your cost structure or contracts that would meaningfully change the trajectory of the margins in the business relative to the first half?

So, first half the margins have been 17.8%, 17.9%. I know you manage it on a dollar basis. But from a modeling perspective is there anything you'd just call out that might change the trajectory one way or the other whether it is how corn costs shape up or how the contracts might be flowing through?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Yes, as you know, we don't get the quarterly guidance just for that reason because we always have fluctuation of how the corn is layered in year-over-year on our fixed-price business and things. And if you think about -- what I would say is if you are looking first half versus second half, the first half worked very well for us, we had good utilization.

I mentioned some of -- the weather was positive, so we had good energy and logistic savings coming out of it. Some of these we are not looking at quite the same type of rates in the second quarter.

And the fourth quarter really comes down to utilization rates. We are still -- I think we talked last quarter a little bit about how with the closure of Port Colborne it allowed us to run during the first quarter a little bit higher utilization rates. And we will be balancing our inventories during the fourth quarter this year.

And so, we will have to see whether we are running strong or weak depending on supply/demand in some of our core ingredients in the fourth quarter. So, I think that that is one of the things that could change around the layout of the quarters.

But fundamentally we are still seeing a very positive outlook in North America. I think we are very pleased with it. Mexico continues to do very well for us and the rest of it kind of just lays out the way we have got our forecast in place.

Akshay Jagdale - *Jefferies LLC - Analyst*

And just one more on North America. If you look at next year just generally speaking and you think of the algorithm between core and specialty. If utilization rates stay where they are today and the contracting season goes okay, we should see productivity improvements driving low- to mid-single-digit EBIT growth in core? And continued double-digit growth and specialty?

Is that how we should think of generally the algorithm with the current operating dynamics? Or is the specialty business maybe going to grow even faster next year because of this new capacity that is coming on?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I think you have to look at our algorithm over a five-year period. Where we are seeing that first of all the operating income was growing at that 6% to 8% type of range organically, the remaining one-third came from acquisitions. And that 2% to 4% in terms of volume growth was really driven by both small core growth and the mid- to high-single-digit specialty growth.

And so, obviously when you start up new facilities you don't sell them out immediately or anything like that, so it takes a while to get them moving through our supply chain and approval by our customers and demand there.

I think what is nice about the capacity increase is we have the capacity to fulfill that future demand. And so, I think you really have to look at that algorithm over like the longer period of time that it is anticipated for and just use it as a guide.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

And I think the other thing I would add is we talk about using our strong balance sheet to look at M&A opportunities. And as we said before, the primary focus is on broadening the portfolio and growing in specialty.

So, talking about Jack's algorithm that he just talked about. I mean that -- in addition to our organic growth and using our capability and product development and R&D out of Bridgewater, we continue to look at M&A that would not -- that would be part of that specialty growth on top of that.

And so, we think that that will continue to support the algorithm over the five years. So, that would enhance that growth rate over the five years.

Akshay Jagdale - *Jefferies LLC - Analyst*

And just one last one on M&A and cash deployment, you also have been very patient with your balance sheet. But given the strong run in the stock with this solid performance, how does that change the priorities for cash? Does it open up in a transformational deal type opportunities?

Or just help me think through -- I know you are very disciplined in terms of [a filter] on what you are going to buy and things like that. But just help me understand, does stock having had a good performance have any real impact on the way you are thinking about cash deployment? Thanks.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

We continue to be very disciplined but M&A of course is a priority. Use of cash after we have funded our operations, so we talked about the $300 million. But we continue to look for opportunities around the world to build the portfolio with acquisitions that would create value for our customers and for shareholders.

And at the same time, as Jack talked about, both our dividend and share buyback is another part of using cash. So, but again, I would say that the priorities haven't change and we just continue to be very disciplined owners of our shareholders' money and delivering value for our customers making us more important in terms of really broadening the portfolio.

Akshay Jagdale - *Jefferies LLC - Analyst*

Thanks a lot, I will pass it on.

Operator

Adam Samuelson, Goldman Sachs.

Adam Samuelson - *Goldman Sachs - Analyst*

So, maybe coming back to the North American margin question and I am trying to just -- and I appreciate some of the incremental color on some of the drivers of the margin upside, gains you have had the last quarter and year, frankly. Logistics, energy and particular, would you characterize those this year as being particularly advantageous or favorable?

Is it something where in a more normal winter environment and over the next 12 months that could be something that is a little bit maybe less favorable than it has been? Or do you think there are more structural transformations in your internal product flows that have been -- that have boosted the bottom line?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Let me just talk a little bit about the first -- the winter is a mild winter. And we have extreme winters, we have mild winters, this was one that was mild. I would say on average within a tolerable range in terms of we didn't have any real upsets this year and the plants ran continually well.

But one of the things that I think we have to give some credit to is that our operations continually drive for reliability. And we have really spent a lot of our continuous improvement in terms of reliability of our facilities. And so we put in backup systems and contingencies on those.

And so we continue to drive that efficiency which makes it much more effective. And that is why we continue to enable ourselves to do network optimization as well. Because as our facilities are very reliable, they continue to -- we continue to say, okay, how do we tweak between our different plants producing product in different locations.

And so, I think I wouldn't put it as -- obviously if we have a spring like we did with a polar vortex, which was the other opposite extreme, it is not at these type of levels. But I think that -- I'd just highlight it because of the fact that it has been a very good quarter from a logistics perspective.

And let's face it, energy rates are down. Diesel prices are down in terms of transportation costs. And so, some of those flow right through to us as well as customers in many cases.

Adam Samuelson - *Goldman Sachs - Analyst*

Okay, that is helpful. And maybe going to one of the comments on the back half outlook and your comments on we will have to see on utilization rates in the fourth quarter as we think about inventories for core products.

Can you talk about the volume and demand trends this year and how the balance of risks on utilization in the fourth quarter and what would make you more concerned about your own or industry inventory levels or less concerned and more optimistic?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Right now -- the demand has been pretty steady in terms and just in general it has been a fairly constant normal year from our perspective from that viewpoint.

I think where I was a little concerned was on the execution of our Port Colborne sale and how we distributed that back into our network to make sure that we are supplying our customers, we have a very high level of customer satisfaction that we are driving towards.

And so therefore I was looking in the fourth quarter and you just never know how that fourth quarter is going to materialize, whether we need -- we thought we were at capacity [with the] extremely tight in the first quarter and as we have built up some of our products, with the plants running extremely well we are in good shape from that perspective.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

And of course in South America seasonally it will be summertime by the fourth quarter. And so, you naturally get better demand than you get right now.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I think that is a very good point. And I would like to highlight something too, Adam. One of the things that is a bit of an anomaly when we look around the entire globe, that South America is one of those few locations that have actually ended up with higher energy costs coming through as well.

But just because some of the subsidies are coming off, some of the dollar impact and things. So unlike a light of our regions, that is one of the negatives that is impacting South America right now.

Adam Samuelson - *Goldman Sachs - Analyst*

Yes, that is helpful color, I will pass it on, thanks.

Operator

Sandy Klugman, Vertical Research.

Sandy Klugman - *Vertical Research - Analyst*

Good morning, you have covered a lot of territory here, but I will try to find some new questions. On FX we continue to see a lot of volatility. I was hoping you could comment on how that is impacting your ability to recoup currency headwinds through higher prices.

Specifically are you finding that the process is taking longer than the typical three to six month time frame that you cited in the past? Or do you expect things to remain in line with your historical trends?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Well, the volatility always changes a little bit because you have seen the dollar strengthen in certain currencies, then move back. So it really is a longer-term type of proposal. But I think that we're actually managing very well. Even in those challenging economies like Brazil and things we have been able to keep our dollar margins.

And don't forget, I just want to highlight the one component is that we are talking about pricing back through, it doesn't necessarily correlate 1 to 1 on the revenue line because we are really pricing back the margin component of that.

And so, I think we are doing a very admirable job in terms of managing through these volatilities. You've see it even in APAC where we have managed to get the margins back in check with after the devaluation. Brazil and Argentina, obviously with the supply/demand balance it is always harder or there is a little bit more headwinds in terms of soft demand and you are not too sure whether it is the FX impact or not.

But I would say that three to six months in our business model is really what we would like to target. And it is one of those ones that I think is a critical differentiator for us because of the fact that we kind of say if our raw materials are basically US dollars our asset base is US dollars, that we need to get those margins back in US dollars. And so, that really is a philosophy of ours.

Sandy Klugman - *Vertical Research - Analyst*

Great, thank you. And I know you are largely unexposed to price movements in corn through your tolling agreements. But is there any tailwind from this year's elevated production that might be reflected in your results? And specifically how should we think about the impact of the lower prices on your co-product sales into the animal feed market?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

We always look at it as principally on pass-through. Even on our grain related we try to pass some of those costs through. There is always the current year crop actually probably sets us up well for better demand because pricing in general is impacted by it.

And so, therefore an abundance of corn and lower price corn has a tendency of [producing] any substitutes at some of the core ingredients that come into play. And so, it is usually good for a volume perspective. We kind of factor in like the short-term fluctuations into our guidance as well. And so, I don't -- we reviewed it and we feel comfortable with it at this point in time.

Sandy Klugman - *Vertical Research - Analyst*

Thank you very much.

Operator

And with no further questions in queue I will turn it back to the Company for any closing comments.

Ilene Gordon - *Ingredion Incorporated - Chairman, CEO & President*

Okay. So just before we sign off I just want to reiterate our confidence in our business model that we have talked about, our strategy, our long-term outlook. We remain keenly focused on value creation and delivering that value to shareholders. So that brings our second-quarter 2016 earnings call to a close. Thanks again for your time today.

Operator

Ladies and gentlemen, that does conclude your conference. Thank you for your participation. You may now disconnect.