Event:

CAGNY 2022 Ingredion Q&A Session (February 23rd,2022)

Speakers:

James P. Zallie, President and CEO

Jim Gray, Executive Vice President & Chief Financial Officer

Moderator:

Jason Payant, Vice President of Corporate Finance and Interim Vice President of Investor Relations

Q&A Session:

Jason Payant: Good afternoon, and welcome to Ingredion's breakout session. I am Jason Payant, Vice President of Corporate Finance and Interim Vice President of Investor Relations. I will serve as your moderator, for today's session. With me, are Jim Zallie our president and Chief Executive Officer, and Jim Gray our executive vice president and Chief Financial Officer.

Our first question, is regarding our profit growth outlook. Are you still comfortable with your long-term profit growth outlook and how is Q1 looking? Are you still being impacted by supply chain disruptions, and have you been able to price through?

Jim Zallie: Jim, I will take that. First of all, as it relates to the long-term profit outlook and are we still comfortable with that outlook, yes, is the answer. Our net sales growth that we are projecting in that long term outlook is greater than 3%, on average, annually off of a 2021 base. And we believe that is very achievable based on the organic growth capital that we highlighted in the presentation, along with the acquisitions we've made over the last few years. It does also assume, and we believe that very strongly, that we can, and we will recapture any of the changes in the cost of raw materials and our operating income growth is expected to be in the high single digits. And that outlook is not reliant upon growth coming from acquisitions for example. As it relates to the first quarter and coming off of the fourth quarter, the supply chain disruptions are steadily improving and in some cases have stabilized. They are getting better and our pricing is flowing through as we had anticipated. And those price increases are absorbing the higher cost of corn as well as other input costs, so we are comfortable with the long-term outlook and we are comfortable with how we are trending in quarter one.

Jason Payant: Our next question relates to our pass through of pricing. Can you elaborate on the level of success passing on price increases more recently, especially in light of that approximately half of negotiated prices you have in the U.S.? Are you seeing any demand elasticity affecting your ability to price?

Jim Zallie: I will take this and then I will let Jim add some color commentary. We are very pleased with how contracting came out in 2022 for sweeteners, starches, and specialties in general. We are very confident to be able to offset inflation. Volumes continue, as I mentioned in the quarter four earnings call to be very strong. Volumes for specialties as well as for our core ingredients continues to be very strong and we're navigating the supply chain issues as well as inflation; but we feel that again contracting went very well. In North America we are anticipating net sales for 2022 to be up high single digits in gross margins and operating income to be relatively flat versus the prior year. And, again for the pass-through customers that 55% that I talked about in the presentation. Operating profit dollars are less volatile as it is effectively a tolling agreement where the customer manages its corn purchasing and we charge a fixed fee for the processing. Jim, do you want to make any comments, in addition to that?

Jim Gray: Yes, I would add that both as we see high net sales growth in the high single digits for North America. We are also expecting North America operating income to be up. So, while we are trying to find for that margin stability on a percentage basis; we do see gross margin dollar growth and operating income profit dollar growth in 2022 for North America. And, that is as that pricing has recaptured some of that corn cost inflation that we encountered in 2021.

Jason Payant: You did mention about the fourteen plant-based new product launches from Ingredion labs. What are the significance of those new products to your customers' product development and sales growth? Did you experience a plant-based offering slow-down in 2021?

Jim Zallie: In 2021, as we exited 2021 and as we entered 2022 our customer project pipeline remains very robust. The significant new product wins that we had and the launches that we are in, for example, are products, such as vegan cheese, vegan tacos and fortified tortillas and fortified bakery opportunities. But our opportunities set again spans traditional alternative meats, alternative dairy, sports nutrition, fortified sports nutrition applications as well. Again, the opportunities for plant-based proteins, still remains very bullish for us. We are very bullish on the prospects across many different product categories.

Jason Payant: You mentioned that you are taking action to better understand your value at risk and improve internal communication and improve how you handle business volatility. Can you be more specific about what this means and why it is necessary?

Jim Zallie: I will let Jim take that.

Jim Gray: Sure. When we look at the last several years in terms of particularly the U.S. market and the impact of global trade as well as COVID has had on demand for either corn or some of the co-products that are sold alongside corn in our production process. We really step back and said are there ways we can look at the layout if the corn from quarter to quarter and reassess how we hedge and if there is not a way we can expand upon that. So, historically we have hedged corn costs to about two thirds of our anticipated corn purchases and that covers the customers who have annual flat-priced contracts. So, we are really thinking about how we can expand those hedging practices in ways that both anticipate further into the year as well as looks at the value of risks in terms of the value of the revenue expected from the co-products. We believe that by hedging more of that we can actually minimize the fluctuation within the year, relative to the annual expectation that we have around guidance. We are moving forward with that and that is one of the bigger impacts in terms of profit movement within our P&L. We also will incur a lot of logistics costs. We move product from our factories to our customers and we are really looking at with regard to both dry van and bulk van and just our overall freight. How can we actually use our contracting with our customers as those rates change that we are sharing in that and passing that through to our customers as we deliver product to them. I think finally, just one note is that while your input cost and raw material costs move; you have to be able to look at your pricing into your customers and be able to say within that market how quickly can we move pricing to cover that raw material. We have often talked about lags in our business, but we have established pricing centers of excellence in each of our regions. These teams within the finance function are working within their commercial counter parts to be able to implement pricing changes as we see both raw materials forex and other input cost move.

Jim Zallie: So, Jim. What I would say is that this year as we see corn costs for example going up, historically we hedge our corn cost to about two thirds of anticipated corn purchases and this year we have expanded our hedging practices to further reduce quarter on quarter volatility. That was one of the other things we were referencing and then the other is the tightness in supply and the supply chain disruptions, enabled us to have very robust conversations with our customers during contracting where we were able to update terms and conditions of those contracts to give us more flexibility, as it relates to being able to price through those pricing centers of excellence. Those two big watch outs, as it relates to inflation this year whether it be corn cost inflation or inflation driven by the unknowns around oil prices and how that may flow through we feel we are better positioned this year than we had been in years prior.

Jim Gray: That’s right.

Jason Payant: Is there any risk of your outlook being impacted by inflation, like you experienced in the fourth quarter of 2021?

Jim Zallie: I will let you take this. We were just touching on that.

Jim Gray: I will grab this one. So, I think there is obviously always unknowns about inflation but in large part the results here year over year were impacted by supply chain disruptions, primarily in December. When you have those disruptions, you have to be able to figure out how we are going to still move our product and whether that is inbound from a port to one of our warehouses. Is it going to one of our factories to a customer. You still need to be able to move the products, so you have supply available to customers who are in the food supply chain. We think that we have looked forward, toward that inflation. And we think that we have captured a lot of changes in ocean freight and changes in dry van rates, as well. We anticipate that our price increases are covering those higher input costs. I think that maybe related to that, even though corn costs have recently increased, within the last two weeks we believe our risk management programs are largely insulating us in the first half. As Jim alluded to and I have spoken to how we are approaching hedging. So, inflation is always going to be a factor but we believe the risk is adequately covered and reflected in our guidance.

Jason Payant: Was surprised by the plant-based protein start-up cost and delay in the latest quarter. May we get an update on that plant and is there a risk that consumer orders for plant-based protein could be delayed or lost due to the plant issue?

Jim Zallie: I am pleased to report that our South Sioux City plant is operating with much better batch-to-batch consistency. And we are through, I think the toughest parts of the start-up for an entirely new food grade operation. We are building ample food grade high quality plant-based protein or pea protein isolate inventory and the customer wins and the working with customers continues. The commissioning of our specialty protein flour concentrates line in Vanscoy, is again up and running and producing very high-quality product. So, the production issues that we were experiencing through the second half of last year when we started to commission the facility, we are through the toughest times of that, and we have steadily delivered a few months consecutively of the kind of operating efficiency that we need and are counting on to be able to ramp up sales. So, I think everything is trending in a very positive direction and again the customer pipeline is as strong as ever, to be honest.

Jason Payant: What percentage of specialty sales are you currently spending on R&D? What does your medium-term profit growth outlook assume for R&D spending both as a percent of sales and growth?

Jim Zallie: I think the number Jim is about 3.2 - 3.4%.

Jim Gray: A little bit above three percent.

Jim Zallie: 3.2% as a percentage of specialties.

Jim Gray: And increasing.

Jim Zallie: And increasing. So, what we had highlighted in the earnings call is that our Cost Smart Program; which again over delivered significantly against our original estimate. One of the things that we were encouraged to do by our board of directors was to take some of that savings and reinvest it in R&D. We reinvested about eight to ten million dollars I believe in specialized R&D related programs and digital transformation to drive efficiencies in our operations. We intend to continue to steadily increase R&D selectively in areas like plant-based proteins, sugar reduction as well as texturizing.

Jason Payant: It looks like you changed the base year for long term growth targets from 2020 to 2021. If I compare apples to apples, did you change your absolute sales and profit dollars for 2024? Why or why not?

Jim Gray: Well, I think the idea of the four-year outlook is that as we progress each year, we update you on what we think the next four years are. Yes, from 2020 where you would have had lower cost of corn, reflected in 2024, now that we have moved forward to 2021 and we have a higher net sales base we wanted to make sure that the growth rates that we are putting forth or that we are anticipate for net sales are kind of aligned around what your base cost structure is and what your revenue is in 2021. So, I would note, just in the four-year outlook that the overall growth and the operating income is between 7-9% and that is higher than last year's range that we had for a four-year outlook.

Jason Payant: Do you see any changes in the percentage of your global footprint?

Jim Zallie: I think that we are looking to expand specialty capabilities that are going to enhance our highest growth possibilities whether it be geographic or whether it be aligned to any of those growth platforms. So, Asia-Pacific continues to represent significant opportunity for us. As you know we are completing a significant investment in China to expand our modified food starch capabilities. China happens to be the largest market for modified food starches. In addition, we think that position is a great capability to expand more broadly into other food ingredients. In China for example we are looking at China as its own growth opportunity and growth market. Asia-Pacific to expand into specialties and if you saw the regional break outs that Jim highlighted, we see great opportunities in South America for sugar reduction for example. We see opportunities in the higher value food systems to be growing in the more developed geographies of North America as well as Europe. So that is where you are likely to see us continue to make investments and expand our geographic capabilities.

Jim Gray: I would just add to that, that is one of the reasons that we wanted to talk about the regional outlook. Is that you can actually see, the higher net sales growth in regions like Asia-Pacific as well as in EMEA. As one, we have had those acquisitions but also as we've focused on our specialty platforms our growth platforms that are reflected in our net sales growth outlook for each region.

Jason Payant: For food systems you bought TIC Gums a few years back, now you've added KaTech. How big is food systems?

Jim Zallie: Well food systems for us represents a tremendous growth opportunity. What we were trying to highlight in the presentation is the drivers behind that and what's changing. What's changing is, the need for customers to simplify their batching requirements, to have ingredient systems that are more integrated and more complete and take steps out of their manufacturing and that are more fool proof. That offers an opportunity for us to be a more intimate, integral supplier to those customers and originally these customers were thought to be small to medium sized customers. What we are seeing is because of the challenges with labor shortages that is pervasive whether you be a smaller manufacturer or a small manufacturer, customers are very receptive. Typically, the margins for those products are higher we talk about forty percent gross margins but most importantly as it relates to the growth prospects, we are looking at doubling that business with an incremental growth of approximately $100-$150 million over the next four years in food systems. The other thing to highlight there, is those products are also higher from a return on invested capital because they are not as capital intensive because you are talking about blending operations as opposed to anything that requires a lot of energy or a lot of water usage.

Jason Payant: How is the company handling increased geopolitical risks in addition to inflation?

Jim Zallie: Well, we are watching it very closely right now. Specifically, the issue that is on everyone's mind right now is Ukraine and the geopolitics of what may happen there as it relates to the impact on corn prices and the impact on oil prices. We mentioned in the fourth quarter earnings call that Ukraine in the 3rd largest exporter of corn, that is why it is relevant to the global corn markets and obviously what is going to happen as it relates to oil prices. That is where again we think the efforts, we've made in relation to contracting and pricing well as being more extended in our hedging as well as updating of those terms and conditions with customers to give us more flexibility to pass through. Now, I am going to ask Jim to help me here but as it relates to where oil prices if they were to surpass $100 a barrel it would impact likely some of the chemicals we use. And, chemicals Jim represent what percentage of our spend in COGS?

Jim Gray: Probably about less than 2% of the chemicals we use would be tied to some type of repricing due to oil.

Jim Zallie: And a small amount of our packaging, which would be more of polypropylene bags for bulk bags, things like that may get impacted but again it is a smaller percentage of our overall spend. Where we spend three billion related to just corn alone. And again, we've talked about the efforts that we have taken to mitigate the volatility there.

Jim Gray: I think really what we watch as well, is not just the cost of corn and obviously corn is a global market so how might that impact the cost of corn or how corn trades in different countries. We also just look at the price of oil and clearly how it impacts diesel and the cost of diesel. Generally, the contracting within in the U.S. for freight rates has some type of diesel or diesel pass through. And, we generally have that surcharge that also impacts our customers, if oil or the cost of diesel happens to rise significantly.

Jason Payant: How much of Cost Smart savings impacted 2021 results? How much will carry forward into 2022? As you look to reduce waste and lower your costs what level of savings are you targeting?

Jim Gray: Do you want me to take that? Great, first of all just to begin if folks are not familiar with Cost Smart. Cost Smart is an extensive global program that we embarked upon over three years ago. We just wrapped that up in 2021. The cumulative run rate of savings for the program was $170 million and we really finish out Q1 here will exceed that number. I am very pleased with how comprehensive Cost Smart was in terms of savings initiatives across the company. We probably had about $60 million of run rate savings that were actioned in 2021. We probably captured half to two thirds of that and we will capture the last maybe third of that in 2022 as those initiatives were completed mid-year 2021 and we will see the impact of that savings as we go into 2022. What we are trying to then do now is to transition to Cost Competitiveness and that is really under-pinned by operational excellence and as we really highlighted in the presentation is that for us operational excellence is not just within our manufacturing team and within our supply chain team. It is also about how we approach our global support functions and what we are doing within our shared services. The idea is that within cost competitiveness is that we can day to day week to week can look at ideas that can help us with increased capacity, improve reliability, help us with predictability within the business. And, so that we are just eliminating cost waste as we go through in our leaning practices, and we are avoiding cost inflation and we are squeezing out productivity where we can. So, we think that if inflation is going to average 2-3%, obviously we are seeing a bit more inflation right now. We are working to offset probably about half of that inflation through our Cost Competitiveness efforts as we go forward.

Jason Payant: Can you also explain why you are only seeing flat growth in South America vs growth everywhere else? Is that based on FX devaluation assumptions or what is driving that outlook?

James Gray: That may be as we presented in the slides and if you have a chance to go back and look at the presentation, the top line growth in South America on a reported basis for 2021 versus the four-year outlook will look flat. Let me just remind everybody that we had within our 2021 results Argentina, Chile, and Uruguay sales for about seven months. Then, we contributed those businesses to a JV where we have a minority interest, so those sales were removed. Then obviously Brazil and our Andean region they're going to make up for that sales growth in 2022 through 2025. So, they claw all of that net sales growth back. So, I think if you look at those two remaining countries that are growing in the mid to high single digits in terms of sales growth.

Jason Payant: Ok, I think we have time for one more question. Your outlook reflects around thirty to fifty basis points of margin expansion over the next four years. How confident are you that you will be able to expand these margins?

Jim Gray: Do you want to take the up-side and then I will talk about OPEX?

Jim Zallie: I think we are feeling obviously, very good about the investments that we've already made, which I highlighted in the presentation take typically four to five years for specialty food ingredient investments to really get the traction that you need to get the kind of pay backs. We are well into that investment phase. So, the investments we've made in plant-based proteins, in sugar reduction, the organic capital investments in starch-based texturizers, the investments in food systems, and the acquisitions of TIC Gums and KaTech, all of that is going to lift margins. At the same time what Jim was highlighting in one of the previous questions in relationship to the focus on operational excellence and to drive margin maintenance and any margin improvements out of the large core business we're very confident that we can do that. So, as it relates to the margin enhancement as a result of that along with the pricing center of excellences we’re confident in the thirty to fifty basis points improvement.

Jim Gray: Yeah, and I would just add that maybe from a CFO perspective as you look at the business where we are adding products and sales are at a much higher sales per metric ton. These products are clearly more valuable to customers and as we move forward with growth in growing markets you just get a weighted average that improves the overall gross profit growth and improves the operating income growth. So, really the thirty to fifty basis points of OI margin improvement, year-by-year over the next four years is really driven by very selectively picking specialty markets, developing product lines, and really pushing those sales successfully with customers. So, really that is the underlining momentum that Jim and I have been working towards.

Jim Zallie: The only other thing that I want to add though that I think is very very important because we were trying to emphasize that in the presentation and that is the work that we have done and are doing to enhance the stability and the cash generation from the core. So, we believe that the core business in comparison to years past, based on where it’s at in its industry cycle, based on the fact that 65% of the core for Ingredion is actually growing, we feel that the prospects for the core to be a stable cash generator bodes very well and then the specialties will help drive the margin enhancement.

Jason Payant: With two minutes left we probably have time for one more quick question. Forex appeared to be relatively benign in 2021 after several years of negative impact. What is your outlook for 2022?

Jim Gray: Yeah, sure. Well, there is obviously some moving markets in terms of interest rates and interest rate environment relative to inflation. Right now, as we look forward we do think we are going to see some slight FX favorability just on the whole. I would say that we are kind of reassessing this almost monthly. As we look forward whether it’s Asia-Pacific versus South America and the Mexico peso and versus the euro and the U.S. dollar. Right now, we are not seeing a lot of significant FX headwinds as we are moving into 2022.

Jason Payant: And then, any closing comments…

Jim Zallie: I just want to thank everybody for their interest in Ingredion and hopefully you found the presentation very informative. We look forward to seeing you at our Investor Day; which is June 2nd in Bridgewater, New Jersey where we have something special cooked up for you. Thank you.