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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Ingredion First Quarter 2018 Earnings Call. (Operator Instructions) As a reminder, today's call is being recorded.

I'd now like to turn the conference over to your host, Heather Kos, Vice President of Investor Relations and Communications for Ingredion. Please go ahead.

Heather Kos - *Ingredion Incorporated - VP, IR & Corporate Communications*

Good morning, good afternoon and good evening, and welcome to Ingredion's First Quarter 2018 Earnings Call. Joining me on the call this morning are Jim Zallie, our President and CEO; and Jim Gray, our Executive Vice President and Chief Financial Officer.

Our results were issued this morning in a press release that could 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 also refer to certain non-GAAP financial measures, including adjusted earnings per share, adjusted operating income and adjusted effective tax rate, which are reconciled to U.S. GAAP measures in Note II non-GAAP information included in our press release and in today's presentation appendix.

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

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

Thanks, Heather, and welcome to everyone joining us today. For the quarter, Ingredion volumes grew by 2%, driven by core and specialties growth. We delivered reported and adjusted earnings per share growth, but operating income was negatively impacted by operational headwinds, which I will cover in more detail momentarily.

South America and EMEA performed strongly; and as expected, Asia Pacific was acutely impacted by extraordinary tapioca costs. North America operating income was impacted by a sharp increase in freight costs, higher production costs caused by inconsistent demand in the Northeast and Canada this past winter as well as commodity pricing pressures.

We have begun mitigating inflationary pressures through pricing actions, customer contract management and accelerating our network optimization and cost-reduction initiatives. These actions complement our existing continuous improvement and Lean Six Sigma programs.

We continue to deploy our cash for shareholder value creation, investing in our higher-value specialty expansion projects. We expect continued growth from our specialty portfolio, which was highlighted this quarter by double-digit growth in our functional native clean label starches.

The integrations and growth of the Sun Flour rice ingredients business and TIC Gums are progressing well. The project pipeline and customer demand for new ingredients produced by these businesses is exciting as is the margin expansion potential. The strategy for the TIC Gums acquisition is enabling us to deliver custom solutions faster to small- and medium-sized customers.

Lastly, year-over-year, our tax rate and financing costs were favorable, which Jim Gray will speak about later.

Now let me turn to North America. First quarter operating income in North America was $143 million, down 9% from last year. Overall volumes were flat. Higher sales from TIC Gums and Kerr were offset by core ingredients. TIC Gums growth was a bright spot for us in the first quarter.

The sharp increase in freight costs in North America was primarily related to a spike in dry van freight rates. Our common carriers faced increased demand as rail delays shifted loads to trucking, and in parallel, the enforcement of new regulations impacted driver availability. During the quarter, we quickly reassessed our broker contracts and moved to recover higher freight costs where possible. We do not anticipate the full recovery of increased rate costs during 2018. However, we anticipate reduced freight cost impacts throughout the rest of the year.

In addition to freight costs, we experienced higher production costs caused by inconsistent demand in the Northeast and Canada this past winter. As a result, at the end of the quarter, we had higher starch inventories, which we anticipate will be rebalanced by the end of the third quarter. Finally, we saw weaker ethanol margins and lower corn oil pricing.

In South America, first quarter operating income was $26 million, up 73% versus the prior year, which marks the highest first quarter operating income since 2014 in South America. Our Brazil and Argentina network optimization and restructurings have positioned us to be more cost-competitive, and we are delivering against the expected benefits. Volumes were up 8% for the quarter but net sales were down, given the pass-through of lower raw material costs in Brazil. We expect the restructurings and organizational actions taken in 2017 will continue to drive operating performance and enable specialties growth.

Moving to Asia Pacific. The region delivered $23 million of operating income in the first quarter, down 23% versus last year. Overall volume was up 2% versus prior year and specialty sales were particularly strong in Southeast Asia. As discussed last quarter, Thailand's excessive rainfall starting last year impacted both the tapioca harvest and root quality, which significantly increased raw material cost during the first quarter. The Thai tapioca industry had not experienced such a sharp and prolonged rise in tapioca costs since 2010.

Consistent with our business model for tapioca, we are actively working to adjust pricing to offset the rapid cost increases. We expect tapioca cost to continue in the second and third quarters until the next harvest in the fourth quarter. Although we experienced an unprecedented run-up in tapioca costs in the last 6 months, our extensive production and sourcing network has enabled us to serve customers in a short continuity of supply.

Finally, the EMEA region reported record first quarter operating income of $31 million, up 11% from last year. Higher specialties volumes and favorable price/mix drove the increase. We anticipate the economic conditions in Pakistan and strong specialties growth in Europe will continue to support operating income growth.

I am pleased now to turn the call over to Jim Gray, who will spend time discussing our financials.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Thanks, Jim. Good morning, everyone. Let me start by covering the highlights of the income statement. Net sales were up for the quarter. Higher volumes and foreign exchange more than offset lower price/mix. Gross profit margin was lower by 10 basis points. Higher freight and production costs in North America and higher tapioca costs in Asia Pacific more than offset lower manufacturing and restructuring costs and better performance in South America and EMEA.

Reported and adjusted operating incomes were $197 million and $200 million, respectively. Reported operating income was lower than adjusted operating income by $3 million. The difference is driven by restructuring costs of $2 million for our finance transformation and $1 million for Brazil leaf extraction. Our reported and adjusted earnings per share of $1.90 and $1.94, respectively.

Moving to the net sales bridge. Our sales were up 1% versus last year. FX contributed $8 million while volume contributed $30 million. This was partially offset by $22 million of unfavorable price/mix, which was driven by higher freight costs in North America and the pass-through of lower raw material costs in Brazil.

As we look more closely by region, you can see unfavorable foreign exchange affected South America but was offset by favorable foreign exchange in Asia Pacific and EMEA.

In North America, volume was flat. Our TIC Gums and Kerr businesses were up, but this was offset by core ingredients. Price/mix in North America was down, given higher freight costs.

In Asia Pacific, volume was up, given our specialty capacity expansions, however, price/mix was down, primarily due to country mix.

In South America, volume was up 8%, led by strong sweetener sales in Argentina as well as growth in Brazil and the Andean region. Price/mix was down, driven by the pass-through of lower raw material costs in Brazil.

EMEA had strong volume growth and modestly positive price/mix, driven by specialty ingredient growth.

For the quarter, reported operating income increased $4 million while adjusted operating income decreased $10 million. North America operating income decreased $15 million due to higher freight costs, higher production costs and pricing pressures in ethanol and corn oil.

South America operating income was up $11 million, driven by volume growth and our more competitive cost structure in Brazil and Argentina from network optimization and restructurings.

Asia Pacific was down $7 million, driven by higher tapioca costs as we highlighted last quarter. Given the magnitude of the tapioca situation and relative strength of the Thai baht during the quarter, we expect price recovery to lag for another 6 months.

EMEA was up $3 million, driven by specialty volume growth.

Corporate costs were higher by $2 million for the quarter, given continued investments to drive global process optimization and efficiency. Internally, we have branded this program [Cost Smart]. We believe Cost Smart will drive future price reductions across our global business.

We'll 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. On the right side, operationally, we saw a decrease of $0.11 per share, primarily driven by margin decline of $0.23 per share. In North America, higher freight and production costs as well as increasing tapioca costs in Asia Pacific more than offset margin improvement in South America and EMEA. The margin decline was partially offset by increased volume of $0.09 a share and foreign exchange.

Moving to our nonoperational items. We recognized a benefit of $0.17 per share for the quarter, largely driven by a lower tax rate and lower financing costs. Adjusted taxes were an $0.11 per share benefit, driven primarily from U.S. tax reform; while financing costs were $0.06 per share benefit, driven by favorable foreign exchange and lower outstanding debt as compared to a-year-ago period.

Moving on to cash flow. For the quarter, cash provided by operations was $150 million. Capital expenditures of $95 million were up $23 million year-over-year, driven by specialty capacity expansion.

Turning to our guidance, we now anticipate 2018 adjusted earnings per share in the range of $7.90 to $8.20, down from our initial guidance of $8.10 to $8.50. We've lowered our guidance given a lower operating income outlook for North America. We expect higher freight and production costs as we rebalance starch inventories throughout the summer and we expect higher tapioca costs to continue in Asia Pacific through the third quarter. This guidance excludes acquisition-related integration and restructuring costs as well as any potential impairment costs.

We expect net sales and volumes to be up from 2017 and we expect continued growth in specialty sales. We anticipate that the impact of foreign exchange will be neutral to slightly positive. As we've explained in the past, given our business model for most regions, foreign exchange is effectively a pass-through.

We expect operating expenses, including corporate expenses, to be up year-over-year as we invest in global business process optimization and efficiency to drive long-term structural cost reductions. We've internally branded this program Cost Smart. The first phase is we're outsourcing IT and establishing a finance shared service center in Tulsa. We anticipate expanding Cost Smart's scope to include other global processes.

We expect financing cost for the year to be in the range of $72 million to $77 million due to higher interest rates on our floating rate debt and our refinanced maturities.

Our adjusted effective annual tax rate is expected to be between 26.5% to 28%. This reflects a benefit of approximately 2% to our weighted average effective tax rate from 2017, driven primarily from U.S. Tax Reform.

We expect total diluted weighted average shares outstanding to be in the range of 73.5 million to 74 million for the year.

In North America, we expect net sales to be flat and volumes up. For the full year, we expect operating income to be below 2017, with improved product mix and margins occurring in the second half of the year.

South America net sales are expected to be up versus the prior year. Volume recovery and favorable price/mix are expected to offset forecasted foreign exchange headwinds. And operating income is expected to be up. In addition, we anticipate positive economic growth in Brazil. We remain cautiously optimistic regarding economic reforms in Argentina and are monitoring the impact of the local drought on the corn harvest. We continue to focus on business process improvement and expect operating income improvement in the region.

Asia Pacific net sales are expected to be up but operating income is expected to be flat to down, given continued tapioca cost headwinds, which we expect to continue until the fourth quarter harvest.

EMEA should continue to deliver net sales and operating income growth. We expect improved core and specialty volume growth.

Excluding onetime cash receipts benefit from tax reform, we expect cash from operations in 2018 to be in the range of $830 million to $880 million. We expect to invest between $330 million and $360 million in capital expenditures around the world in 2018 to support growth as well as cost and process improvements.

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

That brings my comments to a close. Let me turn it back to Jim.

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

Before we go to the Q&A session, I would like to say that despite the headwinds we faced in the quarter, we remain focused on executing strategic actions to deliver against our long-term earnings algorithm. We believe our strong business model, innovation capabilities, global go-to-market reach and unique customer value proposition positions us for continued growth and shareholder value creation.

And now we're glad to take your questions.

QUESTIONS AND ANSWERS

Operator

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(Operator Instructions) Our first question's going to come from the line of Farha Aslam from Stephens Inc.

Farha Aslam - *Stephens Inc., Research Division - MD*

(inaudible) in which it plays? And do you think 2020 can get it there? Or do we need more?

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

I'm sorry, Farha, we -- you kind of -- we've got you midway through your question, so if you could repeat that? Farha, we could not hear the question. If you could repeat it?

Farha Aslam - *Stephens Inc., Research Division - MD*

My question relates to tapioca pricing. When will you reduce -- get the reduction in cost, please?

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

Yes. So tapioca costs, as we had indicated, have remained high for a longer period of time than we had expected. They started going up in Quarter 4 of last year and we expect them to continue through Quarter 2 into Quarter 3, and then when the Quarter 4 harvest comes in, we expect tapioca cost to decrease. Throughout this period, we've been actively moving our prices up with customers, and again, we expect that to reverse itself in -- starting in Quarter 4 when the harvest comes in.

Operator

And our next question is going to come from the line of David Driscoll from Citi Research.

Cornell R. Burnette - *Citigroup Inc, Research Division - VP and Analyst*

This is Cornell in for -- with a few questions for David. Just wanted to start off here, because there's something we've been getting a lot of questions from investors this morning. And relating obviously to North America, I think back at Cagney, total company EPS guidance was reiterated, but now the outlook for North America is perhaps significantly different from where we started out with. I know that freight costs have been well discussed throughout the industry for quite some time now. So one, can you just kind of, again, walk us through exactly what happened to North America in the quarter? And then two, what's your level of confidence that, going forward in some of the outer years, that North America can actually grow operating profits? Or is this kind of telling us that, perhaps, kind of profit growth in North America might be capped?

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

Yes. Let me take it first, and then I'm going to turn it over to Jim Gray to add some kind of color commentary. So for the quarter, the largest impact was higher-than-expected truck rates, and my comments right now are going to be against what we would consider to be the expectation. So taking the baseline actuals of 2017 and taking our guidance of mid-to-single-digit increase in operating income in North America, which is what we expected. And so my comments are going to be based off of that when I start to quantify some of these elements. So the largest impact was higher-than-expected truck freight rates of $8 million in Quarter 1, given the acute inflationary environment for truck rate. In addition, we had some colder winter weather in the first couple of months that impacted rail and shifted loads to truck, and that really further tightened that whole carrier market. And so for the full year in North America, we expect freight increases of $15 million to $17 million, primarily related to -- primarily against the expectations we had for the full year. In addition to freight, we had production costs that increased in the quarter by another $7 million to $8 million, and that was more than anticipated. We started the year with appropriate inventory and a production schedule. As the quarter developed, weather in the Northeast and Canada had caused some inconsistent customer starch demand for industrial and food. And given that lower-than-anticipated demand, we therefore had to reduce our production schedules and expect to continue to do so through Quarter 2. We expect the full year negative impact of fixed cost absorption to be approximately $20 million, again, against our expectations for North America for the quarter -- for the full year, I should say. For the full year. And lastly, again, we were negatively impacted by ethanol, which has impacted the industry, it's a smaller amount. And corn oil pricing was also down, and that impact for the quarter was $5 million. And we expect those commodity headwinds for the full year against full year expectations for North America to be approximately $10 million. So those were the impacts that were unanticipated. And as it relates to on the go-forward, we're obviously moving prices where we can. As it relates to the freight increases, we're passing through higher freight rates on to prepay customers. We're enforcing longer lead times with customers, which hopefully, is going to mitigate some of the risks of having to enter the spot market for last-minute shipping. And as it relates to being able to recover these costs going into next year, we believe we can. And we're working with our customers and contract terms are being updated with new freight rates. And we believe we'll be able to do that.

Cornell R. Burnette - *Citigroup Inc, Research Division - VP and Analyst*

Okay, great. Now I guess the second part of the question, the kind of longer term, and just kind of what's the growth trajectory for North America.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Sure. Cornell, this is Jim Gray. I think what -- the highlight, as we looked at the freight issues, when you had higher wages for drivers, you're going to attract more drivers into the marketplace. And so we'll continue to look at utilization throughout the year. And as we can come back and we can either negotiate lower carrier rates through our brokers and/or then think as we pass through or share those increased freight costs with our customers, as Jim mentioned. So I kind of look to that as more of an issue that we're working through here in the first half of the year. And we should see some of that be more mitigated as we get to the second half of the year. I also...

Cornell R. Burnette - *Citigroup Inc, Research Division - VP and Analyst*

Yes. I was [just understanding], if I heard you correctly, in the second half of the year, that you made the comments, I believe, that the margins in North America would be up, if I heard that correctly. So does that imply that kind of second half of the year, you expect perhaps actually profit growth in the business? Just as, maybe, the production rates at the facilities ramp back up and so fixed cost absorption is better and some of the freight's passed along to customers. Is that the right read?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

That's similar, I would probably say that margins would be -- or that operating income would be kind of more flatter to the prior year. Right. I think that we have an outlook for the second half, it would be we're going to take Q2 and Q3 to recover through this. And then we'll get into I think, the year beyond, we still believe more broadly in our specialty portfolio within North America. We think that the margins there and the growth within our specialty portfolio can absolutely help North America operating income, long term. And then also just to remind you, I mean, we highlighted about Mexico contracting last call, and we need to work through the contracting on both the sweetener pricing as well as within the kind of the brewing industry. But we believe that our outlook there in Mexico is still strong. And we believe that we can still grow in Mexico, given our positions. So I think long term, we would look to North America to be driven by our specialty portfolio in premium starches and we also look to Mexico as growth drivers. And then I think we're always going to be thoughtful about the sweetener business and the sweetener volumes. And we always look to how we manage our costs against the sweetener business, if there's any continued kind of demand fall off.

Operator

And our next question will come from Ken Zaslow from BMO Capital Markets.

Omar J. Mejias - *BMO Capital Markets Equity Research - Associate*

This is actually Omar filling in for Ken. Just a follow-up to the previous question with regards to the -- your ability to recover some of that, some of the pricing pressures that you guys have going on right now with North America. Are you guys going to be able to recover 100% of it? 75%? 50%? Just trying to get a sense of what was -- or the magnitude there, that will be helpful.

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

Yes. As it would relate to freight, I would say it's going to take throughout this year to be able to get as much of that freight increase as possible. And we do anticipate to get the majority, if not all of that freight rate increase back. But that's going to take throughout this year because it's been a very challenging year in relationship to the pace of increase in Quarter 1 and now having to re-contract at higher spot rates, which will take us through 2018, and then renegotiate terms with customers as we head into 2019. So that is the intention. And we do anticipate, as we head into 2019, to recoup most of that, if not all, of that freight cost increase.

Omar J. Mejias - *BMO Capital Markets Equity Research - Associate*

That's helpful. And what are your assumptions on net corn cost? Is that incorporated into the new guidance? I know that net corn cost has been starting to track up here. We have some issues in South America and then the corn oil pricing is starting to decline. Just any color there with regards to how are you guys are looking at net corn cost.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Thank you for the question, Omar. Net corn, as we mentioned in the past, we look and think very much about which markets we can hedge in and then use our hedging as we go forward in the year to contract the gross corn cost and then think about the co-product offsets. I think we feel very comfortable about where we're at with net corn in North America as well as kind of our practices in Brazil. I think the rapid increase of corn cost in Argentina, given the drought, has been something that we're looking at, but that's incorporated into our outlook right now. The only reason we called out corn oil is that, given where the soybean market is and the higher prices for soy meal, it's created abundance of soy oil. And so that's brought down, as a substitute, corn oil pricing. And so that's just a bit unusual in terms of the ratio that we've historically seen corn oil versus soy oil sell at. And so we call it out because it is trading out of a normally expected range. And so we'll see how that shakes out through the second half of the year. But obviously, there's a lot of news around soy, soybean and soybean shipments globally.

Omar J. Mejias - *BMO Capital Markets Equity Research - Associate*

That's very helpful. And lastly from me, from the M&A side, can you guys just talk about the -- how's the pipeline looking? And how are things developing on your end from -- in terms of global opportunities you're seeing? And how's the marketplace?

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

Well, I mean, as always, we're very active with prospects assessment, and we have a number of opportunities that we are continuing to assess. And looking at, certainly, where those valuations are such that we can create shareholder value. And I would say the pipeline is as robust as it has ever been, and it's continue -- it's focused very much on our specialties growth.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

I mean, I'd add, Omar. Obviously, there's been some deals announced recently at higher EBITDA multiples. We continue to just be very disciplined about thinking about the growth prospects, the synergies and all of that relative to a multiple valuation and that the deal has to work in terms of what specialty growth it brings to our portfolio, and the revenue synergies and the cost synergies combined, into a valuation that makes sense for our Ingredion shareholders.

Operator

Our next question then is going to come from the line of Akshay Jagdale with Jefferies.

Lubi John Kutua - *Jefferies LLC, Research Division - Equity Associate*

This is actually Lubi on for Akshay. So my first relates to freight costs, and apologies if I missed this, but you mentioned in your prepared remarks that you've reassessed some broker contracts as a result of the rising freight costs. So just wondering if you could comment a little bit on when that begins to kick in, really, and to what degree that could potentially impact freight cost going forward.

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

It is -- it has already begun to kick in where we have adjusted pricing because we reacted, obviously, very quickly where we could pass through the increase in freight rates. That being said, it's a significant impact for the full year that we're going to have to deal with. And it will be mitigated, again, by the actions we've already taken in Quarter 1. And so the numbers that we projected take into account the mitigation efforts. But the majority of that offset is going to take place as we head into 2019 as customer contracts are renegotiated.

Lubi John Kutua - *Jefferies LLC, Research Division - Equity Associate*

Great. That's helpful. And then if you could just talk a little bit about your specialty business as a whole, just sort of whether it continues to grow online or maybe ahead of your expectations. And just where does the specialty business stand today as sort of a percentage of sales? And any changes to your target? I think you were previously targeting reaching 30% of overall sales in terms of specialty by 2019, I think it was. But yes, just any additional color you can give around that would be helpful.

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

Yes. Our specialty sales are projected to be up for the full year and also in North America despite North America's challenges that we've had in Quarter 1. We remain very much positive towards the specialties portfolio. And that's in all regions. South America, for example, this past quarter, was actually up nearly double digits for us in specialty sales. So overall, specialty sales for Ingredion, on target. We had put out at CAGNY 32% to 35% as a 2022 target. We had indicated previously 28% of our sales are currently of specialties, and that is on target to grow towards that 2022 target this calendar year. So we'll see incremental revenue percentage of our sales that would be specialty sales year-on-year this particular year. So again, remaining very committed to the whole specialties portfolio. You will have seen our capital investments are up in the quarter, that is primarily going against our specialties growth and expansion investments.

Operator

We have a question from the line of Robert Moskow from Credit Suisse.

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

Forgive me because I've had to hop on from a different call. I think the results today kind of raise some questions here, Jim and Jim, about the sustainability of the margin structure in North America after a multiyear period of expansion. And you're seeing some of these dry freight -- the freight costs hurting it in the near term. So forgive me if you've answered this already, but to what extent is that just a transitory issue that can be offset pretty quickly? And to what extent should we be concerned about more structural issues that could impact either this year or going into 2019 also?

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

Yes, let me take it first and then I'll turn it right over Jim. I think first of all, it's important to remember that this is only one quarter, and we believe -- weather was a contributing factor, we talked about it as it related to the production scheduling. And certainly, the freight issue we see as more of a transitory type of an issue that we will work to mitigate, again, in 2019, as we go into 2019. And we've modeled these impacts very carefully as it relates to being reflected in our guidance for 2018. So we feel good about that. But I think right now, I think it's just important to put in perspective, it's one quarter. You have a shock to the system throughout the industry related to freight rates. And we are working to mitigate that. And as it relates to a couple of the other extraordinary negative items on ethanol and corn oil pricing, we've seen those kind of blips before. And those are -- I don't want to say insignificant, but they are something that we've been able to manage the business against. And again, we're very positive towards the specialties portfolio, which is a significant piece of the North America business, considering not just net sales but also from a gross profit standpoint, the contribution. So with that focus, we feel that the margin structure does remain intact for North America. And also, and Jim mentioned this, sweetener fundamentals are still solid. So the sweetener fundamentals are solid, we talked about the production cost issue is mainly a starch-related issue, and it was actually weighted, interestingly, towards industrial starch, which on a proportion of usage by our customers, is a higher volume contributor. And actually, this was actually signaled by a couple of our largest customers in their earnings reports, actually attributing it to the weather, which kind of helped us interpret this inconsistent demand pattern that we actually saw in the quarter. So you take those factors in totality and you put it in perspective as a 1-quarter event, I think that we're trying to interpret it longer term, that we think we can manage through this very nicely. Jim, do you want to add some color to that?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes, I was just going to highlight, Rob, what I think most investors' concerns have been around, well, is the margin structure in sweetener vulnerable? And I would say it's not. And we're not indicating on this call nor anything really in our guidance around where we think sweetener and/or kind of the margins. We're still kind of pleased with how contracting came out. We're managing the volume of sweetener demand in the overall portfolio. This is really -- I think maybe some of our investors don't understand that starch orders tend to have a replenishment cycle that's much longer than sweeteners. So customers may order monthly or 6 weeks or 8 weeks. And so when you get nor'easters or you get really cold rail and you have a crunch on carriers showing up to take orders, you're going to get some hiccups in that supply chain and you need to let time, along with our customers' demand take away for starch, move through the inventories and get the inventories smoothed out. So this is really something where were really looking at and being -- I think we're being prudent about looking at our production schedule and saying, "We going to run through the first half of the year slower." That's going to have a higher costs for us, we're affecting that in our guidance. But we do assume that the overall starch demand is going to be healthy, it's going to pull through. And as we see the second half of the year come through, we're going to get back more to a normal production cost for our starches.

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

Yes. And I would just supplement it, and we can certainly talk more about it. We're using this as a catalyst for us, as an opportunity to drive, internally throughout the organization, the Cost Smart initiative for structural longer-term cost reduction as well as to complement continuous improvement and Lean Six Sigma efforts that have been ongoing for a long time. So we're trying to take the situation we're faced with and actually help to strengthen the business for the longer term as well.

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

Just a follow-up. I mean, you didn't really mention pricing specifically as a lever to mitigate these issues. Is that just not one of those levers that you pull to cover freight? And then a second question, is this an overall industry issue? Or do other carriers have -- or do other competitors have their own transportation to some degree?

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

Yes. I can't comment on what our other competitors would have in their particular systems and fleets. I do know, obviously, that it's impacted a lot of our customer base. As it relates to pricing, again, where contractually possible, we're already passing higher freight rates onto prepay customers and to new customers. In addition, we're enforcing longer lead times with our customers, which again, helps to mitigate the risk of having to enter the spot market for last-minute shipping. So all of those things have already been done and that's one lever that's been pulled. I know your question is about North America, but clearly, as it relates to the tapioca situation in Asia Pacific, we've been actively moving pricing, and that is a lever to offset the other, I would say, significant inflationary issue that we've been faced with in the global business.

Operator

We have a question from the line of Brett Hundley from Vertical Group.

Brandon Groeger - *Vertical Group - Analyst*

This is Brandon on for Brett. I wanted to ask you a question about your bulk business in North America. So this business has benefited in recent years from a favorable supply/demand balance and benign corn cost. One could argue that the capacity closures in '14 and '15 put that supply/demand balance into a much better position relative to the years of declining demand for some of those sweetener products. We've been looking at the situation in Mexico this past contracting season, along with whether or not any actors on the corn wet milling side are changing their behavior. And we're wondering if the supply/demand balance has started to erode in any meaningful way. When we couple that with potential for corn to move higher or bad crops or any other catalysts, we're wondering if the corn wet milling industry needs to take a look at supply modification or optimization. Do you think that as an industry, corn wet millers will proactively manage that supply base? Or do you think that it will be more reactionary going forward?

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

All I can say is that the industry fundamentals in sweeteners, as we've said, we think, remain very solid. And I believe you're referring to our core sweeteners business, and I think we talked about it that we felt good coming out of contracting as we headed into this year. And we feel, as it relates to our core sweeteners business, both in U.S., Canada and in Mexico, again, fundamentals remain very solid and we feel that we did as expected and well as we went through contracting.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Maybe just a comment, Brandon. Always a consideration on sweeteners, whether it's within North America or even worldwide, you have to look at where sugar is also worldwide. And we've seen some pretty dramatic lower sugar prices worldwide, kind of outside the United States and Mexico, but worldwide. And that won't always be great. You've had some crops that have come in that have been -- it's rare that you've had 3 of the 4 major producers of sugar worldwide all have bumper crops. So I think that, that will, in due course, will self-correct because lower sugar prices just won't attract as much of the -- of farmer demand and the refining. And so I do think that, that also plays into a bit of long-term demand for corn-sweetened products.

Operator

Our next question will come from Arthur Reeves from Société Générale.

Arthur John Reeves - *Societe Generale Cross Asset Research - Equity Analyst*

My question is about tapioca, where we started. You helpfully gave us, on your North American business, what the hit have been for some of the problems in the quarter and what you thought it would be for the year. Can you tell us the numbers for tapioca in the same way, please?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

I think, Arthur, what we would say is that, as you thought about Asia Pac being slightly up on operating income for the full year, we now would see that tapioca, kind of in addition to where we would have thought it was, probably about a $7 million additional headwind versus where you might have put your expectations. And that will occur mostly kind of in Q2 and Q3. So -- okay?

Arthur John Reeves - *Societe Generale Cross Asset Research - Equity Analyst*

Yes. Understood.

Operator

We have a question from the line of Adam Samuelson from Goldman Sachs.

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

So I guess the first question, I wanted just be clear in North America. So I think if I added up the freight, the fixed cost absorption and the commodity impacts for the year, that was a $45 million delta to your North American outlook, of which, $23-or-so-million was in the first quarter. Is that -- relative to your expectations. Is that right?

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

Yes, I think that's about right.

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

Okay. And secondly, as I think of -- and Jim Gray, you just talked, alluded, to sugar prices being low. And I'm wondering, has that been reflected in the outlook at all? I mean, sugar prices have come down since the start of the year. They are at low levels. I'd imagine in places outside the U.S.: Mexico, Argentina, Pakistan, Asia, they would be -- that will be putting some pressure on the corn sweetener business that's non-U.S. Has that been -- was that in your outlook? Has that been reflected in the updated outlook in any way? Just any color on that would be helpful.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes, sure, thanks, Adam. I would say that we have a couple of markets where you would have some world sugar impact, I think in Argentina. It's a little bit confusing in terms of how much sugar is exported out of Argentina, but that definitely has had some pressure internally on the domestic price of sugar. And that is in our forecast for the year. And then we also see world sugar impact us in Canada little bit. And that's also reflected in our outlook. It's really more from an opportunity for additional volume and Canada as opposed to kind of more broadly across our sweetener customer base.

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

Okay. And then just a quick modeling question. The guidance for interest expense for the year implied a pretty healthy step up from where you were in the first quarter. I don't think any debt refinancing is coming due in the short term. Just can you just explain what's going on in the interest line for the rest of the year?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

We just had -- just in Q1, I just had some favorable FX or some interest offset currency. As currency moved, we had some favorability there that I think that we've -- it's hard to say that, that would replicate in Q2 and for the balance of the year. So that's why you're just seeing that step up.

Operator

(Operator Instructions) And our final question comes from the line of Farha Aslam from Stephens.

Farha Aslam - *Stephens Inc., Research Division - MD*

Just a question on volume, did volume stabilized here in the second quarter? And how has the volume fared as you've raised pricing with customers? Did the customers renew at the higher price with the same volume commitments?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Farha, maybe which region?

Farha Aslam - *Stephens Inc., Research Division - MD*

North America in particular.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. So I'll -- you want to tell?

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

Sure, you do it. Yes.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

I think north -- I think volumes have -- overall, I think volumes on sweetener are very much kind of in line with what we've expected as well as I think with regard to overall starch, we've alluded to that there was kind of some ups and downs. I do think that as we get into the warmer weather and we are getting better tender acceptance from our freight carriers, we're hitting that more consistently. I think the only thing that we would kind of be cautious about is as we think about our industrial starches and just making sure that the flow into the industries that we serve for industrial starches is going to be consistent.

Farha Aslam - *Stephens Inc., Research Division - MD*

Okay. So as you've renewed your contracts at the higher prices, have you started to renew and pass on pricing? And how has the volume fared on those contracts?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Let me try and maybe take a part your question into 2 parts. So as we've finished our contracting for food starches and for sweeteners in the fall, going into the beginning of '18, we felt that we were still kind of happy with where contracting came out and we were okay with where volumes were going to be. The only twist has been, as we have gone through here and we have seen a rapid increase in freight rates, particularly for dry van, going through and putting through some of those freight rate increases into mostly into starch contracts. Okay? So that's in -- and freight is usually priced separately within contracts -- customer contracts.

Farha Aslam - *Stephens Inc., Research Division - MD*

Okay. And you're doing that right now? Or you'll do that once we re-contract?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

So again -- so a portion of the contracts have a term with the customer where you're allowed to pass through the freight automatically. And then there's other customers, usually medium and small customers, who may not have the scale in their freight purchasing nor the sophistication. They say, "Ingredion, you're a large dry van freight purchaser, can I rely upon your rate that you can secure from your factory to my dock?" And so for those, they may just want a fixed rate. So what we need to do then is just go back and negotiate with those customers, probably more as we get into the contracting for 2019 in terms of an updated freight rate. We can go back and have those conversations now, but it's also one where -- it's a to and fro, I think, with your medium and small customers as they're looking at that freight rate change.

Operator

Thank you. And at this time, I have no further questions in queue.

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

Okay. Before we sign off, I'd just like to wrap up with a few comments. In North America, we're taking actions to mitigate the impact of inflationary pressures. Our specialty sales are projected to be up for the full year and we're keenly focused on driving specialty starch sales.

Our Mexican business is performing as expected and our sweetener business continues to perform well across the region.

In South America, we are very pleased with our first quarter results, which as a reminder, was the best first quarter since 2014. And we feel we are well positioned to deliver significant year-over-year growth.

In Asia Pacific, although we see the tapioca situation as more protracted than originally anticipated, we've managed through tight tapioca markets in the past and we expect to do so again.

EMEA continues to be a bright spot with a record quarter of operating income with continued strong specialties growth.

We've expanded our global process optimization efforts and drive for efficiencies and long-term cost reductions. We branded this initiative internally as Cost Smart.

And lastly, although we focused this morning on operational issues, I'd like to remind you that our business generates strong cash flows from operations. We will continue to deploy cash strategically to create value for shareholders.

So with that, I would like to thank you for your time today and I hope to see many of you at the BMO Conference, May 17. Thanks very much.

Operator

Thank you. And ladies and gentlemen, that does conclude our conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.
