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INGR - Q4 2017 Ingredion Inc Earnings Call

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OVERVIEW:

Co. reported 4Q17 reported operating income of $203m and reported EPS of $1.35. Expects 2018 adjusted EPS to be $8.10-8.50.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Ingredion Fourth Quarter 2017 Earnings Call. (Operator Instructions) And as a reminder, this conference is being recorded. I would now like to turn the conference over to our host, Mr. Heather Kos. Please go ahead.

Heather Kos

Good morning, and welcome to Ingredion's Fourth Quarter 2017 Earnings Call. Joining me on the call this morning are Jim Zallie, our President and Chief Executive Officer; and Jim Gray; 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 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 to 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. Before we delve into the quarter, I wanted to take a moment to offer my thoughts on the year. For 2017, Ingredion delivered strong growth and ended with records in earnings per share, operating income, adjusted operating income and adjusted earnings per share.

Volumes grew by 3%, driven by acquisition-related and specialty volumes. In fact, specialties ended the year at 28% of net sales. On the cost side, we completed our Brazil and Argentina network optimization and restructurings, and we continue to drive continuous improvement initiatives globally.

We also continue to deploy our cash for shareholder value creation. We repurchased over 1 million shares during the quarter of 2017, increased our dividend 20% in September and continued to invest in our higher-value specialty production expansion projects. We remain excited about the prospects for growth coming from these investments in the future.

Additionally, we acquired the Sun Flour rice ingredients business in March, further strengthening our capabilities in the higher-value specialty ingredient portfolio. Our integration of this business, along with TIC Gums and Shandong Huanong, are well underway. We remain excited about the pipeline of projects and customer demand from new ingredients produced by these businesses as well as the margin expansion potential from synergy opportunities.

Now let's spend a moment on each region. Fourth quarter operating income in North America was $141 million for the quarter, up 3% versus last year. Overall volumes were up 3%, driven by the TIC Gums acquisition. Mexico core volumes were down for the quarter due to brewery customers shipping their production volumes across their networks. Additionally, Mexico results were impacted by higher inflation, slower-than-anticipated economic growth and the lapping of the 2016 inventory build.

For the full year, North America achieved record operating income of $661 million, up $51 million from the year-ago period. The TIC Gums integration is further enhancing our texture capabilities and enabling us to deliver custom solutions faster to innovative small and medium-sized customers. We are pleased with our profit growth as we continue to focus on our trade-up strategy, underpinned by our emphasis on the customer experience.

In South America, fourth quarter operating income was $36 million, up 24% versus the prior year. Our Brazil and Argentina network optimization and restructurings have made us more cost competitive and are delivering the expected benefits. Volumes were up 3% for the quarter, but net sales were down given the pass-through of lower raw material costs in Brazil.

For the full year, operating income was $80 million. We expect the actions we have taken will continue to drive operating excellence and grow specialty sales.

Moving to Asia Pacific, the region delivered $24 million of operating income in the fourth quarter, in line with last year. Overall volume was up 4% versus the prior year, and specialty sales were particularly strong in China and Southeast Asia. As discussed in past quarters, in Korea, price/mix was affected by our decision to diversify our core customer mix to repurpose capacity to higher-margin sweetener blends.

In the short term, moderate margin compression is expected as we shed some of our HFCS business to make room for new specialty sweetener solutions. As we continue to grow our specialty sweeteners, we anticipate higher operational efficiencies and improved price/mix.

In Thailand, excessive rainfall impacted the tapioca supply, which significantly increased raw materials during the quarter. For the full year, Asia Pacific posted record operating income of $112 million. Our Sun Flour rice ingredients business and Shandong Huanong integrations are going well. The demand for our rice-based ingredients is strong, and our Shandong cost synergies are on track for 2018.

Finally, the EMEA region reported fourth quarter operating income of $30 million, up 15% from last year. Higher volumes and favorable price/mix drove the increase. For the full year, EMEA delivered record operating income of $113 million, up $7 million from the year-ago period.

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

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

Thanks, Jim. Good morning, everyone. Let me start by covering the highlights of the income statement. Net sales were up for the fourth quarter. Higher volumes and foreign exchange more than offset lower price/mix. Gross profit was higher by $21 million as a result of margin expansion in South America and EMEA, the inclusion of the TIC Gums business and specialty ingredients volume growth.

Reported and adjusted operating incomes were $203 million and $210 million, respectively. Reported operating income was lower than adjusted operating income by $7 million. This difference is driven by restructuring cost related to a $13 million write-down of certain stevia leave extraction assets, severance of $2 million and acquisition and integration costs associated with TIC Gums of $1 million. Offsetting these charges was $9 million from insurance recovery primarily related to capital reconstruction.

Our reported and adjusted earnings per share were $1.35 and $1.73, respectively. Beside the reconciling items I just mentioned, reported earnings per share were lower than adjusted earnings given the enactment of the Tax Cuts and Jobs Act in December 2017, which resulted in a onetime estimated charge of $23 million in the fourth quarter. The estimated charge includes the transition tax on cumulated earnings overseas and foreign taxes on a portion of our unremitted earnings, partially offset by the remeasurement of net tax -- net deferred tax liabilities.

Moving on to the net sales bridge. Our sales were up versus last year. FX contributed $12 million, while volume contributed $42 million. This was partially offset by $60 million of unfavorable price/mix, which was largely driven by 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. Volumes were up in all 4 regions. In North America, volume was up driven by our TIC Gums acquisition. In Asia Pacific, volume was up given our specialty capacity expansions. However, price/mix was down due to our decision to diversify our core Korea customer mix. In South America, price/mix was down, driven by the pass-through of lower material costs. EMEA was strong in volume and price/mix, driven by specialty and core ingredient growth.

For the quarter, reported operating income increased $14 million while adjusted operating income increased $16 million. North America operating income increased due to acquisition-related volumes and effective pass-through of changes in raw material costs, partially offset by higher operating costs in Mexico.

South America operating income was driven -- was up, driven by volume growth in our more competitive cost structure from network optimization and restructurings. Asia Pacific was flat given that volume growth was offset by higher tapioca costs, which spiked during the quarter given supply shortfall.

Given the magnitude of the tapioca crop shortfall and relative strength of the Thai baht during the quarter, we expect price recovery lag of 6 to 9 months.

EMEA was up $4 million, driven by volume growth and favorable price/mix. Corporate costs were lower by $1 million for the quarter given smart cost discipline and timing of expenses.

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 an improvement of $0.15 per share, primarily the result of volume due to acquisition and specialty-related ingredients with a lesser benefit from foreign exchange. This was partially offset by a margin of minus $0.03 per share, primarily driven by higher operating costs in Mexico as well as the increase of tapioca costs in Asia Pacific.

Moving to our nonoperational items. We recognized a decrease of $0.09 per share for the quarter. Adjusted taxes were minus $0.13 per share, largely driven by decreased foreign tax credits in 2017 as compared to the year-ago period. The higher tax rate was partially offset by a $0.02 per share benefit from fewer shares outstanding and $0.02 per share benefit from lower financing costs.

Turning to our full-year figures. Net sales were up 2%. Higher volumes and foreign exchange more than offset lower price/mix. Gross profit was higher by $71 million as a result of margin expansion in North America and higher volumes from the inclusion of the TIC Gums business and organic growth in specialty ingredients globally.

Reported and adjusted operating incomes were $842 million and $884 million, respectively. Reported operating income was lower than adjusted operating income by $42 million. This difference is largely related to pretax restructuring charges of $17 million in Argentina for employee severance as we took action to improve efficiency and lower our operating costs, a $13 million write-down for certain stevia leaf extraction assets, $6 million for our finance transformation initiative and $2 million of other severance.

Additionally, we had pretax expense of $13 million for integration and acquisition costs, including the fair value markup of acquired TIC Gums inventory. This was partially offset by the $9 million of insurance recovery I talked about earlier. Our reported and adjusted earnings per share were $7.06 and $7.70, respectively.

Moving on to the net sales bridge. Our full-year sales were up versus last year. FX contributed $49 million. Furthermore, volume was the biggest driver and contributed $165 million. This was partially offset by $86 million of price/mix. Our price/mix was largely driven by the pass-through of lower raw material costs.

As we look more closely by region, you can see foreign exchange was flat to favorable on all 4 regions. Volumes were up in North America, Asia Pacific and EMEA. In North America, volume was up, driven by TIC Gums acquisition. In Asia Pacific, volume was up given our specialty capacity expansions. Price/mix was down 2%, largely driven by the pass-through of lower raw material costs in 3 of our 4 regions and the diversification of our core customer mix in Korea.

For the year, reported operating income increased $34 million, while adjusted operating income increased $54 million. North America posted strong results due to margin expansion driven by operational efficiencies and growth in acquisition and specialty related ingredients.

South America operating income decreased by $9 million. The decrease was largely a result of Argentina's difficult macroeconomic conditions and the strike in Argentina and resulting temporary higher cost during the first half of this year.

Asia Pacific and EMEA were up $1 million and $7 million, respectively. Corporate costs were lower given expense timing and smart cost discipline.

Moving to earnings per share. Operations drove an improvement of $0.52 per share, primarily the result of volume of $0.48 per share with the lesser benefit from foreign exchange of $0.12 per share and $0.03 per share of other income. This was partially offset by a margin impact of minus $0.11. The lower margins were largely caused by South America with Argentina's difficult macroeconomic conditions and temporary higher cost during the first half of the year.

Moving to our nonoperational changes. We recognized a benefit of $0.05 per share. Our adjusted tax rate was lower, contributing $0.08 per share benefit driven by appreciation of the Mexican peso during the year and the result of valuation of U.S. dollar-denominated balances in Mexico and a lower valuation allowance on the net deferred tax assets of a foreign subsidiary.

Fewer shares outstanding added a per-share benefit of $0.06. These benefits were offset by higher financing costs of minus $0.07 per share due to a higher debt balance and higher interest rates.

Moving to cash flow. Our full year cash flow provided by operations was $769 million. During the year, we deployed cash in the form of capital expenditures, dividends, share repurchases and acquisitions. Our full year capital expenditures of $306 million were up $23 million from last year, primarily driven by growth and cost savings initiatives.

I'd like to note that our full year working capital was impacted by the timing associated with the U.S.-Canada tax settlement. If you recall, during the third quarter, we paid the U.S. $63 million but do not anticipate receiving the offsetting payment of $45 million from the Canadian rebate until 2018.

Turning to our guidance. We anticipate 2018 adjusted earnings per share in the range of $8.10 to $8.50. This includes the estimated benefit of tax reform of approximately 1 percentage point of ETR. Additionally, 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. As we explained in the past, given our business models for most regions, foreign exchange is effectively a pass-through. We expect operating expenses, including corporate expenses, to be up year-over-year due to continued investments in innovation through R&D, customer experience and administrative processes to strengthen our capabilities and drive future efficiencies. We expect financing costs 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 27.5% to 29%. This reflects a benefit from U.S. tax reform of approximately 1 percentage point on our globally weighted effective tax rate. We expect total diluted weighted average shares outstanding to be in the range of 73.5 million to 74 million for the year.

I want to highlight the new accounting standard update related to pension -- presentation of pension expense and its implications to our operating income. In 2017, our net pension expense was about $4 million for the company. This includes a service cost of about $10 million, offset by $6 million of income net and other components, which relates to the expected return on our pension assets.

Beginning in 2018, our operating income will reflect only the service costs, while the other components, in this case, $6 million as an income, will be classified as other nonoperating income. The presentation change will impact regional operating income. However, there is really no impact to net income or earnings per share. Beginning in the first quarter of 2018, we will reflect this impact -- we'll reflect the impact of this accounting standard update in our results and we'll restate prior periods for comparability.

Turning to the regional outlook. In North America, we expect net sales to be up. For the full year, we expect operating income to be above the 2017 level in the low single to mid-single digits with improved product mix and margin to turn in the latter half of the year. Additionally, our guidance for Mexico assumes higher operating costs due to general inflation and the increased sweetener price competition from U.S. imports.

South America net sales are expected to be flat to up versus 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, and we remain slightly optimistic regarding economic reforms in Argentina and the impacts on our Southern Cone business. We continue to focus on business performance improvement and expect operating income improvement in the region.

Asia Pacific net sales are expected to be up, but operating income growth is not expected until the latter half of the year, given tapioca cost headwinds.

EMEA should continue to deliver net sales and operating income growth. We expect improved core and specialty volume growth. We continue to monitor the political environment in Pakistan and potential risks to our business.

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. Back to Mr. Zallie.

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

Before we go to the Q&A session, as the new CEO of Ingredion, I'm pleased with our performance this year and I'm excited about our future. I believe in our business model, our innovation capabilities, our global footprint and sophisticated go-to-market model, which allows us to create value for our customers and for us to grow.

I look forward to future interactions with the investor community as we deliver shareholder value creation.

And now we're glad to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will go to the line of David Driscoll with Citi Research.

David Christopher Driscoll - *Citigroup Inc, Research Division - MD and Senior Research Analyst*

I apologize. But during the call, I was slightly late. So if this -- part of this, you mentioned in your script, but I don't think you probably did, I'd like you to talk a little bit about North America and just the pricing environment here post all the contracting. Anyway, how strong do you still consider the operating environment? And just as much color as we can get here on how pricing has gone and what to expect in 2018.

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

Sure, I'll take that. This is Jim Zallie. So for U.S. and Canada, David, I would say we were pleased with contracting. In Mexico, we faced decreased sweetener price competition. And relative to where domestic sugar was trading and is trading now, we believe where we're positioned right now really provides tremendous value to our customers. So overall capacity utilization to the industry remain high. And I would say, again, U.S./Canada, we were pleased. But with sweeteners in Mexico, it was a little bit price competitive.

David Christopher Driscoll - *Citigroup Inc, Research Division - MD and Senior Research Analyst*

And then on South America, this has just been a long difficult story down there. How optimistic are you in 2018 for a significant turn in profitability of the business? And what I'm just trying to get a sense here guys is, is this still many, many, many years before we see material changes in the profitability of that operation? And any, I guess, -- again, color you can give us to -- looking at the signpost that will help us understand the direction of that business would be helpful.

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

Yes. David, we indicated previously that we're very pleased with the quarter that we just delivered in South America. It's been a long time coming. We delivered $36 million in operating income for the quarter. And as you know, we have been working to get our cost structure really, I would say, fighting fit for the last couple of years. We have a very strong operator down in South America that is driving operational efficiency, continuous improvement. We've taken actions, as you know, to restructure our network and the actions that we took last year in Argentina. So really great to see how we're positioned now that we see some green shoots in Brazil that appeared to be sustainable going forward. Probably the second straight quarter that we've seen positivity out of Brazil. And then Argentina, again, we're very well positioned as that economy continues to recover. And we've got a very strong position in Colombia and the Indian region. So I would say we're certainly more optimistic on South America than we have been in recent years. The economies from a political standpoint seems stable for now. There obviously are important elections coming up in Brazil in October. But overall, I would say we're very pleased with the quarter and very pleased overall with where we sit with South America as we head into 2018. So that's how I would kind of characterize South America.

Operator

And next we will go to the line of Farha Aslam with Stephens Inc.

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

Your range for 2018 of $8.10 to $8.50 is relatively wise. Could you share with us kind of what gets you to $8.10 versus $8.50?

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

Sure. I think on the upside, what we would see is that there -- I think there's always opportunities to kind of fill in some volume in various countries. We would kind of expect kind of at least some raw material and price stability would help us towards the high end. And then we would probably see kind of kind of less inflation in some of our manufacturing and in our energy costs. I think on the kind of the opposite and the low end, we're a bit cautious about freight rates and diesel costs, particularly in U.S., U.S./Canada. We also kind of have our eye on oil and its kind of related impact to natural gas. And then what would help -- what might constrain us a bit is just how -- in Asia Pac, how the tapioca root shortfall plays out. If that has kind of continued shortfalls in terms of root supply, the raw material costs will be higher. You may have some kind of intermittency in terms of your production, which can always impact you on your manufacturing costs. And then we're a little bit watchful around just some of the core prices that we've seen around the world. And then I would probably say, finally just on the side of Mexico, we've kind of noted around the pricing competitiveness that we saw here at the beginning of the year. What we really want to do is just manage through the grind, the production and kind of all of our costs. And to the extent that we do that well would be kind of in the center of where we're at. But there's just a little greater variability, I think, introduced in what we're seeing and going into the year in Mexico.

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

Helpful. And could you just share with us your key start initiatives for this year and kind of what you expect the product mix improvement to be in 2018?

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

Yes, let me take that. I think that as it relates to our specialty starch focus, it really is centered around breadth and depth of the portfolio that we have. So breadth across various starch types, so that would be corn, tapioca, potato, rice and variations thereof, okay, so from a standpoint of that portfolio. And the clean label initiative with our franchise products of NOVATION continued to grow well. We continue to expand functionalities for those products. And so for wholesome clean label and the whole area of texturization, where -- as food formulations get reformulated and they are optimized for, say, health and wellness, it's very important to build back texture for overall taste and texture. And so under that clean label wholesome umbrella, our starch texturization program, along with the TIC Gums acquisition as it relates to more complete formulations, is a big drive. Then in addition, from a product focus standpoint, our potato starches, which we acquired with the Penford acquisition a couple of years ago, continues to do well because it provides different functionalities and certain applications like snacks and meats and cheese. And then also, we're very optimistic, I would say, on the prospects for our rice starch acquisition from Banglen just this past year. And year-on-year, we are anticipating very healthy growth from that rice portfolio not just in Asia Pacific, but also in EMEA as well as in North America.

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

So the -- pretend that's going to be specialty starch in terms of target?

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

Well, what I would say is that our specialty sales are 28%. As you know, they've hit a recent high, and we don't actually break out the percentage of our sale that will be dedicated to specialty starches per se.

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

And your target of that 28%, where do you anticipate that level of specialty sales to go?

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

Well...

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

I mean, we would -- again, we'd be more back to kind of Analyst Day, right, where we kind of see that in the mid-30% kind of 5 years out, so we just kind of continue along that track. So we don't really advertise kind of a future annual target. We put out there more of a horizon view of where we're going. Before I just -- I'd add to what Jim says, we do have assets that are kind of continuing to ramp up in their capacity. So in -- he mentioned Banglen in Thailand, but we also have other specialty assets that we've invested in, in Thailand and China as well as the U.S. and Brazil that we have coming on line that continue to show that we're investing ahead of the specialty starch growth with capacities that enable us to continue compete there.

Operator

And next we will go to the line of Ken Zaslow with BMO Capital Markets.

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

A couple of questions I have. One is when I think about North America, you're looking for volume and pricing to go higher in 2018. But this year, it seems to be somewhat lower. What is the change that you think that there's a reacceleration of top line growth in North America?

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

Do you want to take that?

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

Sure. I think within -- well, overall, within that sale, what we're seeing is that the, I think, part of the, obviously, the specialty products, we continue to see those growing both in U.S./Canada as well as in Mexico. So that impacts kind of the positive price/mix, assuming that kind of corn costs are constant throughout the year. And then what we're also seeing is that our utilizations are pretty good as we look at a plan. And so I would say kind of the rest the product lines are at least going to be flattish to slightly up.

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

Yes. And I just would like to add that I think Mexico has done extremely well for us obviously. And recently, Mexico economy, a little bit soft and inflation, one of the things that people perhaps are not familiar with. Inflation at the end of '17 in Mexico hit a 16-year high at 6.77%. So that has impacted our cost structure. And so that -- there's been an energy change regulation in Mexico as well. And so I would say in the main, I would say it's more of a Mexican issue as it relates to the overall North America results that you're referring to. I think U.S./Canada continues to do well for us.

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

But -- and then just to be clear, the 2018 outlook, there is no incremental acquisition, is that internal growth that you're looking at, that you're talking about?

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

That's correct.

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

And then what about natural -- what is the magnitude of impact from freight, diesel and nat gas that you're thinking about in 2018 in order of magnitude? I'm not looking for exact. But are these material headwinds? Are these -- I don't know. I mean, I know you guys don't give exact numbers, but it's high, low, medium? It's some sort of context to how we can think about the relative headwinds from those 3 issues?

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

Yes. 2 things on overall and the energy complex. I mean, I think what we would see is that generally, the inflation rates are kind of more low single to mid-single digit, right? With regard to different regions, we're kind of more or less exposed to nat gas. Where we have nat gas in our energy complex, we hatch. So relatively, we've taken positions in U.S., we've taken positions in Mexico against our nat gas. So we've mitigated a little bit of that. Where we have a little bit of volatility in the up or down is going to be on freight, what our carriers are seeing in terms of their change in diesel costs and whether or not that gets passed through to us and we then subsequently have either customer pick up or we pass it through the customers. So just there's a little bit more customer volatility given both the constraint on drivers, but in terms of where diesel might go given what we've seen in kind of cost per oil per barrel.

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

Okay. And then my last question is you mentioned of corn. That's somewhat surprising to me that you would -- because I know it's been several years since we've had any corn inflation of any significance. But my recollection is that the majority of your corn pricing is outside the U.S. pass-through within the 30- to 60-day basis. And then in the U.S., you're locking in contracts. So to what extent are you truly concerned about corn? Or is this kind of a red herring?

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

Yes. Let's just clarify though, we have tapioca root cost inflation. We're in Asia Pacific. I don't know if you -- just clarify, what -- did you say corn?

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

Yes, it's corn. I thought you mentioned corn in one of the answers to the question that you were -- on the upside, downside is -- that you are -- I mean, I could have misunderstood it, which is what I would hope to have said.

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

No, no, I don't think so.

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

Okay. So [new] corn is -- so the price of corn is not an issue at all in your outlook one way or the other way?

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

No, no, no. Because as we continue into our business model, right, we look at what's the growth cost of the corn and we look at the other strains that come off of the corn and we look at that over the layout of the year. And in another countries besides U.S./Canada, we price through on kind of a 3-month to 6-month basis. In U.S., in Canada and in Mexico, we have kind of different types of contracts that usually pass through.

Operator

And next, we will go to the line of Akshay Jagdale with Jefferies LLC.

Akshay S. Jagdale - *Jefferies LLC, Research Division - Equity Analyst*

So Jim, maybe my first question is if I could ask you to just sort of look back a little bit in -- at 2017 and maybe give us a little -- relative to what could have happened on the upside case, can you just remind us some of the issues, the bigger issues that impacted you? I mean, from what I remember, you had -- the South America recovery, obviously, was a little more back half weighted. You had some issues in the first half that probably weren't planned. And then you've had some issues in Mexico and now also in Asia that you've absorbed, right? That's what I remember. But it seems like those are relatively large issues that you've navigated through and still delivered on your algorithm. But I'm -- the reason I'm asking that is I think a lot of that is coming back in '18 and beyond. So if you could just help me with that, and then I have a follow-up.

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

Maybe -- this is Jim Gray. Actually, I'll -- maybe I'll take the lead. I think when we looked -- when we started 2017, we were clearly looking at South America, and we were unsure about the economic recovery within Brazil. And also, we were still facing kind of fairly high inflation rates in Argentina, Southern Cone. As we took actions in the first half in Argentina, the combination of a strike, how we tried to serve our customers as well as the economic conditions through their winter, I think, led to a slower capture back of our customers than we would have kind of expected or planned for. So that added to a little bit of kind of a onetime impact to South America, particularly in Southern Cone. I think as we've moved to 2018 outlook, while we've seen Macri's tenure strengthen in Argentina, which gives us slight optimism, we've seen some -- still some ups and downs in Brazil, but clearly, there's stronger economic growth in Brazil, which we're excited about and I think well positioned for. So we're -- I think we're much more optimistic about South America going in, relative to maybe some of the uncertainties we had at the beginning of 2017. With regard to Mexico, as we're going into 2017, just to remind you, what we were doing was as we had a capacity expansion that was coming online in Q2, and we had built some inventories in Q4 '16 to serve our customers on those contracts in that first third of the year, and then as the suspension agreements kind of impact it, I think there was a little bit of uncertainty as to where there would be supply of high fructose imports. I think that created some ups and downs in volume within Mexico. We also had a shift in our brewery customers. And so there was just a little bit more of kind of new stimulus that impacted kind of where our volume was going in Mexico. I think that's clearer as we go into 2018. And it's a different type of pressure that we face in '18, which is really around kind of sweetener pricing competitiveness. And there's a little bit of the inflations from the peso devaluation. It impacted the consumers, it's impacted some energy costs. So we're going to -- we'll digest that cost inflation as we go into '18 within Mexico. Asia, I would say our outlook was fairly -- I mean, I think we're pretty excited about Asia Pac. I think we did have the opportunity to look at Korea and rebalance that in one of the key customers there. And that's largely, I think, behind us. We're also exacted that we have a specialty sweetener investment in Korea, comes online more middle of the year of '18, but that allows us to take our great customer base and move into kind of specialty sweetener blends, which we think are really great for the South Korea market. So we're kind of -- that's moving and progressing forward. I think the real issue in front of us in Asia Pac is going to be tapioca root shortfall. So I'll just leave it there.

Akshay S. Jagdale - *Jefferies LLC, Research Division - Equity Analyst*

That's extremely helpful. And then just on the CapEx increase, I think you mentioned it's in -- you said U.S. or North America. I might have missed the detail there. Can you give us some color on what's -- where you're investing that money and maybe how that connects with the -- with your specialty strategy in that region?

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

Yes, Akshay. So what I got it towards was a total CapEx number on -- at the upper end of $360 million, which is a step up from 2017. From a finance perspective, the benefits from U.S. tax reform for investing capital in the U.S. are exciting. Maybe I'll let Jim talk about -- obviously, we're looking at specialty.

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

Right. No, so that's where obviously we've -- at the range, to $330 million to $360 million for this 2018 year. And we're obviously looking at the benefits of the opportunities afforded by the Tax Reform Act for investments in the U.S. But overridingly, our global specialties strategy is where our investments are targeted for growth. And so we're obviously looking opportunistically at what the tax reform opportunity can provide for us, in the way equally driving efficiencies and cost savings. But at the same time, globally, it's really about our specialties strategy. But we have increased our CapEx for '18 to $330 million to $360 million.

Akshay S. Jagdale - *Jefferies LLC, Research Division - Equity Analyst*

Right. So if I interpret that correctly, so you're saying because of the tax change, the mix geographically will shift a little bit more to North America, but it's not necessarily all specialty and assigned to a certain project. You've got a mix of things going on. Is that...

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

I think we're looking -- again, I think we're looking opportunistically at what the Tax Reform Act provides us in the U.S. for both cost reduction, efficiency as well as growth. But then overridingly, what's driving our CapEx spend is opportunities for growth with our global specialties focused globally, if that helps.

Operator

And next, we will go to the line of Brett Hundley with The Vertical Group.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

My first question was just I just wanted to revisit Mexico. You guys brought up the price competitiveness seen during contracting, which kind of filters more into your core business there. And I wanted to ask you a question on specialty in that country and just get a sense qualitatively for how you're thinking about that in the '18 here. Curious if your specialty business gets negatively impacted by some of the other things you talked about, which might be inflation or a slowing macro or anything related to that or if you continue to see solid growth in that business. Curious if there's been any added competition in that area in that country. Just any color you can give on that would be helpful.

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

Yes. No, thanks for that question because it's something that we have wanted to emphasize in the past in a relationship to specifically specialty in Mexico because it is a strategic focus for us. And what I would say is actually the very significant position that we have in Mexico with both our core sweetener business as well as our specialty business, but that size of the core sweetener business in that position with 3 manufacturing facilities down there, creates tremendous customer relevance and intimacy. And that thus has provided us tremendous opportunities to engage with customers for specialties growth opportunities. So for example, we said this in the past, when the Mexican government had imposed the obesity tax a few years ago, that actually created a lot of reformulation in beverages as well as snacks. And that actually provided opportunities for us to sell our very functional specialty portfolio and specialty ingredients portfolio. And as it relates to the weighting of our overall portfolio, the focus very much is on specialties growth. And there are the same health and wellness trends, the same trends that are driving growth in the U.S./Canada that are very relevant in Mexico as well. So it's an area of a lot of focus for us, and it's all about the innovation platforms that we are driving globally but are equally relevant in Mexico as well for specialties.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

But Jim, would you say that your -- as you look to 2018, that you're growing specialty business in Mexico similarly to 2017 or at a rate that you would like? Or do you think that it's come down a little bit?

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

No. I actually think for specialties, from a standpoint of the target, we actually have a target to increase specialty sales in Mexico, the issue that we were faced with that I was calling out. So again, I really appreciate the question because it's differentiating between core sweeteners, which we did indicate that, through contracting, was I would say, somewhat surprisingly price competitive. And so -- but that's completely a separate issue from the specialties business and the opportunities that, that affords us and the focus and also, the growth projections that we're anticipating for specialties in Mexico. So again, thanks for that question.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay. And then just my second question is M&A related. Just because -- I mean, when you look globally at ingredient valuations, they've really gone higher in recent years, particularly in Europe. And as I think about the valuation backdrop against what you guys are trying to do from a growth standpoint, the pursuit of SMEs, food service customers, things like that, I'm starting to wonder if instead of just acquiring your way into certain customer lists or product categories, are there partnerships that you can create with other ingredient companies that can leverage you in the faster growth? I think about everyone going after those customer areas that I mentioned right now and how formulated solutions have become so important. And I know you want to build your toolkit going forward. And so I just wanted to ask you if partnerships are something that come up and if they make sense with that regard.

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

Yes. I think partnerships for us is something that we've done to a very large degree in our business. We have a partnership, as you know, as it relates to the distribution right now of a very good tasting stevia Reb M and that is part of our stevia offering. But our go-to-market model globally and how we're positioned with our customers makes us a very attractive partner, and that's why many companies come to us to want to leverage the sales marketing capabilities and the reach that we have globally. So we're very open minded to partnerships. But at the end of the day, as it relates to M&A partnerships, it's all about value creation. It's all about shareholder value creation and we're going to be very disciplined as it relates to the multiples that you referred to. And if multiples take us to an area that's not going to create value for us, we're going to be very disciplined and continue to execute on our strategy to create shareholder value because at of the end of the day, that's got to be the barometer, and that's what we're going to follow very strictly.

Operator

And next, we will go to the line of Adam Samuelson, Goldman Sachs.

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

Maybe the first question, just on the fourth quarter, I'm thinking about the North American margins a little bit more. The margins were flat year-over-year, which is a notable [de-sell] from how they've been trending for all over the past year. And I didn't think you called out organic specialty volume growth in the fourth quarter, which is the second quarter in a row now. Just wondering if you can provide a little more context around that. Is it all just the Mexico pressures that we've talked about? Have there been factors at play on the specialty side? Did that surprise you at all and really just the North American performance generally at a negative variance versus your forecast in the fourth quarter?

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

I mean, I've got margins relatively flat for North America quarter-over-quarter, so I don't know now how you necessarily get into down, maybe we'll...

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

Well, I said de-sell. So you've been trending up more than 100 basis points year-over-year for well over a year. And you were now flat year-over-year in the fourth quarter.

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

And so you just had -- de-sell type of margins are generally attractive on an operating income margin basis. And then I would just say that what we did see was there was a difference between Q4 '17, Q4 '16. Q4 '16, we were running our grind a little bit, higher anticipation of building some inventory as we're bringing some customer commitments online in the first third of the year of '17 versus half of '17 as this expansion of Mexico came on. And in Q4 '17, we didn't have to run the grind as much. We didn't have to build that inventory. So you get a little bit less in terms of cost absorption. And on top of that, it is a little bit -- I mean, I think there was some unique inflation residuals into Q4 from some of the specialty chem or the chemicals that we buy related to kind of what we're getting out of Houston. So -- but other than that, I don't think there's anything necessarily pressuring the overall margins that's unique in Q4.

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

Okay. And the specialty volumes? I mean, were they flat again in the fourth quarter? And was that -- I think...

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

I'm not going to comment on that quarterly.

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

Okay. And then just on '18, I think the comment was North American profit growth up low to mid-single digits. And it seemed like there was an allusion to maybe a more back half weighted growth outlook there. And maybe a little bit more color, if you could, on just the first half versus second half dynamics, its -- the comps, some of the Mexico dynamics and how those layers through the year, corn layout, et cetera.

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

Yes, so the comments were definitely related to Asia Pac as we see the tapioca root costs. So that will impact us in Q1 and Q2, and then we'll see that kind of more recovery in the second half for Asia Pac.

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

Okay. So nothing about the quarterly layout in North America to call out?

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

I would say that within North America, as we look at the Q1 layout, that will be -- I think, probably the most challenging only is that we're looking at kind of just how we look at our volume lapse and the layout of the corn. Other than that, I think they will have fairly -- the lapsing, we don't really comment quarterly. But I would just say to you, I would agree that it's a little bit of a challenge. It should be more -- the historic lower end of our range.

Operator

And our final question comes from the line of Arthur Reeves, Societe Generale.

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

My first question is about NAFTA. I know we keep talking about this, but can you give me an update please as to how you're looking at it now. Have your thoughts progressed? When will it ever come to an end? And my second question is just picking up really on this tapioca issue. What do you have to do to get back on track after that? Do you have to wait for next year's crop? Or can you put price increases through?

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

Thank you for the question, Arthur. So as it relates to NAFTA, we're obviously monitoring the situation like everyone else is. And what we believe is taking place right now is that the negotiations have reached a more conventional stage of negotiation and expectation. And the current consensus is that the negotiations are going to go longer than -- had it been anticipated that they may, in fact, drag past the July Mexican elections and perhaps even towards the end of this year. I mean, that's currently the kind of the consensus view that's forming and that all parties involved are interested in modernizing as opposed to withdrawing necessarily from that then. That's what we're very hopeful of as well. So at this point in time, I would say that everything is tracking more in a conventional negotiation as opposed to what was maybe 6 months ago. And that if the negotiations get completed, it's going to get completed later this year more likely. And then as it relates to tapioca, we've been operating in tapioca -- we've been operating in Thailand and we have 3 manufacturing facilities that all process tapioca. So we are, I would say, very experienced operators in Thailand as relates to tapioca and we've been through this before. Specifically, the last time this kind of an increase in this period of time taken place was back 8 years ago. So we've seen a pretty rapid spike in the last 4 months, and we are passing price increases through very aggressively, passing those price increases through. And as Jim said, we're just anticipating, based the steepness of the (inaudible) a little bit more time than (inaudible) 9 months to be able to get back to a steady state in Thailand.

Operator

And we do have something from the line of Robert Moskow, Crédit Suisse.

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

I guess, it's something, but I'm sure everything has been asked. Operating income expected to be up in South America. If I look at the last 4, 5 years, plans for South America have not played out the way that you expect it. Can you talk a little bit, Jim and Jim, about how much degree of confidence you have that this is the year that you finally found a bottom in South America. And I guess, what could go wrong to offset the plan?

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

Look. Let me start. I think we're kind of competing to answer this question, so maybe there's a message in that. I think that we are -- I'm very confident that we've reached the bottom in 2017 as it relates to South America performance. And the team has persevered through obviously some very, very significant macroeconomic headwinds and conditions and has used it as a means to really get our cost structure, both fixed asset as well as operational costs, as competitive as possible. And we also have made and are making significant investments in specialties to work with our customers locally for specialties growth. And so I'm very confident this year that this year, we will see, based on just how we're positioned in the marketplace with our customers, kind of regardless of the normal ups and downs that you see macroeconomically that based on what I know of the customer-related activity that we have and the anticipations of some business coming our way, et cetera, et cetera, that you're feeling pretty good about where we are positioned in South America for 2018. Jim?

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

And just to clarify, within the first half of 2017, included as a onetime expense all related to the strike in a plant being done in Argentina. We incurred about $8 million of onetime costs, which we do not expect repeat as we go into 2018. Furthermore, we've advertised around $12 million, and I would say, that's our run rate of our savings. I think we've realized maybe $4 million of that in the latter part of Q3 and some of Q4. So we'll pick up another $8 million [plus $1 million] just in terms of run rate savings as we go into 2018. And then on top of that starting point, you'll have, I think, the benefit of some of the volume growth as the Brazil economy continues to grow. I think we're really well positioned to capture that growth upside. And then we're cautiously optimistic around Macri and Argentina as well as kind of some of Columbia's kind of continued growth after implementing a kind of a VAT change in 2017. So just to quantify some numbers for South America, that's why we're feeling that there is a base that has been established, I think, in 2017 and it's going to be better in 2018.

Operator

And we have no further questions. Please go ahead.

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

All right, okay. So before we sign off, I just wanted to thank you for your time today, and I hope to see many of you at the CAGNY Conference, February 20, where we will be sponsoring a luncheon, which will feature our specialty ingredients. So again, thanks for your time today.

Operator

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