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INGR - Q3 2019 Ingredion Inc Earnings Call

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OVERVIEW:

Co. reported 3Q19 net sales of $1.457b, reported operating income of $165m and reported EPS of $1.47.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Third Quarter 2019 Ingredion Incorporated Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions).

I would now like to hand the conference over to Director Corporate Finance and Investor Relations, Ryan Koller.

Ryan Koller - *Ingredion Incorporated - Interim Director of IR & Director of Finance*

Good morning, and welcome to Ingredion's Third Quarter 2019 Earnings Call. On today's call, you will hear from 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 can be found on our website, ingredion.com, in the Investors section. 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, adjusted effective tax rate and adjusted cash flow from operations, which are reconciled to U.S. GAAP measures in Note 2 non-GAAP information, included in our press release and in today's presentation's appendix.

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

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

Thank you, Ryan, and welcome to everyone joining us today. I would like to begin today's call with my perspective on our third quarter performance.

For the quarter, our global net sales were up slightly. Absent $52 million of negative foreign exchange impacts, net sales were up 4% versus the prior year. Our pricing actions delivered $50 million of favorability in the quarter, nearly offsetting all of the foreign exchange impacts versus the year ago period.

Adjusted operating income for the quarter was up 2% year-over-year and up 7% absent foreign exchange translation impacts.

I am pleased to share that North America returned to profit growth and delivered a 5% increase in adjusted operating income.

During the quarter, production utilization increased throughout our network, driven by greater reliability and operational efficiencies as the rebalancing of Stockton volumes took full effect. Furthermore, our successful integration of Western Polymer contributed to North America's growth.

We're pleased that specialty ingredients delivered net sales growth across all regions, led primarily by starch-based texturizers and specialty sweeteners. Consumer preferred demand continues to grow for specialty sweeteners, including non-GMO sweeteners and naturally reduced calorie sweeteners such as Stevia.

To further align with consumer preference for natural sweeteners, we are excited about the opening in a few weeks of our new allulose production line at our San Juan del Rio, Mexico facility.

Our starch-based texturizers delivered solid growth led by specialty potato starches globally. We are formulating systems, which include specialty starches, plant-based proteins and hydrocolloids for consumer-preferred, clean-labeled textural solutions.

For example, we're working closely with customers, both large and small, to innovate and co-create solutions by combining potato starch, pea protein, gums and Kerr extracts to formulate texturized meat alternatives. Capitalizing on this collaboration, we are actively filling our customer pipeline for plant-based protein ingredients.

We are aggressively driving our Cost Smart program, and the results are transforming how we work and deliver value. We have had to make difficult but necessary decisions, which will streamline operations to create a more agile business. For example, we made the decision to move to an import model and cease production at our Lane Cove Australia facility to address, among other factors, persistent corn cost increases due to water scarcity.

In addition, we initiated a significant restructuring of our South America business to reduce organizational layers and enable quicker decision making.

As stated previously, we expect to deliver $30 million to $40 million of 2019 year-end cumulative run rate savings, and I look forward to updating you on the program's full year delivery at our next earnings call.

Now let's move to discussing each region's performance during the quarter. North America operating income was up year-over-year. The increase was driven by improved price mix versus the prior year and benefits from our Cost Smart savings program, which were partially offset by higher net corn costs due to lower co-product values.

South America operating income was also up year-over-year, driven by 3 factors. Favorable pricing actions, which offset foreign currency impacts, higher volume and benefits from our Cost Smart savings program. Our team in South America has done an exceptional job taking aggressive pricing actions against a constantly fluctuating currency environment.

Asia-Pacific operating income was down, driven by increased operating costs in Australia and the continuing weakness across northern Asian economies, impacted by trade disputes.

Our Korea and China businesses have experienced increased input costs and intensified competitive price pressure.

EMEA operating income was down, driven by higher corn costs primarily in Pakistan and foreign exchange impacts, which were partially offset by strong pricing actions.

Now let me turn it over to Jim Gray, who will review the financial results in more detail. Jim?

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

Thank you, Jim. Net sales of $1.457 billion were slightly up for the quarter. Gross profit margin was higher by 60 basis points, driven by favorable price mix, partially offset by higher input costs. Reported and adjusted operating incomes were $165 million and $193 million, respectively.

Third quarter reported operating income was lower than adjusted operating income by $28 million due to restructuring costs related to Cost Smart program. These costs were primarily attributable to the transition of our Australia operations to an import model and planned cessation of production at our Lane Cove facility. We also initiated a significant organizational restructuring in South America.

Our reported and adjusted earnings per share were $1.47 and $1.82, respectively. Q3 net sales of $1.457 billion were up slightly from the same quarter last year. Unfavorable FX of $52 million was primarily attributable to weaker currency valuations. Higher volumes accounted for $9 million of sales increase, while favorable price and product mix was a $50 million increase or 3% of net sales.

In North America, volume was down year-over-year, driven by volume shed as we see ceased wet milling at our Stockton facility last November. Price mix in North America was up 1%, driven by product mix and the pass through of higher corn costs.

In South America, net sales were up 3%, volume was up 5% across the region. Price and product mix were up 13% as our teams took price increases to recapture some of the foreign exchange impacts that we've been experiencing in Argentina and Colombia.

APAC net sales declined 1% due to foreign exchange impacts and unfavorable price mix. This was partially offset by favorable volume driven by specialty growth.

EMEA experienced lower net sales due to foreign exchange impacts primarily in Pakistan, that were only partially offset by favorable price mix and volume.

For the quarter, reported and adjusted operating income increased $10 million and $4 million, respectively.

North America operating income increased $7 million due to improved price mix, the lapping of unplanned outages in the prior year and benefits from our Cost Smart program, which were partially offset by higher net corn costs.

South America operating income was up by $5 million, driven by aggressive pricing actions to offset foreign currency impacts, higher volume and benefits from the Cost Smart savings program.

Asia-Pacific operating income was down $3 million from the year ago period, driven by increased operating cost in Australia and the continuing impact of trade disputes, which have increased input costs and intensified competitive price pressures.

EMEA operating income was down $2 million from a year ago, driven by higher corn costs and foreign exchange impacts, which were partially offset by strong pricing actions primarily in Pakistan.

Corporate costs were higher by $3 million for the quarter, driven by a lapping of prior year adjustments and continued investments to drive innovation and optimize global processes.

Let me turn to the third quarter 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 increase of $0.03 per share, driven by margin and volume improvements $0.06 and $0.10 per share, respectively.

Foreign exchange impacts were an unfavorable $0.11 per share and other income was a decline of $0.02 per share.

Moving to our nonoperational items. We saw an increase of $0.09 per share for the quarter, driven by lower average shares outstanding, which contributed a benefit of $0.12 a share.

Financing costs include the impact of hyperinflation and revaluation of Argentina's peso denominated balances, which are lapping 2018's initial peso devaluation.

Moving to cash flow, year-to-date cash provided by operations was $490 million. Capital expenditures were $231 million, down slightly from the prior year. Acquisitions and investments were $52 million, reflecting investments in Western Polymer and other ventures, and we have returned $131 million year-to-date to investors through dividend payments.

Turning to our income statement outlook. Due to the expected impacts of trade disputes weakening the economy of our northern Asian businesses, political uncertainty in Argentina and the postponement of Brexit, we have lowered our expectations for the fourth quarter. As a result, we anticipate 2019 adjusted earnings per share in the range of $6.45 to $6.65. We expect net sales and adjusted operating income to be down versus last year.

FX impact is expected to be a negative $0.45 to $0.55 per share, which is an increased impact of a negative $0.05 over our prior guidance due to the continued currency weakness in EMEA and softer economic growth in northern Asian businesses.

We expect corporate expenses to be moderately higher year-over-year as we invest in global business process optimization, digital capabilities and innovation, partially offset by Cost Smart savings.

2019 financing costs are expected to be in the range of $85 million to $90 million, including the effects of Argentina hyperinflationary accounting and revaluation of peso-denominated balances impacting the second half of the year.

Our adjusted effective annual tax rate is expected to be between 27% and 28%. We expect total diluted weighted average shares outstanding to be in the range of 67 million to 68 million for the year considering the impact of the accelerated share repurchase agreement.

As Jim mentioned, we are very pleased with the momentum we have developed behind our Cost Smart savings program, which is helping to transform our business. We expect to deliver $30 million to $40 million in 2019 year-end cumulative run-rate savings.

In North America, 2019 net sales are expected to be slightly down and operating income is expected to be down assuming higher net corn costs, which have been negatively impacted by late crop plantings an expected later harvest in the U.S. and a greater cost to move corn across the U.S. In addition, continued crop inventory imbalances arising from the U.S.-China trade dispute are expected to depress co-product values.

Moving to South America. Full year net sales and adjusted operating income are expected to be down. Volumes are expected to be up modestly. Most of the impact from currency weaknesses was experienced in the first half of the year. However, we are watching closely the presidential transition in Argentina for any policy changes that may impact our business.

2019 Asia-Pacific net sales and operating income are expected to be down, due to the impact of trade disputes between the U.S. and China as well as between Korea and Japan and foreign currency weakness across the region. The currency weakness of the Korean Won has resulted in higher transactional corn costs, which are difficult to pass through while the local economy is experiencing a slowdown.

In EMEA, we expect net sales to be flat to down. We expect operating income to be down due to currency impacts throughout the region, higher raw materials cost and the postponement of Brexit to January next year.

In past conversations, we have highlighted that our business experiences some seasonality as the summer months in the northern hemisphere bring greater demand for our ingredients. Therefore, as we complete 2019, we expect similar seasonal demand to be reflected in our results.

In 2019, we expect cash from operations to be in the range of $600 million to $640 million. We expect to invest between $335 million and $355 million in capital expenditures, of which a significant portion will support our specialty growth platforms. And as Jim stated in his opening, we are committed to returning value to shareholders. Our 1% dividend increase this year reflects our desire to balance the cash-generating capacity of our core business with future investments to fund organic specialty growth opportunities.

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

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

Thanks, Jim. As you heard from us today, we are delivering on our strategy and are pleased that the business demonstrated growth. The network optimization moves that we have made -- and our progress, improving operational efficiencies are paying off. We delivered specialty net sales growth across all 4 regions, and our team continues to advance our roadmap for driving growth. Our recent specialty investments provide new and expanded capabilities that position us even better to meet the growing consumer demand, serve our customers and deliver net sales growth. As the leader in starch-based texturizers, combined with our new plant-based protein offerings, we are broadening our portfolio of consumer-preferred, clean-label ingredients and systems. Doing so, enables us to increase our solutions capabilities to co-create with customers to successfully drive their growth and ours.

And now let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Robert Moskow with Credit Suisse.

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

Jim, and Jim, I know that you were in the progress earlier this year to try to educate customers about the impact of falling values for corn byproducts and what that might mean for pricing going forward on corn sweeteners. And I just want to know if you can give us an update on how that's being received? And whether you think that will help you take the pricing you need? And then secondly, does it open up any kind of a risk that byproduct values are pretty volatile? If they start rising again, does it open the risk that those customers might demand that pricing to be revoked, I guess?

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

Okay. Let me take it first, and then I'll turn it over to Jim Gray. So thanks, Rob, for the question. As we look ahead to 2020, to your point, we continue to face 3 factors impacting our net corn costs. One is certainly the uncertainty of the crop size leading to higher gross cost of corn, co-product values which remain at a structurally lower level than it has been historically, and also the higher cost to move corn, which is reflected higher basis costs. And all 3 of those factors will certainly be important considerations in our pricing actions. And specifically, as it relates to the structurally lower corn co-product recoveries. We are carefully looking at all of our customers and analyzing our pricing requirements as we go into contracting for next year and where we need to make adjustments with how those pricing contracts are structured. And so we're looking to optimize against all 3 components of the corn cost increase. But in particularly, what we're customers is educating customers and working with customers to share in the cost increase of something that has structurally impacted the entire industry. And so I think whatever model we come up with is meant to take into account what might happen in the future as well.

So hopefully, that answers your question. Jim, do you want to add anything in addition?

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

No. I mean I would only add that I think when we were heading into '19, having experienced some depressed values for corn gluten meal and for corn oil, we viewed it really as something that was more temporal, and we've continued to experience those lower co-product values throughout all of 2019. And so I think when we're having the conversation with the customers who understand corn and the corn structure quite well, they're facing that choice, which is we need to the able to figure out how we can't just take a one-sided impact to our cost of corn and that would differ traditionally what we have done in our business. And so very much to what Jim said, and we are exploring different options with customers in order to make sure that as we go forward as -- hopefully as the U.S.-China trade dispute unwinds, and there is more of a rebalancing of how soy ships out of the U.S., and we see some values for our corn co-products returns, that is a benefit that -- not just to us but our customers as well.

Operator

And our next question comes from the line of Ken Zaslow with Bank of Montreal.

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

Can you frame how much the U.S.-China and Japan-Korea trade issues have depressed 2019 operating profit?

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

For Asia-Pac?

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

For Asia PAC regions?

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

Oh, no, no, for the whole company. For -- the U.S.-China first, is kind of the bigger one I think. And then you mentioned Korea, Japan. But -- I just want -- not just for APAC, but just for the company. Just so if there was a resolution, what would return and what wouldn't return, how to think about it I guess is kind of the framework on that. I think that's kind of where I'm looking to go.

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

Yes. I think we understand clearly your question. And Jim and I are discussing it here. It's actually a very good question because I think what we should do first is just breakdown for everyone the components of that. So U.S.-China trade dispute obviously impacts the soy complex and the impact on coproducts and net corn costs. And then equally, you have an increase in tariffs on imports going into China. You have a depression related to the economies in northern Asia. You have trade disputes between Japan and Korea as well as between the U.S. and China. And we're seeing some macro economic impacts there.

So Jim I'll I'm going to turn over to you to try to help quantify the perimeters around that.

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

Yes. Yes. I mean I think, Ken, as we look to impact in the North America business from '18 into '19 in terms of the co-product values that we think have not passed through, that's probably in excess of $20 million impact to the region.

On the flip side, when we look at our Asia-Pac business, clearly, what we're seeing in China is, as you have a higher tariff on the imported goods that's raising our need to try and price, it's a competitive market in China, lots of customers and couple of local options. And so I would say that, that is putting some pressure on China. And then, probably more of an impact for us has really been Korea. And the Korea -- with the Korea won showing some weakness, the producers in Korea buy corn off of the world market. That increases the transactional cost of that corn. And with the economy slow, it's very difficult to price through, the demand isn't there. So I would probably say that Asia-Pac impact, if I look kind of year-over-year, it's struggling excess of $10 million, right, combined.

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

Yes.

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

Great. And then my -- just my second question is, in the U.S. you said your utilization rates had gone up. Can you talk about where they were, where they are now? And then how that's impacting pricing into 2020? I'll leave it there.

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

I would just say that they have improved significantly based on the focus, the intense focus that we have put on -- up on reliability improvements and operational efficiencies. And they are operating at higher levels of capacity utilization than they were certainly in 2018 and in the earlier part of the year. And so with that, along with the 3 factors that are contributing to the cost increases that are, we think, very well justified and understood, and again, we're doing some educating with customers specifically, it positions us as best as possible as it relates to pricing as we go into contracting for 2020.

Operator

And our next question comes from the line of Brett Hundley with Seaport Global.

Brett Michael Hundley - *Seaport Global Securities LLC, Research Division - Research Analyst*

I wanted to dig in first on your volume performance in South America during the quarter. Can you just give us some added color on where this is coming from either from a countries or a product standpoint as you do take pricing across the region? And then how sustainable you think this is just given all the headline challenges in place across the region?

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

Yes. I'll just make a quick comment and turn it over to Jim. I think that one of the things that we were pleased about was that our -- in Brazil, adjunct volumes for us were up mid- to high single digits for the quarter. I think the brewing sector had a weaker quarter. But we did...

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

We feel positive on it.

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

We did pretty well on volumes. So that was one. And I would say what we've have -- not necessarily related to volume, but we've just done an exceptional job, really, the South American team in light of incredible ForEx headwinds have put through significant pricing to offset and to mitigate that ForEx impact, specifically in Argentina and in Brazil. And obviously, even Columbia has been impacted by ForEx devaluations. And we're doing that there is well. So Jim, you want to make some additional comments?

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

I think maybe the only -- obviously, into the -- in the growth that we saw in Brazil and in Andean. What may be surprising was just that you have to step back in Argentina to Q3 and Q4 in '18, and the consumer was really shellshocked by the devaluation of the peso, it wasn't planned, it wasn't expected. It was post kind of the traditional national wage increases. And so I think it really left consumers in Argentina really tight on their pock book. And what we've seen now here in Q3 and Q4 is actually some better volume into the types of beverage and food products, even though still uncertainty in the peso, the return of the consumer to somewhat of the return of the consumer to the grocery store and what I might characterize as a normal grocery cart, I think that some of that's occurring because we are seeing volume increase in Argentina.

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

The other thing that I would just add to that is, just as it relates to the outlook. One of the things that I'm sure you all saw is the progress in Brazil, that pension reform did pass, and it now will become law. And so that's leading the government to now look to fiscal reform on top of pension reform. And so that has put a little bit of an upward trajectory from neutral, I would say, to positive because of the progress in Brazil. So we're hopeful that, that stimulates economic growth, not in the 1% range, which has been for the last year or 2, but something a little bit higher as we head into next year. And that will stimulate more volume growth. So I would just -- that's what I would add to that.

Brett Michael Hundley - *Seaport Global Securities LLC, Research Division - Research Analyst*

I appreciate those comments. And then just my second question is actually on the M&A environment. So you guys, obviously, have your stated goal of mixing toward specialty over time and you're certainly affecting that strategy internally by developing capabilities on plant protein, allulose, et cetera. But obviously, M&A does need to be a sizable part of that conversation, at least, in my opinion in an effort to derisk and grow the business on a faster time line, while also acquiring new technologies and expertise. On the topic of maybe more meaningful M&A, do you guys think that the deal market has become more challenged in recent time? One of the main reasons I'm looking too is, one of my other ingredient companies has had a hard time in acting a similar M&A strategy moving toward specialty, and it now appears they're going to go private with the help of private equity in order to compete better for future targets. So I wanted to get your perspective on the deal market for specialty ingredient companies right now. It seems like they're out there, but it also seems like there is a void of activity.

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

Yes. I mean I think that for us, we remain very focused on building out the 5 growth platforms that we've identified that are very much on trend. And we're looking to add on to those value propositions that underpin each one of those growth platforms with either business acquisition M&A or through technology capabilities that we're adding.

And as it relates to the market at large, I think that certainly over the last number of years multiples have increased and that makes it more challenging to get the math to work from a standpoint to making sure that you're deploying shareholders assets wisely to make sure that you're going to get a return. So -- but that all being said, what I would say for us is we have still a very active M&A pipeline, when you think about 5 growth platforms that are very on trend. And so we are evaluating at any one time always a number of opportunities. And so we have active discussions and meetings, but at the same time, want to make sure that the value and the terms and conditions would be beneficial to us. So that's how I would answer it.

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

I mean Brett, I would just add that sometimes it's easy to focus back on the U.S. market or the Western Europe market for ingredients companies. But our footprint and our connections with customers and with distributors and with other kind of other competitors around the world really leads us to a lot of different opportunities. So we absolutely are looking at Asia-Pac, we're looking at South America, we're looking at the rest of the region through EMEA. And so when we think about very active discussions in our pipeline, we're looking at where we can add in those various geographies to our existing business. I think really the benefit of coming up with the driving growth roadmap and being very clear about where we want to go has really also then helped us align with other companies that may actually look at Ingredion as a strategic partner or ultimately someone to collaborate with.

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

Yes. I mean -- and the other thing is that we are also looking to partners with companies, and specifically in the of allulose, we partnered with a Japanese company that had great technology that enabled us to enter that market. So there's a variety of opportunities I think open to us to continue to grow, both organically and inorganically.

Operator

Our next question comes from the line of Heather Jones with Heather Jones.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

So I had -- I guess I had 2 questions. And I was -- I wanted to start with, could you give us a sense of -- based upon your analysis of the region -- your footprints region and all, what are your thoughts about basis trends for corn in the U.S. market going into 2020? It's just I don't know if you -- did you finalize your thoughts, but...

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

Yes. We can answer that. I think we're sitting here in Chicago this morning on Halloween and it is snowing outside and some parts may get 5 inches of snow today. So -- and this is a second pretty significant snow storm here in the early part of the fall. So that has added to the late corn harvest, which everyone was worried about, and now it's about being able to move and transport corn. So actually, we're actually seen an increasing trend towards basis as we head into contracting in 2020. Jim, do you want to add something?

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

Yes. I mean it's -- I think it's spread a little broader, right? And that given the late plantings early on, I think there was some issues in the eastern part of the corn belt to move corn kind of maybe across summer. But obviously, as the moisture content is higher on the corn and farmers desire to leave it on the field and not pull it off necessarily and have to absorb any type of discount for that corn. What that is a bit of it to and fro is that, you need to dry field and you also need some lovely dry fall weather to dry out that corn. And so you've got a blizzard in the upper plain states. You're now having Chicago across the kind of a broader mid part of the corn belt. And so I just don't think that things are necessarily setting up for anything that's going improve immediate availability of corn in drive basis a little bit lower.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

And remind me of how you purchase your specialty corn? I mean do you have to deal with basis there as well? And if so, how is the basis outlook for that?

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

Jim. Do you want to comment?

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

Yes. So we -- generally, with our different varietals of specialty corn, we're just -- we're prearranging with farmers to make sure that they're dedicated the acres to planting that, and they get a small premium for that commitment to us. And that corn is typically growing very close proximity to those plants that are specialty plants. So transportation cost can be a little bit lower in that regard, yes.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

Okay. And then going back to your comments about the contracting season for 2020 and your conversations with customers as far as the challenges on the byproduct recovery side. So in discussing this and sharing the burden of that challenge, are -- is Ingredion moving more towards higher tolling mix? Or I mean is that essentially what you all are talking about because I think historically, Ingredion's mix has been more fixed price, less tolling. But with this -- would this be shifting you more towards tolling? Are you talking about some other kind of arrangements?

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

Yes. Just to kind of correct one of those assumptions. Historically, what we've said is about half of our business in U.S./Canada is fixed versus what we call fee or toll business. And what I said is the input cost increases that we're seeing and the industry is seeing is, in some ways, unprecedented in relationship to the decoupling of co-product values from the cost of corn. And so that does require us as we head into 2022 to look across the entire segmentation of our customers and where we have either fixed or toll and look at what makes the most sense based on those educational discussions and those exploratory discussions that we're having with customers to share in the cost increase, especially as it relates to the cost of co-product recoveries, whereas any increases in gross corn cost or bases is clearly well understood. So I think I would just say that we're taking a very analytical and methodical segmentation approach to our customers since we see something has structurally changed and it really requires us to do that and have those discussions with customers going forward.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

Okay. And my final question is, this is a big if, but if you assume the ForEx stabilized, not any dollar weakness or -- but just stabilized, what could that add to 2020 earnings for you just to be able to catch up on price and not have to -- not constantly playing catch up? How much do you estimate that could add to 2020 EBIT?

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

Yes. Let me make an opening comment, and I'm going to turn it over to Jim. So I just want to remind everyone that if you look at our year-to-date ForEx headwinds that we've had to offset in price, we've priced year-to-date through 75%. In the quarter, we had $50 million of price increase against $52 million of ForEx. So we are getting through the pricing increases that we need to get through. So -- and we've gotten, I don't know, say better, but certainly stronger muscles in regards to dealing with something that's been such a significant headwind for us. If that were to stabilize, Jim, going forward?

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

Well, I guess, it depends on what point in time you choose to say, okay, the dollar is not going to move versus the variety of currencies in different territories in which we do business. Let's just say, though, that if you held it here, we're still going to have some first half headwinds if you look at the European currencies and a little bit in terms of where more than northern Asian currencies are, those really have had kind of some additional weakness here more in the second half of '19. And then you always have our kind of 2 bigger movers which are -- what happens within Pakistan and what happens with Argentina. I would say that Pakistan is a little more stable, given the country's view towards the IMF and their choice of towards their monetary policy. But Argentina, I think is still always a question mark. So I'm going to hold off and trying to quantify it, we can follow up on that because I think it's still a little early in the year to be calling 2020 impacts due to FX. But I do -- I very much appreciate the sentiment and it probably does weigh an investors' minds in terms of, hey, when does this amazing strength in the dollar that we've seen start to just flatten relative to some other developed or emerging economy.

Operator

And our next question comes from the line of Ben Bienvenu with Stephens.

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

I want to ask if you could provide some follow-up color on your comments around the restructuring of South America's business. Any elaboration you can provide on whether that tends to capacity adjustments or otherwise would be helpful to give us a sense of understanding what's going on there?

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

Yes. Just a reminder, over the last few years, we've taken some restructurings in relationship to some asset consolidations in South America. In fact, we closed 2 facilities back about 3 years ago, that laid -- that led to $6 million to $8 million of savings, if I remember. This is a more comprehensive and sweeping view across both operations and go to market. It does not involve any asset consolidations or closures...

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

Organizational.

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

It's much more around organizational agility, reducing spans and layers, clarifying lines of accountability and also operating as one South America region because we do have 3 subregions, one would be Brazil, the largest country, largest subregion. You have the Southern Cone, and then you have the Andean region. And so what we've done is, we have consolidated. An example would be around manufacturing and supply chain excellence to now have that operate as one operations function, streamlining the direct lines of reporting to share best practice and drive one management operating system for manufacturing operations, supply chain and procurement, for example. And it's really been met with a lot of very positive receptivity. And that's going to be a major driver for us as we head into 2020 to not just deliver savings, but also drive efficiencies.

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

Great. Very helpful. My second question relates to capital allocation. We've talked about M&A, but I'm curious, what is your thought process on embracing a more aggressive buyback strategy in light of current challenging fundamentals weighing on valuation, juxtaposed with still good cash generation and a pretty solid balance sheet.

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

Jim, do you want to take that?

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

Yes. Sure. So when we - I think what I've described to yourself and investors is that, we look at our overall cash from operations each year. And we're trying to target both, first, our capital investments necessary to maintain our existing plants, but are also putting some capital towards organic growth opportunity. Those organic growth opportunities tend to have very attractive returns and payback relative to the investment time line. They're also kind of the least risky because usually it's an area where our team has a lot of familiarity with the capabilities and capacities that we're adding.

Second, we think very much about the dividends. And then we have the remainder, which is typically 30% to 40% of our cash from operations. And that's going to the kind of more strategic cash flow. So if an M&A is available and it has appropriate synergies and an attractive return and it fits in our strategy, we'll pursue that because that's going to be a higher return than our WACC. But we'll also look at that cash flow and in conversations with the Board, think about how we approach share repurchase and enhance the total returns, the total payback to our shareholders. But generally, we're going to prioritize organic opportunities in growth and M&A that's attractive, accelerating against the 5 growth platforms. First, that tends to be a better return for our overall shareholders. We're very attuned to the dividend as one way of reflecting the cash generative capabilities of our company and are quite proud of -- we are -- for 5 years in a row now with consecutive dividend increase. And then we'll always make sure that we're looking at the valuation of the stock and thinking about share repurchase.

Operator

And our next question comes from the line of Adam Samuelson with Goldman Sachs.

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

I was hoping first to really make sure we're clear on kind of the components of the tempered full year outlook, and it seems like most of that's baked into 4Q. And if you could just kind of bucket it amongst the key drivers of what became more pressured in the business between FX. Seems like FX, higher corn costs in North America and kind of the below line the financing tax components and the mix of earnings are biggest divers. But if you could bucket and quantify those a little bit and just maybe expand on how many -- how much of those we should think about as continuing into 2020, whether it's financing, whether it's kind of how corn costs look like they're laying into next year? And then a follow-up.

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

Yes, happy to, Adam, because I think this is important. So as we finish the year, we expect our full year earnings guidance to be impacted really by 3 factors and in this order. So within our higher financing cost reported line item, you get the impacts of hedge gains or losses. This is also where changes in balance sheets, particularly in Argentina were hyperinflation. Those changes in the balance sheet now under hyperinflation accounting impact the P&L. And that's where it impacts the P&L. So instead of going to all other comprehensive income. It impacts the P&L. So first is the impact of Argentina hyperinflation, really, as a reminder that we've revalued that balance sheet in Argentina pesos back to dollars. And so that's the first impact that will be felt really in -- a little bit in Q3, but in Q4.

Number two then is just our effective tax rate, really just due to the mix of earnings is really between 27% and 28%. So that's just -- I think it's a little net higher than where we previously guided. And that's just how the income generation is earning across the different businesses. And then finally, our adjusted operating income is expected to be flat to slightly down, really driven by lower expectations for Asia-Pacific, really due to the higher raw material costs in Australia. It's a very expensive corn crop this year in Australia. And weaker gross margins across our northern Asian businesses due to higher input costs. So each of those drivers are contributing approximately 1/3 of the change in our EPS guidance.

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

Okay. And just to be clear, in North America then. So you're saying the impact of North America of the higher corn cost of delayed harvest basis and the freight cost that you're absorbing that is not dramatically worse than you'd previously contemplated? I'm just making sure I'm clear on that point.

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

Yes. That's correct, you're right.

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

That is coming in Q2, and we really talked about, well, we're anticipating the North America might finish the year stronger where we kind of updated our outlook to -- for operating income to be down. What we were really considering was really just a higher net corn cost, both in Q3, but particularly in Q4. So I think we've previously had kind of guided to that.

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

Okay. That's helpful. And then follow-up. As we think about next year and there's been a lot of ground covered on contracting already, but just wanted to make sure, would you characterize -- would you characterize the contracting progression kind of to date? I mean it's the end of October, would you say that we're on schedule? Things is lower than normal? Faster than normal? And just how kind of the receptivity to some of these changes on kind of co-product basis and the impact that, that has on price, just how do you feel that's being received by your customers?

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

Yes. I mean I'll make a comment as best I can. Typically, we don't make comments in relationship to contracting for the forward year. What I would say is that because of the corn situation in relationship to the uncertainty around the crop, the elevated bases levels, I think you're seeing customers moving more slowly in relationship to commitments that they would like to make in hope that there may be some relief related to which way the weather would break or some of the input costs that they're being educated on and they do understand themselves. So I would say the contracting is slower than it may be against, say, a 5-year historical norm. But it will get done -- it typically gets done in a flurry towards the end of the year. But I think it's slower this year, but then that will be catalyzed by, I think, companies that have only so much supply to allocate and we'll need to complete contracting in a more compressed time period. So -- but it's a little bit slower I think out of the gate than -- for those reasons that I just described.

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

Maybe just to iterate, I mean, customers I think, generally, across the U.S., they do understand year-to-year change in just the growth cost of corn. They can look at what the forward strip might say and just the forward strip on corn is higher this year. And a lot of customers might just choose the wait for an opportune moment. So we're not worried about it, we just think it's a little bit...

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

It's just a little bit slower, and it's human nature on the part of the customers to behave the way they are, given the way corn has increased from a net corn standpoint in all of its components.

Operator

And I'm showing no further questions at this time. I will now turn the call back over to President and CEO, Jim Zallie, for closing remarks.

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

Thank you. I would just like to thank everyone today for their time, and we all hope to see you again in the very near future in our travels. So thank you so much.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.