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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Ingredion First Quarter 2023 Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Noah Weiss, Vice President of Investor Relations. Please go ahead.

Noah Weiss - *Ingredion Incorporated - VP of IR*

Good morning, and welcome to Ingredion's First Quarter 2023 Earnings Call. I'm Noah Weiss, Vice President of Investor Relations. On today's call are Jim Zallie, our President and CEO; and Jim Gray, our Executive Vice President and CFO. The press release issued today and the presentation we'll reference for the first quarter results can be found on our website, ingredion.com, in the Investors section.

As a reminder, our comments within the presentation may contain forward-looking statements. These statements are subject to various risks and uncertainties and include expectations and assumptions regarding the company's future operations and financial performance. Actual results could differ materially from those estimated in the forward-looking statements, and Ingredion assumes 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 on the company's most recently filed annual report on Form 10-K and subsequent reports on Form 10-Q and 8-K.

During the call, we will also refer to certain non-GAAP financial measures, including adjusted earnings per share, adjusted operating income and adjusted effective tax rate, which are reconciled to U.S. GAAP measures in Note 2 non-GAAP information included in our press release and in today's presentation's appendix.

With that, I will turn the call over to Jim Zallie.

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

Thank you, Noah, and good morning, everyone. We started the year with exceptional performance, delivering our highest ever quarterly profit and earnings per share. Net sales grew 13%, and adjusted operating profit was up 39%, driven by broad-based growth in both core and specialty ingredients. From a segment perspective, net sales were up in each region with notable increases in North America and EMEA.

Entering this year, we anticipated a second consecutive year of corn and manufacturing cost inflation. Our sales teams effectively executed product and customer mix management, including price adjustments against expiring multiyear customer contracts to deliver mid-double-digit price increases and successfully expanded margins for the third consecutive quarter.

Now turning to our strategic pillars. Our teams continue to do an outstanding job executing against our 4 strategic pillars for growth. Beginning with Specialties growth, we achieved a double-digit increase overall, driven by Clean & Simple ingredients, which were up 20%, and Texturizers, which were up 13% from the same period last year.

Turning to Commercial Excellence. We further fine-tuned our pricing centers of excellence to optimize price and customer mix, and we were able to renew expiring multiyear customer contracts to reflect current market pricing as industry fundamentals remain strong. In addition, we progressed our trade-up strategy for core ingredients. Evidence of this can be seen, for example, in our U.S. Canada core sweetener products, where both volumes increased and gross margins expanded for the first time in several years.

Against our Cost Competitiveness pillar, we improved service delivery and selectively increased inventories for those specialty product lines that have been in the highest demand over the last 2 years. This inventory investment to strengthen supply chain resiliency also provided improved fixed cost absorption as our plants operated well throughout the winter quarter.

Supply chain constraints eased significantly, reducing the need for costly premium routes. In parallel, we have invested in global digital order tracking to provide real-time transparency to customers. This additional investment in logistics tracking capabilities is enhancing the customer experience. I'm also particularly proud of how our global procurement team has anticipated and responded to agri supply risks through our global sourcing network. This has enabled us to effectively meet customers' demand, despite isolated regional grain shortages.

Lastly, our purpose-driven and people-centric growth culture, as always, remains a top priority for us. Just this week, we announced the appointment of a 26-year Ingredion employee and industry veteran, Rob Richie, to the role of Senior Vice President, Food and Industrial Ingredients, Americas. Rob has joined my executive leadership team with responsibility spanning both North and South America.

In addition, in 2023, we are pleased to have been recognized by Ethisphere for the 9th time as one of the World's Most Ethical Companies and to have been included in the Bloomberg Gender-Equality Index for the 6th consecutive year.

Now turning to our Specialty growth highlights. During the quarter, Specialty Ingredients continued their positive momentum, achieving double-digit net sales growth. Better price and customer mix favorably impacted net sales growth, which was partially offset by customer inventory rebalancing and softer overall category volumes. During the quarter, PureCircle continued to win business with customers by co-creating natural high-intensity sweetener solutions using our Stevia portfolio to replace artificial sweeteners.

The number of sugar reduction projects continue to increase, driven by customers' preference for high-intensity natural solutions. Our Clean & Simple ingredient platform benefited from the ramp-up of the capacity expansion completed in 2022, which is now exceeding our commercial growth expectations, enabling us to meet customer demand in both the U.S. and Europe.

Our KaTech Food Systems business continued to exhibit strong net sales growth in the quarter, up over 40% from last year, driven largely by wins in North Africa and Europe. This commercial integration has gone extremely well, and we are winning new contracts in both developed and emerging markets.

Finally, our Shandong China expansion for starch-based texturizers is enabling solid volume growth with sales ahead of expectations. I'm pleased to say that this strategic investment is delivering preferred local supply to meet China's growing domestic demand for highly functional, modified starches.

Overall, when it comes to specialties, we continue to see a number of exciting opportunities to invest, to drive both organic and inorganic growth and expand our portfolio.

Before I turn it over to Jim, let me comment briefly on our continued progress against our sustainability targets. We will soon be issuing our 12th annual edition of our All Life sustainability report.

As a quick preview, we are well on our way to meeting our goal of having 100% of our Tier 1 crops sustainably sourced by 2025, having reached 48% at the end of the quarter. Our commitment to reducing Scope 1 and Scope 2 emissions progressed meaningfully last year with the conversion from coal to natural gas at our largest site in Bedford, Illinois. This year, we are installing renewable biomass boilers at our 2 largest facilities in Brazil and switching to 100% renewable electricity, thereby reducing CO2 emissions by 7% annually in Brazil.

With that, let me turn it over to Jim for the financial review.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Thank you, Jim, and good morning to everyone. Moving to our income statement. Net sales of approximately $2.1 billion, were up 13% for the quarter versus prior year. Gross profit dollars grew 28% versus prior year, driven by a combination of factors that Jim has mentioned and that I will highlight further in one moment.

It is encouraging that gross margin is above 20%, and beginning to resemble historical averages, even though corn costs remain elevated globally.

Reported and adjusted operating income were $291 million and $296 million, respectively. The increases year-over-year were driven by favorable price and customer mix, partially offset by higher input costs and lower volumes. Reported operating income was lower than adjusted operating income, primarily related to the remaining costs for the U.S.-based work stoppage at Cedar Rapids facility, which returned to normal operations in mid-February.

Our first quarter reported and adjusted earnings per share were $2.85 and $2.80, respectively, for the period, up significantly from the prior year.

As Jim mentioned, our sales teams effectively executed product and customer mix management to deliver mid-double-digit price increases to cover anticipated double-digit corn and input cost inflation. As economic growth slowed in the quarter and supply chain costs moderated, actual cost inflation, albeit still in the mid-double digits per ton, was lower than expected, which contributed to record operating income.

Turning to our Q1 net sales bridge. We achieved strong price mix of $424 million, including the pass-through of higher corn and input costs. This was partially offset by decreased volumes of $116 million and foreign exchange impacts of minus $63 million.

Turning to the next slide. We highlight net sales drivers for the first quarter. Foreign exchange was a minus 3% headwind in the quarter with the most significant impact in EMEA, particularly in Pakistan. Sales volume was down minus 6% as we experienced the impacts of economic slowdown against some of our product lines such as industrial starch and the paper making and corrugated box assembly as well as some customers, primarily selling food products and the food service sought to rebalance their inventory levels.

We anticipate sales volume demand improving steadily from Q1 levels throughout the second half of the year. Contributing to net sales growth, price mix was up 22% compared to prior year due to North America and EMEA executing value-based pricing to improve customer mix.

To highlight the drivers of improved gross margin, I would like to make a few comments. To begin, as we were entering 2023 contracting, we were anticipating double-digit corn and manufacturing cost inflation. Our sales teams approached customer contracting with the objective to begin to restore the margin compression that we experienced in 2021 and 2022 as corn prices and other input costs increased globally.

As we completed the quarter, our actual cost inflation, while still significant in the mid-double digits per ton, was lower than anticipated. Also, our manufacturing costs in the quarter benefited from favorable fixed cost absorption as we ran our plants well and made progress to increase specialty ingredient availability. We also carried lower cost of inventory from the fourth quarter into the first quarter.

Combined with new higher contract pricing beginning in January, we experienced a one-time bump in North America and Europe businesses. We expect contract pricing to remain at Q1 levels and primarily higher corn costs, absent the hedge gains from last year to work through inventory as we progress throughout the year.

Importantly, we continue to make structural improvements to the business from increased specialty sales contribution, new markets for trading up core ingredients and expanded commodity hedging. These improvements are not transient changes that will go away once inflation subsides, but will endure to strengthen our margin profile.

Let me turn to a recap of Q1 regional performance. North America net sales were up 16% when compared to the same period in 2022. The increase was driven by strong price mix where dynamic value-based pricing and customer mix optimization drove top line performance.

North America operating income was $207 million, up 33% versus last year. In South America, comparable net sales were up 7% versus last year and up 12% on a constant currency basis. South America operating income was up 8% to $41 million, with increases primarily driven by favorable price mix, partially offset by higher input costs, foreign exchange impacts and lower volume. Excluding foreign exchange impacts, adjusted operating income was up 18% for the quarter.

Moving to Asia-Pacific. Net sales were up 2% for the quarter and up 7% on a constant currency basis. Asia-Pacific operating income was $28 million, up 27% versus prior year, recognizing the unfavorable impacts in the prior year due to Omicron lockdowns. Favorable price mix was partially offset by higher input costs and lower volumes. Excluding foreign exchange impacts, adjusted operating income was up 32% for the quarter.

In EMEA, net sales increased 21% for the quarter, and absent foreign exchange impacts, net sales were up 36%. EMEA operating income was $57 million in the quarter, up 84% compared to the prior year. This exceptional performance was attributable to Europe, which benefited from the combination of favorable timing of new contract pricing and lower cost of carry in inventory from the fourth quarter.

This performance was partially offset by macroeconomic challenges in Pakistan and foreign exchange impacts across the region. Excluding foreign exchange impacts, adjusted operating income doubled in the quarter.

Turning to our earnings bridge. On the left side of the slide, you can see the reconciliation from reported to adjusted earnings per share.

On the right side, operationally, we saw an increase of $0.88 per share for the quarter. The increase was driven primarily by an operating margin increase of $1.42, partially offset by unfavorable volume of minus $0.36 and an unfavorable foreign exchange of minus $0.12 per share.

Moving to our non-operational items. We had a decrease of minus $0.03 per share in the quarter. This decrease was primarily driven by higher financing costs of minus $0.09, offset partially by a favorable tax rate.

Moving to cash flow. First quarter cash from operations was minus $51 million. Through the end of Q1, our net working capital investment is $300 million, and we expect this investment to remain relatively flat or slightly lower for the balance of the year, assuming the current volume demand trend and corn cost layout. Net capital expenditures were $75 million and in line with full year expectations.

In the first quarter, we paid $47 million in dividends to shareholders and announced our quarterly dividend of $0.71 per share to be paid in the second quarter.

Now I'd like to walk through our updated 2023 outlook. We now expect net sales to be up high single digits to low double digits, reflecting softer sales volume and the anticipated layout of corn costs.

As a reminder, a significant portion of our revenue is tied closely to changes in the value of corn or other raw materials. If corn prices decline, we pass through lower corn costs to our variable contract rate customers usually within a few months with little to no impact to our gross profit dollars. We now expect reported and adjusted operating income to be up high double digits compared to last year.

2023 financing costs are now expected to be in the range of $115 million to $130 million, reflecting higher net debt balances and fluctuating exchange rates. Our adjusted effective annual tax rate is anticipated to be between 27% and 28.5%. Cash from operations is expected to be in the range of $550 million to $650 million, which reflects the investment in working capital that I mentioned earlier.

Capital expenditures for the full year are expected to be approximately $300 million. We now expect our full year 2023 adjusted EPS to be in the range of $8.70 to $9.40. We expect total diluted weighted average shares outstanding to be in the range of 66.5 million to 67.5 million for the year.

In terms of our regional outlook, North America net sales are now expected to be up 5% to 10%, driven by favorable price mix. Operating income is expected to be up 20% to 25%, with price mix continuing to outpace lower sales volume and increasing costs.

For South America, we now expect net sales to be flat to up 5%. South America operating income is expected to be flat to down mid-single digits, with higher input costs being partially offset by favorable price mix.

In Asia-Pacific, we anticipate net sales to be up 5% to 10% versus the prior year. We now expect operating income to be up high double digits, driven by favorable price mix and PureCircle growth.

For EMEA, we expect net sales to be up 10% to 15%, and we anticipate operating income to now be up greater than 40%, due to favorable price mix. Corporate costs are expected to be up high single digits.

For the second quarter, we expect Ingredion net sales to be up mid-single digits and operating income to be up low double digits to mid-double digits when compared to the second quarter last year.

That concludes my comments, and I'll turn it back to Jim.

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

Thanks, Jim. Before we go to the Q&A, just a few final thoughts on how we see the business outlook for the remainder of the year.

As discussed, we're off to a very strong start in 2023. Our updated full year outlook reflects the effective customer and price mix management that our commercial teams have executed and the cost efficiency opportunities, our operations and supply chain teams are pursuing.

We are carefully watching volume demand and are expecting customer inventories to normalize in the second quarter. Thereafter, we expect to see a steady pickup in volumes throughout the second half. We are seeing innovation activity from our customers picking up and are encouraged by the opportunities for co-creation, particularly for affordable formulating, sugar reduction and clean label solutions.

Lastly, our business continues to demonstrate resilience, and our teams are responding with agility, despite slowing economic growth. We see opportunities to invest in Specialties growth and upgrade our core product mix. And we remain focused on executing against our driving growth road map to create long-term value for our shareholders.

Now let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from the line of Cody Ross from UBS, your line is now open.

Cody T. Ross - *UBS Investment Bank, Research Division - Analyst*

Good morning folks. Thank you for taking my question.

Congrats on a great quarter. You put up much better results than we expected gross margin, profitability and EPS. Can you help us just understand the puts and takes going forward? It looks like your run rate or what you're assuming for the back half is a considerable slowdown from the first quarter on gross margin, on EPS. Can you just help us understand some of the puts and takes and how you expect the cadence of the year to unfold going forward? And then I have a follow-up. Thank you

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

Hi Cody, this is Jim Zallie. I'll take, say, quarter 1 and try to put quarter 1 in perspective, and then I'll let Jim talk a little bit about the outlook maybe for the layout for the following quarters and how we see that. So we were, of course, very pleased with the record revenue, operating income and earnings per share performance in quarter 1.

As we mentioned, our commercial teams were extremely effective in managing product, price, customer mix management in the face of anticipated inflation. And it's important to point out that industry fundamentals were strong in '22 and remain so through the end of contracting, which supported customer acceptance of current market pricing which was much broader than we had thought.

Manufacturing costs in the quarter benefited from favorable fixed cost absorption as our plants ran well throughout the winter, and we made progress to increase specialty ingredient availability, supply chain constraints eased and that reduced the need for costly premium shipping routes. So for example, in prior earnings calls, perhaps through the last 18 months, we've talked about how we prioritized customers and service, given how strong demand was and the deep relationships we had with certain customers that needed our product, and we incurred significant air freight over the last, say, number of quarters, and that has come down significantly.

Europe's performance, in particular, benefited from the combination of favorable timing of new contract pricing and lower cost of carrying inventory from the fourth quarter. And so this margin expansion in Europe will soften as we go through the remainder of the year.

And another thing that we were, I would say, pleasantly surprised with is that due to Pakistan's country situation and the difficulty in importing certain products because of the lack of U.S. dollars, the co-product recovery rate and the value for co-products produced in Pakistan for domestic supply was particularly favorable given the economic situation in the country.

As far as the layout now going forward, I'm going to turn it over to Jim to talk about the phasing maybe for quarters 2, 3 and going forward. Jim?

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Cody, I think to your question, as we think about the gross margin and the operating income that we achieved in Q1, as Jim highlighted, some of the benefits were a little bit unique to the timing of Q1. What we see for Q2, Q3 and Q4 and our outlook is we're going to see the softer sales volume maybe from some of the products that we sell more into industrial, like industrial starch. We factor that into our outlook, and that helps us with our net sales guidance.

And then as we see Q2, Q3 and Q4, we're just going to be working in the cost of our corn, including the impact of our hedges as we work through each year. So gross profit margins may not be as high as what we witnessed in Q1, but that helps guide still an improvement in each quarter in gross margin versus the prior year's quarter.

Cody T. Ross - *UBS Investment Bank, Research Division - Analyst*

Thank you for that, that is very helpful. And then last question is just on gross profit dollars because that was particularly strong, as you mentioned, growing 28% in the quarter. Last year, you had pretty consistent gross profit dollar delivery throughout the year. Do you still expect that this year? And can you help us just understand some of the initiatives you put in place to deliver more consistent gross profit dollars in the future? And I'll pass it on.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

So obviously, gross profit is really 3 things, right? So it's one, how well you're doing managing your revenue and your product and your customer, which I think the teams have done a fantastic job with.

The second is, is how do you think about our COGS and corn and how corn lays out, which we've highlighted. But the third thing is, is what's our manufacturing expense. And I think what we're just cognizant of and aware of is that we need to balance our manufacturing production run rates with our volume demand as we go through the year. And so as we slow down a bit in our production, we're anticipating that we have some higher fixed costs that we have to absorb, that's in our outlook already.

So that's really what's going to, I think, be impacting some of our gross margin improvement. Again, to reiterate, we do see gross margins expanding in each quarter versus their prior quarter.

Cody T. Ross - *UBS Investment Bank, Research Division - Analyst*

Thanks very much, I'll pass it on.

Operator

Our next question comes from the line of Ben Theurer from Barclays, your line is open.

Benjamin M. Theurer - *Barclays Bank PLC, Research Division - Head of the Mexico Equity Research & Director*

Good morning Jim & Jim and congrats on this very strong first quarter. So I wanted to understand a little bit the volume backdrop and obviously, how it then relates into the guidance. And just to understand the pricing you've done and the pricing you've implemented, how much do you think of that was ultimately driving maybe some lower volumes? Or was it just further down the line that some of the end products had softer demand?

Just to understand a little bit how much was you impacting maybe the volumes by being so aggressive from pricing and now being a little softer on the sales guidance versus initially? And how much was just the general economic backdrop as to the lower volumes? That would be my first question.

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

Okay. Well, let me take that, and I'll let Jim add any color or commentary. So first of all, when it comes to volumes, one thing that Jim mentioned that's worth again highlighting is that the volumes that we ship, of course, into papermaking and corrugating and their usage is obviously much larger than a food customer would use a specialty starch for example. So papermaking and corrugated starch volumes that I'm sure you're all very aware of, were down mid-double digits across the industry really due to inventory rebalancing and reduced demand just due to the economic slowdown that we're seeing.

And it's worth noting that our industrial starch volumes represent about 17% of our total head product volumes. So that particular, say, category is going through an inventory rebalancing that, again, we expect to see a slow but steady pickup in the second half. When it comes to food and beverage customers, we're seeing customers also adjusting inventories, particularly at distributors, and there's some volume softness, obviously, as consumers economize.

And so we see that in quarter 1. As far as our pricing, the other thing that I would indicate when we talk about customer mix management, one of the things that we have done throughout the last, say, 18 months has been to really look very carefully at those customers that our products align most well with from a standpoint of future innovation opportunities and innovation partner opportunities. And some of the decisions that we've taken is to prioritize profitability over volume in certain cases.

So I don't believe that our pricing, which we believe is in line with market pricing, led in any way to any loss of volume or share erosion. It was much more of a conscious decision in some cases, but also overall, we're seeing inventory rebalancing and just overall softening related to economic slowdown. That's how I would kind of answer it.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. I would just emphasize that as our commercial teams and our pricing centers of excellence have really focused where our highest value per ton ingredients that go into food solutions, into beverage solutions for nutrition and for texture, we really, I think, have emphasized what's the value of our ingredient and that functionality. And that's what we're going to be carrying through in terms of driving our top line through the year.

And we needed to do that because we needed to cover anticipated inflation costs, and we were successful doing that. So I think that's probably the biggest theme to carry through, which is going to drive improvement in gross margins.

Benjamin M. Theurer - *Barclays Bank PLC, Research Division - Head of the Mexico Equity Research & Director*

Okay. Perfect. And then just my follow-up is really around some of the other items. And I kind of wanted to understand the effect on the working capital and how that's going to play out through the year and where you see maybe some opportunities versus risk as to the level of investments here? Is it then also relates obviously to your cash from operations and stretch that maybe a little bit for me?

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Maybe I can take that one.

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

Sure.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. So thanks for asking. I think most importantly, in Q1, given that time of the year and given where some of the fall harvest have ended, generally, in our working capital, as you would look at our balance sheet, probably more of a reduction in accounts payable, and that's really just paying for the corn that we need to stockpile, and we're going to deplete those stockpiles as we go through the year and that inventory will turn into cash.

I think, when we think about the accounts receivable and the inventory balances, we really see those increases really moderating sequentially from quarter-to-quarter. I'm seeing kind of a better trend relative to kind of where our pricing has come in and the kind of the change in the cost of corn. So right now, as we said on the call here, about $300 million we've invested into working capital, we generally see that staying constant, maybe a bit better as we roll through each quarter.

And then obviously, we're going to generate cash as each quarter progresses, and that will bring us up to our expectation for our cash from operations to be in the $550 million to $650 million and perhaps better.

Benjamin M. Theurer - *Barclays Bank PLC, Research Division - Head of the Mexico Equity Research & Director*

Ok, thank you very much Jim.

Operator

And our next question comes from the line of Adam Samuelson from Goldman Sachs, your line is open.

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

Thank you. Good morning everyone.

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

Good morning.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Good morning Adam.

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

So I guess, first, I just want to maybe parse a little bit about the results in the quarter and the change in outlook. And Jim Gray, maybe if I think about kind of the balance of the year in North America, where it does seem like you have to kind of modulate the operating rates of the network to deal with the lower industrial starch demand. How do we think about the cost absorption or under absorption that you're going to have as a result of that?

And kind of if I think about the increase in guidance, how much of that is being offset or mitigated by kind of some fixed cost kind of charges and the lower volumes to, where it is not a small end market for you?

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. Adam, thank you for, I think, picking up on that and highlighting it. We -- in our guidance, we are anticipating that, as we mentioned, some of our industrial starches, that volume is down in Q1. We do see that, that will be -- that volume will be challenged as we go through the remainder of the year. We're going to see it steadily improving, I think, as we see economic pickup.

So you can see economic pickup, we can see economic pickup. And yet, when we do that, we know that we're going to be running the plants a little slower. And so we've anticipated some of that fixed cost absorption into our costs, and that has been part of our outlook for the balance of the year. So while -- again, it doesn't overwhelm the improvement in the top line. We, I think, have a fairly good layout for our corn costs.

We are -- versus maybe where we began the year, we are anticipating higher manufacturing costs due to the fixed cost absorption already in our guidance. And yet, we still, I think, are leading to kind of improved gross margins in each quarter.

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

Yes. What I would say just to supplement what Jim said is that, if you go back to the end of 2021 and as we enter 2022, what we implemented was a dynamic pricing tracker that was being updated weekly by the teams as we monitored input cost inflation and thus, what we needed to do with dynamic in-year pricing beyond even contract pricing. And I think that served us extremely well throughout 2022.

As we entered quarter 4 of 2022, we anticipated already that volumes were likely to begin to soften, given all of the forecasts in relationship to a progressive move into potentially a recessionary environment. And we implemented a dynamic volume tracker. And specifically, why we did that, was -- it's being updated by finance with operations, and they are monitoring volumes on a bimonthly basis. So twice a month. And they're looking at that extremely carefully and ops is using that to wisely plan certain outages, certain preventative maintenance and trying to optimize that situation as best as possible.

As we have modeled where volumes could go based on just using kind of a logical view of how much inventory rebalancing we anticipate is happening in quarter 1, we factored in, as Jim said, an impact to fixed cost absorption for the remainder of the year, and that is factored into our guidance and that is factored into the outlook.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. And Adam, I think as you picked up, right, we've lowered the company full year net sales guidance, and part of that is -- a large part of that is driven within North America. And you know the company well. But I think what we're responding is that we are seeing it and we're demonstrating that agility to be able to balance that production schedule with that demand.

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

Okay. No, that's all really helpful. And if I could maybe kind of pivot off of that a little bit, just to make sure I understand the first quarter performance a little bit and it ties to the point on the dynamic pricing and the dynamic volume modeling. If I rewind to where you guys were in early February when you gave your fiscal '23 outlook and kind of framed expectations for the first quarter, you obviously came in significantly above that in the quarter.

And so if I parse the pieces in the quarter that were the big sources of upside, certainly, it seems like a big chunk of EMEA in terms of the timing of price cost spread, co-products and Pakistan were particularly beneficial. But when I think about the upside in North America in the quarter, is it just the pricing? Is it the way the corn costs laid out and the way the pricing responded in that environment? I'm just trying to make sure I understand kind of where the bigger upside on the quarter kind of was between the different pieces versus your own outlook 3 months ago?

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

In North America, specifically, I would say our customer product price mix management was better than we had anticipated because industry fundamentals remain strong through the end of contracting. Typically, when we put forward our, say, internal budgets and forecasts, we anticipate that there'll be some, say, erosion in relationship to how contracting will go, which is very typical as you get into the remaining 10%, let's say, or 15% of contracting.

This year, contracting went later than anticipated with customers anticipating that prices would start to come down. The industry fundamentals did not show that. And market pricing prevailed throughout the end of contracting for us. And so that was, say, a pleasant surprise.

The other thing, again, my Head of Global Operations is entering his third year, and he's really got his arms around the global operations. And I'll just give you this as a little anecdote, we've end the first quarter never in the company's history with no recordable injuries. That's never happened in the history of Ingredion.

And so our operations team is really, I believe, doing very well, and our plants ran very well throughout the winter month. And so that has helped, again, along with how the communication between ops and the commercial teams are coordinating the dynamic volume impact that we're seeing. When you run heavy fixed assets business, it's very tough to balance that, but we're doing the best we can, and we think we've done a very good job up until now.

We think that, that's helped as well, Adam. And then, of course, you highlighted some of that unique upside surprise in Pakistan, where again the country is preserving hard currency and that's benefited co-product recoveries, for example, that's something we did not anticipate. And again, I talked about Europe's benefiting from the timing of contract pricing and lower cost of carry in inventory. And again, what we're saying is that margin expansion will soften as we go through the remainder of the year.

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

Alright, that is all very helpful color. I will pass it on. Thank you

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

Thank you

Operator

Our next question comes from the line of Ben Bienvenu from Stephens, your line is open.

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

Hi, thanks. Good morning guys.

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

Hi Ben.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Good morning Ben.

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

So I want to revisit this volume discussion. And I think everything you said makes sense in 1Q and the outlook as well. I want to ask the degree of visibility that you feel like you have into, albeit not a full recovery in volumes, but some recovery through the balance of the year. You cited 2Q inventory rebalancing, looking a little better and then volume building into the back half. Are you already getting inbound orders on that? And just how far forward do you have visibility?

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

Yes. It's really different, first of all, across the globe. What I would say is, where we're seeing some interesting dynamics in relationship to volume for the first quarter, I will say, that surprisingly, volumes in Europe were flattish, which we took as a positive. They were also flat in Mexico, and they were up certainly in China in February and March as the country obviously opened up after they decided to pursue herd immunity in January. So there, those were some positives. But overall, we're seeing pretty much in most places that volumes softened throughout the first quarter. And I would say that we're anticipating that, that will steadily pick up into Q2, but Q2 will remain soft.

And I think the watch out for business in general is, if inflation does stay stubbornly high or perhaps would take a reversal and actually start ticking up a bit, that could depress volumes, but for our most revenue-generating and profitable product line, which is into the food sector, again, which cuts across private label, which is actually in some pockets doing better than branded. We're seeing more consumption of food at home as opposed to food service, which is a dynamic that's switching related to perhaps some structural changes in the way in the United States, for example, work is getting done both at home as well as in the office, even though in the office has picked up.

But there are some structural changes and our products, and we talked about this at CAGNY, are very versatile and they go into so many different channels and applications, both at retail for branded, retail for private label, food service, quick service restaurants, but everybody is seeing the same thing in relationship to the consumer buying behavior being crimped by ongoing inflation.

So I think the watchout is, will inflation settle into a more modest norm and volumes naturally after the rebalancing of inventories steadily pick up. That's what we're counting on for the second half. And we're counting on a modest pickup in Q2. That's factored into our guidance.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

And Ben, I would just maybe characterize in that because upwards of 80% of our volumes are into food and beverage, core ingredients and therefore solutions. It's generally easier to see what the consumer demand is off the shelf as well as what our customer inventories and takes are. It gets a little harder to see in foodservice because sometimes that supply chain has a few more steps in it. And that's really what we referenced here in our comments was that we do see some of our foodservice distributors probably trying to optimize as they're really adjusting to what's happening in traffic and cash rings really in foodservice outlets.

But as Jim mentioned and what I'm particularly watching is, hey, what's that industrial demand, those segments for our customers tend to be a little bit more up and down with the economy and it track a little bit more to GDP. So we're going to be watching kind of GDP and various manufacturing index indicators as pull for, say, starches that go into paper and corrugated. But generally, by far, the majority of our revenue is coming from a food and beverage ingredients, which is very steady demand.

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

And diversified.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes.

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

Yes. Okay. Very good. My second question is related to sugar prices. We're bumping up on all-time highs. I think we understand that to be a qualitative benefit to you all. But to the degree that it is, can you help us bridge the benefits to a more quantitative positive for your business? Or is it just that? Is it just a qualitative benefit that helps your relative price differential and competitiveness in the market?

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

Yes, well, let me take a shot at it, and then you can add a couple other commentary. Given your CPG background, I would say that sugar prices is certainly helpful to the caloric sweeteners that we supply from a standpoint of being very favorable to pricing as well as volume. But equally, obviously, it doesn't hurt that sugar prices are going up when you think about the long-term trend towards sugar reduction.

And certainly, what we're seeing is a strong preference for high-intensity natural sweeteners to replace artificial sweeteners. But also, obviously, when sugar prices are high, that just as a further tailwind. So I think what we called out during the script is the fact that, for this quarter, we saw both volumes as well as pricing improve and margins improve for core sweeteners for the first time in several years. I have to believe that has something to do with sugar prices going up, but also certainly strong industry fundamentals.

Operator

Our next question comes from the line of Andrew Strelzik from BMO Capital Markets, your line is open.

Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

Good morning.

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

Good morning, welcome.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Good morning.

Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

Good morning, thank you very much. So my first question, I was -- I know there's a lot of moving parts here, obviously, in the outlook. But as a baseline, I was hoping to go back to the corn cost side. And so I guess when you think about the back half outlook in particular, can you frame the corn cost outlay versus the first half, particularly given the hedges, the low-cost inventories that you brought into 1Q?

And then related to that outside of North America, how much of a headwind in South America from corn are you realizing? Or did you realize in the quarter that you'd expect to offset by pricing actions for the rest of the year, just given the typical lag there?

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

Jim, do you want to take the corn prices?

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. So Andrew, what we're seeing in terms of our corn cost layout, particularly as we now are in our second year of what I would say, our expanded hedging practices within U.S./Canada, essentially, each quarter, we're going to see an increase in the corn anywhere between 15% and 20%. Last year, at the beginning of the year, we had a bit of favorability on co-products. So that kind of lowered our net corn.

And then as you remember, as we got into Q2 and Q3 of last year, the kind of the nominal cost of corn really jumped because of Ukraine, Russia, but we had hedges in place. And so that offset and dampened some of that increase. And so just as we lay it out now, we started the year with corn relatively elevated. We had a little bit of softness in maybe the futures as you look at Q3, Q4.

But we're just take away that basically each quarter, this year, we have about the same type of change in our corn cost for Q1 all the way through Q4.

Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

Is there anything you could share on the South America side, how much you'd expect to offset for the rest of the year just through pricing with that lag?

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. So what we'll see on South America is that as the kind of pricing came in right now, the teams should have already been repricing some of that anticipated cost. So what they're doing is they're looking out with customers anywhere between 1 month to 3 months. And in aligning with customers, hey, do you want to -- are you comfortable with this pricing, which is implied by this cost of corn?

And as customers agree, then we're really kind of locking in that corn. So those pricing conversations relative to the change in corn are always active and generally occurring kind of between 1 and 3 months type of time frames. So we shouldn't see as much of a lag in South America because we've really expanded the conversations with customers to be able to say, "Hey, we can go forward a bit more, we can lock in some of the corn as long as the farmers or the intermediaries are willing to sell to us at that price." And so that should be 1 to 3 month-ish type of lag.

Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

Got it. Okay. Okay. That makes sense. And then just my last one, real quick. You talked about the resetting of some of these multiyear contracts. Is there any way to frame how big a piece of the business that is? What the impact was? I guess, did they renew at multiyears as well? I'm just trying to think as we maybe go into a lower corn cost environment at some point potentially, does that turn into a nice margin expansion opportunity as well, I guess? Thank you.

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

Yes. I think that not an insignificant percentage of our contracts are multiyear contracts. And the fact that those contracts renewed at full market adjusted pricing. It was very pleasantly surprising for us. Because, obviously, those customers were protected in 2022. And for 2023 and then onward, as those contracts renewed, typically, there are 2, perhaps in some rare cases, 3-year contracts formulaic to a large degree, but have inflationary-related clauses in there.

So they serve as an important part of the overall customer mix that we have. And many customers based on what they've endured through the pandemic with supply chain shortages, et cetera, are looking more strategically at multiyear commitments and contracts to assure, secure supply. And so a lot of those dynamics favorably helped us. Because in the nature of our businesses, we have to also contract not only the corn but you have to contract the seed to grow the corn in the case of many of the specialty products.

And some of these customers obviously are very sophisticated and strategic, they understand that. They understand the risk to them if they don't partner with us over a multiyear period. And so -- and then, again, when those contracts renewed, they renewed favorably for us. So that's how I would answer that.

Andrew Strelzik - *BMO Capital Markets Equity Research - Restaurants Analyst*

Great, very helpful. Thank you very much.

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

Thank you.

Operator

And I'm not showing any further questions in the queue at this moment. I'd like to turn the call back over to Jim Zallie for any closing remarks.

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

Well, I want to thank all of you for joining us this morning. We look forward to seeing many of you at our upcoming investor events, and I want to thank everyone for your continued interest in Ingredion.

Operator

And with that, this concludes today's conference call. Thank you for participating. You may now disconnect. Everyone, have a great day.
