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INGR - Q1 2015 Ingredion Inc Earnings Call

EVENT DATE/TIME: APRIL 30, 2015 / 1:00PM GMT

OVERVIEW:

Co. reported 1Q15 sales of $1.3b, reported EPS of $1.15 and adjusted EPS of $1.30. Expects 2015 adjusted EPS to be $5.50-6.00.

CORPORATE PARTICIPANTS

Heather Kos *Ingredion Incorporated - VP of IR*

Ilene Gordon *Ingredion Incorporated - Chairman & CEO*

Jack Fortnum *Ingredion Incorporated - CFO*

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Patrick Chen *BMO Capital Markets - Analyst*

Farha Aslam *Stephens Inc. - Analyst*

Rob Moskow *Credit Suisse - Analyst*

David Driscoll *Citi Research - Analyst*

Brett Hundley *BB&T Capital Markets - Analyst*

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Adam Samuelson *Goldman Sachs - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Ingredion First Quarter 2015 Earnings Conference Call.

(Operator Instructions)

As a reminder, today's call is being recorded. I'll turn the conference now over to Ms. Heather Kos. Please go ahead.

Heather Kos - *Ingredion Incorporated - VP of IR*

Good morning, and welcome to Ingredion's first quarter 2015 earnings call. Joining me on the call this morning are Ilene Gordon, our Chairman and CEO; and Jack Fortnum, our Chief Financial Officer. Our results were issued this morning in a press release that can be found on our website, ingredion.com.

The slides accompanying this presentation can also be found on the website and were posted about an hour 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. Now I'm pleased to turn the call over to Ilene.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

Thanks, Heather, and let me add my welcome to everyone joining us today. We appreciate your time and interest. As we communicated a few months ago, we expected headwinds this year with foreign exchange and slowing economies in South America, but felt our strong business model and management team could deliver solid operating results.

I am pleased, our first quarter results were up on a year-over-year basis and in line with our expectations just as we signaled. We ended the quarter with growth in our volumes, operating income and earnings per share. Organic volumes grew 3%, while Penford volumes added 2 percentage points. North America delivered a good quarter and lapped last year's adverse weather.

In March, we finalized the Penford transaction, which will expand our higher value specialty ingredient portfolio. North America and EMEA had strong operating income. APAC was in line with last year, while South America was down $5 million due to weaker volumes in Brazil and inflationary pressures in Argentina.

Now let's spend a moment on each region's performance in the quarter. Operating income in North America was $102 million for the quarter, up 57% versus last year, as we lapped last year's adverse weather and our facilities performed admirably through this year's cold winter.

Volumes were up 8% -- 5% driven by strong demand for our core and specialty products and 3% due to the impacts of the Penford acquisition. Mexico experienced its fifth consecutive quarter of double-digit specialty growth as consumers continued to demand healthier food and beverage options.

In South America, operating income was $25 million, down $5 million from last year. General slowness in the Brazil economy and cost pressures in Argentina continued as inflation exceeded currency devaluation. Worth noting was our ability to increase pricing throughout the region to help offset foreign exchange and higher input costs.

Brazil experienced weakness given the industrial slowdown and minimal GDP growth. With the brewery industry down low-single digit and lower volumes in confectionery and food products, our local leadership team continues to accelerate their focus on cost reductions and price mix management.

Although, the Southern Cone economy continues to be challenging, operating income was in line with our expectations. The Andean region delivered modest volume growth and continues to be a bright spot in the region. Although we expect another challenging year in 2015, we still believe in the underlying business in the long term and remain profitable in the region.

Moving along to Asia-Pacific, this region delivered $26 million of operating income, flat with last year. Strong volumes across the region and double-digit growth in our specialty food business offset currency headwinds. Even in Korea, one of our mature markets, we had specialty growth during the quarter.

Finally, the EMEA region reported operating income of $22 million. Currency headwinds were offset by good cost management through our global network optimization programs. Our portfolio in Europe, which is primarily specialty products, continued to deliver on trend products and performed well despite the mixed economic trends.

The team in Pakistan has done an excellent job of implementing cost reductions and managing an unreliable energy environment. For our Company overall, our expected cash flow from operations and strong balance sheet enabled us to strategically deploy cash to advance our strategic blueprint in spite of currency headwinds caused by the strong US dollar.

During the quarter, we repurchased 234,000 shares and closed on the Penford acquisition. I'm pleased to now turn the time over to Jack who will spend time on our financials. Jack?

Jack Fortnum - *Ingredion Incorporated - CFO*

Thank you, Ilene. Good morning, everyone. Let me start by covering the highlights of the income statement. I should note that these results include Penford operations as of March 11.

Net sales were down $27 million for the quarter. The majority of the decline is attributable to foreign exchange along with lower priced corn, which is passed through in our selling prices. This decline was partially offset by solid volume growth both in our organic business as well as the impact of Penford.

Gross profit was up $31 million as a result of lapping North America's adverse weather effects in the first quarter of last year, higher volumes and lower energy and corn costs. Reported and adjusted operating income were higher than last year by $17 million and $34 million, respectively, as the increase in gross profit was complemented by lower operating expenses.

Reported operating income was lower than adjusted operating income by $17 million, primarily due to the acquisition and integration costs related to the Penford transaction. On earnings per share, reported and adjusted earnings per share were $1.15 and $1.30 per share, respectively. For the quarter, our adjusted earnings per share was $0.34 higher than last year's earnings per share.

Moving on to the net sales bridge, our sales of $1.3 billion are lower than last year by $27 million. Volume growth contributed $67 million, but was more than offset by $77 million of foreign exchange headwind. The price mix reduction in net sales is largely due to lower pricing from passing through - passing along lower corn cost relative to last year.

As we look more closely by region, you can see foreign exchange headwinds affected us across all four regions. Good volume growth in North America, Asia-Pacific and EMEA help to offset weaker volumes in South America, specifically Brazil. Lower price mix in North America and Asia-Pacific was due to passing through lower corn cost. Price mix was favorable by 8% in South America as we started the re-price our contracts to recover currency devaluations.

Adjusted operating income increased $34 million in the quarter. North America posted strong results as it lapped results from the impact of the adverse weather from last year and had stronger corn and specialty volumes and lower operating costs.

North America price mix was down as a result of the pass-through of lower net corn costs. Also included in North America's result, is a small benefit of $4 million from the insurance payment received this year related to the business interruption resulting from the adverse weather conditions in the first quarter of 2014. The impact of Penford's earnings was immaterial given its mid-March close.

South America had weaker volumes - weaker volumes in Southern Cone and Brazil, and higher operating expenses and other costs attributable to the inflationary environment.

We'll wrap up the quarter with the earnings per share. On the left side of the page, you can see the reconciliation from reported to adjusted. The acquisition and integration costs are from the Penford transaction. On the right side, operationally, we saw an improvement of $0.32 per share, primarily, margin improvement including last year's weather impact with some volume lift, partially offset by foreign exchange.

The nonoperational benefits for the quarter were $0.02. Our tax rate was higher, which had a $0.06 per share impact, primarily due to the devaluation of the Mexican peso during the quarter. The devaluation increased the tax expense of our Mexican subsidiaries, which use the US dollar as their functional currency.

This was more than offset by other favorable items such as financing costs, and the impact of last year's accelerated share repurchase. Financing costs were favorable about $0.02 due to lower interest rates, resulting from interest rate swaps executed last year. The accelerated share repurchase from July of 2014 resulted in a $0.05 per share benefit, and this program will continue to benefit earnings per share through 2015.

Turning to our guidance. We expect net sales and volumes to be up from 2014, and specialty volumes are expected to show continued growth. Both volume and sales will include Penford starting March 11, 2015, the date the transaction was finalized.

Adjusted earnings per share are expected to be in the range of $5.50 to $6. This includes the impact of the Penford acquisition of $0.08 to $0.12 per share, but excludes the acquisition and integration costs. This is essentially unchanged from what we showed last quarter.

As more than two-thirds of our sales are outside of the US, we expect foreign exchange headwinds around the world to continue as a result of the strengthening US dollar. Therefore, we have increased our anticipated foreign exchange impact by $0.10 per share and now anticipate a negative $0.35 to $0.40 per share impact on our 2015 earnings per share guidance, which we expect to be partially offset by incremental pricing. As we have explained in our business model, these pricing actions typically require three months to six months to fully - to take full effect.

We expect corporate expenses to be up year-over-year to a more normalized level. Recall that our 2014 corporate expenses were lower than normal due to the classification of the German tax indemnity and other small items.

We expect financing costs to be up slightly as we refinance a portion of our debt coming due later in the year, and have more debt outstanding as a result of the Penford acquisition. And our effective annual tax rate is expected to be in the range of 29% to 31%. As you recall, our 2014 adjusted tax rate was 28.3%. Finally, the accelerated share repurchase we completed in 2014 will continue to benefit us in 2015.

In North America, we expect net sales and volume to be up from 2014. Our contracting with customers is complete and it has been factored into our guidance. It is important to keep in mind that with a large portion of our sales and costs based in US dollars, it helps mitigate some of the foreign exchange headwinds.

We expect the operating income to increase in North America as we lap the adverse weather effect in the first quarter of last year, expected improved product mix and margins and will include Penford's post acquisition earnings. For the balance of the year, we expect adjusted operating income in North America to be up versus the prior year. The Penford integration is on track to achieve our run rate target of $20 million in synergies and the underlying business is performing as expected.

South American net sales are expected to be down versus the prior year. We anticipate slow economic growth and foreign exchange headwinds to continue in the region. The Argentina situation remains challenging, and uncertain, however, our outlook is for operating income to be flat relative to 2014.

In Brazil, we expect some volume weakness, offset by good cost management control, as we expect the Indian region to continue to perform well. We continue to actively manage our costs to drive efficiencies to offset inflationary pressures. Overall, we expect operating income to be flat to slightly up in South America, primarily as a result of an increased focus on good cost management.

Asia-Pacific should continue to deliver modest operating income. We expect the business to be negatively impacted by currency headwinds associated with the strengthening US dollar, but we expect to overcome these headwinds with good cost management and product mix enhancement from continued growth in our specialty portfolio.

We expect our EMEA region to have lower net sales compared to the prior year, as foreign exchange headwinds offset volume growth. Operating income is anticipated to be in line with the prior year. The underlying European business is anticipated to continue to grow fueled by our specialty ingredient portfolio, and our investments in the region. However, we expect the currency headwinds to offset the improvement.

Pakistan is expected to continue its effective cost management and core product growth.

Moving on to our cash flow. Our cash flow provided by operations was $69 million, which is $52 million less than last year, primarily as a result of higher working capital use, partially offset by higher net income. We continued to deploy our cash strategically during the quarter in the form of an acquisition, capital expenditures, dividend payments, and share repurchases. This speaks to a very healthy business that has the ability to both reinvest and return capital to shareholders, which we expect to continue in the future.

Looking to 2015, we expect cash from operations of approximately $650 million to $700 million. This will be slightly down from last year as working capital normalizes after we benefited in 2014 from significantly lower corn costs versus 2013, which impacted inventories, payables and receivables.

Importantly, we continue to deploy our cash for capital expenditures, explore M&A opportunities, and we expect to return cash in shareholder-friendly ways, including share repurchases. We expect to spend around $300 million in capital expenditures in 2015 for growth as well as cost and process improvements around the world.

We're excited about closing the Penford acquisition. Potential M&A targets may include complementary businesses that add long-term value to our portfolio. As Ilene mentioned, we repurchased 234,000 shares during the quarter.

We generally expect to buy back dilution going forward, but we have the flexibility to buy back additional shares, giving us the ability to deploy our cash in shareholder-friendly ways. That brings my section of the presentation to a close. So now I will turn the time back over to Ilene.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

Thanks, Jack. As we've said before, our business model and strategic blueprint are working. In spite of currency headwinds and economic challenges in Brazil and Argentina, our underlying business is doing well.

Our geographic footprint, broad product portfolio and focus on higher value specialty products are expected to drive growth and shareholder value. North America is expected to continue its positive trajectory. Asia-Pacific and EMEA are projecting modest and inline growth, respectively, in the face of currency headwinds resulting from a strengthening US dollar. And South America continues to manage through its challenges.

We continue to demonstrate a track record of good stewardship of shareholder capital. We're excited to integrate Penford into our business. This acquisition continues our transformation into an ingredients company by addressing growing consumer trends including nutrition, gluten-free, food textures and sustainable biomaterial solutions. As Jack mentioned, in 2015, we expect the Penford acquisition to be $0.08 to $0.12 per share accretive to earnings, excluding integration and acquisition costs.

In 2016 and beyond, we expect earnings accretion to be even greater. This, coupled with attractive dividends and share repurchases, demonstrates our ongoing commitment to shareholders.

With our strong balance sheet, we continue to explore other M&A opportunities to accelerate our growth, broaden our portfolio and expand our geographic reach. Taken together, we are confident that we will continue to deliver excellent shareholder value. And now we're glad to take your questions.

QUESTIONS AND ANSWERS

Operator

Ken Zaslow, BMO Capital Markets.

Patrick Chen - *BMO Capital Markets - Analyst*

This is Patrick Chen for Ken Zaslow. I have a question regarding specialty products. You had previously mentioned that some of your products will become more commoditized over time.

How long do you expect these prices to become or to stay specialty until it happens, particularly, in regions such as Europe, where it's primarily specialty?

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

This is Ilene. Our specialty product portfolio is very robust and it's made up of products that are focused on consumer trends. And, so we do not - have not stated that we see them tapering over towards become more commoditized.

In fact, many of our specialty products as an example, our NOVATION products, have a really barriers to other people transitioning over to them and that they really deal with consumer trends such as Clean Label. And so, it takes a while for customers to switch from one product to another, so there are some barriers there to switching.

And so - and these products have higher than average margins. They have features that customers cannot get somewhere else, they are part of recipes that are drilled into products that have specific consumer textures and tastes. And so, we think our specialty portfolio, which if you recall in 2014, was 24% of our sales and that our strategy is to grow that to 28% to 30%, should continue to be - remain very robust.

Jack, I don't know if you have something else you want to add to that?

Jack Fortnum - *Ingredion Incorporated - CFO*

Just the nature of the food industry as well, the products have a long product lifecycle, and we've seen our products have a very durable longevity to them from a historical perspective. And while the trends continue to evolve in - throughout the world actually in terms of the different components, we continue to evolve our offerings as well.

And so, that's all from a positive perspective, and we are very excited about the portfolio.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

I guess, the other thing I would add to that is, our portfolio is very broad and serves many customers with many products. We've talked about specific consumer trends that we're focused on. And therefore, we become entrenched and an important part of the recipes of our customers, but again with a very broad offering and a broad customer set.

Patrick Chen - *BMO Capital Markets - Analyst*

Great. Thanks. I guess I was more concerned that you had mentioned during CAGE that these products become more core over time, implying margins will decrease whenever they become more core?

I guess, separate question, you had mentioned that you will continue to keep adding pricing outside of US, how long is that - how sustainable is that? I assume local competitors will not have increased price given they don't really have an FX translation impact?

Jack Fortnum - *Ingredion Incorporated - CFO*

Well, how you have to look at things is from an input perspective particularly in our core business components. If you think about the raw material being primarily corn and tapioca, it's largely a US denominated type of raw material, in addition to that energy costs and the investments are primarily derived from a US dollar base.

So, both us and our competitors face those same headwinds. And, in addition to that, the inflation in the country is obviously your competitors are faced with the same type of issues there. And so, the pricing really is just a natural extension in terms of how we will increase our price from a competitive perspective.

And the other side of the equation is, is how we continue to drive for low delivered costs in each one of our regions and focus on our continuous improvement program to really deliver the value to our customers in these challenging times, so that we can be competitive in the region.

Patrick Chen - *BMO Capital Markets - Analyst*

Great. Thank you. I'll pass it along.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

Thank you.

Operator

Farha Aslam, Stephens.

Farha Aslam - *Stephens Inc. - Analyst*

Looking at your commentary, you have highlighted cost savings program, could you just put a square around it and tell us where you're getting those cost savings? And, probably, what the cost savings are in the core business that you plan to achieve this year and what ongoing cost savings could be for Ingredion?

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

Farha, this is Ilene. And we are having trouble hearing you clearly, but I believe that your question was about cost reduction opportunities. And, I'll answer that in general, and then, if you have something more specific, we can talk about it.

But when I talk about our continuous improvement, we have a very good process that we rolled out originally in North America to drive costs and this could be anything from energy efficiency to yield improvements, some of which uses capital, other is focused on methods. And what I've said before, we continue especially in challenging economic times in South America, we continue to roll this out in South America.

And we train our people in solving business problems with specific issues and so in South America as an example the opportunities would also be in energy efficiency and yield improvement and productivity. So there is opportunities globally and one of the best parts is that we're able to transfer best practices from one region to another, with our operating excellence background, we're really a leader in this area and I know, Jack, do you want to add something to that?

Jack Fortnum - *Ingredion Incorporated - CFO*

Yes, I think there's the component pertaining to a continuous improvement within facilities and then there is the entire global network that we continue to foster our improvement through. And I can use Europe as a good example even during the quarter where we were importing a lot of products from the United States in the past and our previous investments, so that they could become much more self sufficient within Europe, has really paid off in terms of their competitiveness within Europe even though it's a specialty product.

Effectively we're sourcing most of that product or a greater percentage of that product from Europe now. And we continue to look at our North American blueprint in terms of how we're organized from a plant perspective and optimizing that.

And then I would say that just even in South America as we look through our manufacturing footprint from a network optimization, we continue to explore opportunities how we can be more efficient down there too. So there is both the micro in terms of how you produce the product and run very efficiently and then the macro, how you source product between our different locations the most effectively.

Farha Aslam - *Stephens Inc. - Analyst*

Great. And just one follow-up. Could you just share with us the competition you're seeing in Asia. Do you - have you seen it mitigate over the last month as US has heated up in both the sweetener, the specialty starches and ethanol markets? Have you seen any declines in competition in Asia?

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

I'll start out. Well, first of all, in general, our Asia portfolio as an example in China is really in specialty starch ingredients. We are not in the sweetener business. So, I couldn't comment on that.

But certainly we have competition with the local competitors in China and it's obviously a very good market for us to be able to be one of those suppliers that is thought of as very reliable and high quality. If you look at something like Korea, which is again a localized market and there are four competitors, the competition has been pretty similar and again delivering value in sweeteners, but also for us as I mentioned, we've been focusing on specialty sweeteners and starches and have done well in terms of growing that in Korea.

Thailand, obviously, we have very successful business there, both local and we use it for export for tapioca and again, being a leader there, we've been able to continue to be very successful. But I would not say there is new competition in the businesses that we're in. I don't know, Jack, do you have any examples you want to add?

Jack Fortnum - *Ingredion Incorporated - CFO*

Farha, I think you made one valid point though is we have seen because of some of the capacity reductions in North America, the market tightening up in North America. And I guess, we haven't really seen the impact of that directly in Asia at this point in time, but certainly the market in North America appears to be robust as you can tell by our volume improvements in the current year - current quarter.

Farha Aslam - *Stephens Inc. - Analyst*

Fantastic. Thank you very much.

Operator

Rob Moskow, Credit Suisse.

Rob Moskow - *Credit Suisse - Analyst*

Hi. Thank you. Just a couple of questions. One is, can I read the outlook correctly that you're raising your fundamental outlook by about $0.10. When I strip out the FX impact and then the acquisitions, it seems like - it seemed like you're raising your fundamental outlook a little bit.

And then the second thing is, for LatAm, your pricing is up 8% and I get the three month to six month lag in pricing, but your customers like Mondelez and others, their pricing is up 20% or more in these types of markets to offset all of the currency impacts on their costs. So, if - I guess, my - if your customers are raising price to that degree, what is the challenge of going to them and raising pricing a lot faster? Thanks.

Jack Fortnum - *Ingredion Incorporated - CFO*

Rob, let me start and if there is anything else to add. Let me start with your second question first, where you indicated that South America's pricing is up 8%. I would put it into a couple buckets.

One is, corn prices are down and traditionally you would see your price mix down anyway. And so, using Asia-Pacific or North America as a benchmark for that, you've seen the price mix ratio both down around that 4% to 5%, which have very similar type of marketplaces. And so, South America would have been down just because of the pass through of the lower corn cost to a certain extent anyway.

So, we are actually fairly pleased with the pass through of pricing into our customers at this point in time to cover most of the devaluations, which you see on that line of 16%. And, again, I guess the other part -- the only other portion I would comment on is, in Argentina, itself, sometimes it's a little more challenging to get the prices up, given the environment in Argentina. Even though it's a high inflationary country, it's still a little bit - you're always chasing prices in that environment, as there's still some price restriction, as well as there is a large sugar market, domestic sugar market down there.

In terms of the guidance, I think I'm just going to continue with that, in terms of the guidance, I would say that, you are correct, we've been able to offset, and we've always stated that the foreign exchange is being offset by pricing. And it's just a matter of how quickly we can get pricing up when the devaluations take place. So, I would say, yes, I agree with your comment that we're saying that we have about an incremental $0.10 of headwinds, and we've offset that either through pricing or reduce - our cost reduction type exercises, which allows us to hold our guidance where we originally planned it.

Rob Moskow - *Credit Suisse - Analyst*

Okay, I'll follow up later. Thanks, Jack.

Operator

David Driscoll, Citi Research. Please go ahead.

David Driscoll - *Citi Research - Analyst*

Great, thank you, and good morning. I wanted to go back to the guidance for a second. So, when I look at your segment comments, there is a little bit of a delinkage I think for me on the fact that you raised the full-year number.

But in your segment commentary, it seems like operating income for North America has not really changed. Your South American comments are now in line to slightly up, but you had previously thought it was going to be a modest improvement, I take that as slightly worse.

Asia, a modest improvement versus the increase comment from last time, again, modestly, worse. And, EMEA in line versus 2014 versus your last time comment of increase, again modestly worse. So if I am reading these words right, it's always a difficulty of reading these little words, if I am reading these words right, it seems like the segment commentary on balance got worse.

The FX numbers and the Penford accretion would seemingly be offsetting one another. So, Jack, could you try it again and what am I missing here such that you raised the guidance?

Jack Fortnum - *Ingredion Incorporated - CFO*

Well, David, first of all, we held the guidance, because the impact was being offset as you know. And the second piece is really, I think, if you go by region, I would say we're a little bit more optimistic in North America, because that's really driving a big piece of our business.

And if you think even in the current quarter, I know that we had commented on the $20 million of lapping from last year and things, but there was still very solid improvement in North America. And so I would say the clarity we're seeing is in our North American business where we're seeing the volumes, the pricing being fairly stable throughout the year, so we have a bit more insight into it, so I think we're a little bit bullish on North America.

You are correct, South America continues from a macroeconomic perspective to really be challenging. I think we're executing well down there, but it's still one of those - the macroeconomics are challenging. And then when you get into EMEA and Asia, APAC, I would say both of them actually performed very admirably in the quarter from my perspective.

And I would say that we're looking out into the future and we don't want to put rose colored glasses on or anything like that with respect to the foreign exchange potential headwinds, but the underlying businesses seem to be performing very well for us.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

And the only thing I would add is that we don't separate out foreign exchange, and then look at the underlying business. Obviously, our goal is to be passing on any headwinds of exchange.

But I do think that where you would read through those comments, the strength would be North America. And that remember, that also includes Mexico. And Mexico, the GDP continues to be let's say at the 3% level in Mexico, we are growing our specialty products there double-digit, the demand for healthy products is growing.

And so, if you look at the total North America system, that's where we're feeling that we're running well, that the right products for the consumer trends are accelerating. And so, that's where I think where we're trying to reflect the renewed enthusiasm.

David Driscoll - *Citi Research - Analyst*

Two quick follow-ups, on North America, in last year's second quarter results, did last year's second quarter see any significant volume benefits because of the difficulties in the first quarter? So, you had all kinds of shipment issues and logistic problems. Did some of that vol slip into the second quarter and does it make it a harder comp?

Jack Fortnum - *Ingredion Incorporated - CFO*

No, I just - we didn't see the volumes down that robustly in the second quarter. Second quarter was an okay quarter, but it was almost the contrary, David, I think if -- and I'm going by memory a little bit, we still had some trailing issues, as the supply chain freed up, because the rails were still backlogged, and we were using more trucks and things.

And so, we had a little bit of supply chain issues, even trailing into the second quarter there, as supply chain got normalized. So, we didn't really - I don't really perceive to be a big issue in terms of the comps this year, where we got some big windfall last year in our second quarter.

David Driscoll - *Citi Research - Analyst*

And the Mexican fourth quarter co-product issue, that did not reoccur in the first quarter, nor would you expect it to have impact in 2015, is that fair?

Jack Fortnum - *Ingredion Incorporated - CFO*

That's absolutely fair. As I mentioned in the last quarterly call, what happened was, it was a pricing issue and adjusting to the currency, the devaluation as quickly as we could in terms of US dollar equivalency. And so, we have put actually processes in place to put our pricing out in a shorter window, I'll call it.

And so, I don't think that should occur. Obviously you can never predict whether there is some major devaluation or something like that, where we get hung out with some prices, but I would say that was a one-time fast devaluation type of issue.

David Driscoll - *Citi Research - Analyst*

Nice start to the year. Thank you.

Operator

Brett Hundley, BB&T Capital Markets.

Brett Hundley - *BB&T Capital Markets - Analyst*

Hey, good morning, everyone, and let me offer my congratulations on some nice execution this quarter. Ilene, I have two higher level questions for you. The first is on your product portfolio, which we have discussed a little bit on this call and I sometimes get questions on just the net effect of some changes that are occurring within the food industry.

And obviously from what we're seeing, added sugar is becoming a big issue, companies are talking about removing ingredients that consumers don't have in their pantry or aren't easily recognizable. McDonald's talked a while back about taking maltodextrin out of its Grilled Chicken recipe.

So, you have the withdrawal here of some legacy CPO products, some of those more core commoditized products and then you have the replacement hopefully of some National Starch products and other things that you guys bring to the table. And so, I'm just curious from a high level, how you see this paying out for Ingredion, whether it's a one-for-one swap with margin benefits for the company or is it an opportunity to win business, is it a threat? If you just talk qualitatively about that.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

Sure. Well, as we talked before about our R&D portfolio, we're very much focused as a texturizing leader to being the go-to company for texture and that our knowledge of sweeteners is helpful in formulating those recipes. And so we've expanded it in our R&D area to make sure that we address the different trends.

So I would say that the texture is even accelerating even more the importance. I've said before the texture is the new taste, and you'll see offerings by food companies that talk about crunchy and creamy and whether it's in the dairy area or it's in the snacking area or baking area.

And so, we've come up with formulations and work directly with our customers to deliver those solutions for the products that they're bringing to market, many of which are in this category, good for you. And so, we realize that the sweetener portfolios are changing. In fact, we have one product we've talked about. We do have a Stevia product.

There are other sweeteners like polyols that we also supply, but we see the trend focusing very much on texturizers as the important part of the portfolio to grow these specialty products and to grow these new food categories. And that's why, also when I talk about our M&A and using our balance sheet, our strong balance sheet, we look to broaden the portfolio and, number one, we look in texturizers, because we're the leader.

So, that's why the Penford acquisition made a lot of sense with potato starch, which is gluten-free, it's non-GMO, another trend. But we also look for other texturizers that could be non-starch like hydrocolloids, that really can build on the texture portfolio.

So, I see the future of texture as very important, but we also look at adjacencies that -- formulated with texture, that will be important for these new products.

Brett Hundley - *BB&T Capital Markets - Analyst*

And, Ilene, have you talked at all about the size of where your texturizing business stands today from a revenue standpoint? Or if you're not willing to do that, at least talk about maybe the size relative to your sweeteners portfolio today?

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

Well, we haven't broken it out. We have said that our specialty products in total are, I think was [$1.3] billion, it was 24% of the portfolio for 2014 and we continue along that trajectory. We haven't really broken that out.

The other piece, because I do talk a lot about our ingredients for the food side, but there also is a piece in the industrial side. And we started to talk about this more with our Penford acquisition, which is really the biomaterial solutions, which could be liquid natural polymers, or bioadhesives or bioplastics.

And that's another growing trend that allows us to address some of the non-food opportunities that are based on similar trends. So, we haven't broken that out per se, though, I think you can look at our portfolio and our industrial piece is, certainly, the food piece and the beverage are the largest portion.

I think food is about 50%, and the beverage is about 13%, but that's a combination of some corn syrup and some other types of sweeteners and even our delivery system specialties are in that and then, of course, there's the beer industry. So I would say that you can look at the industry outlook, but we haven't broken it out, per se, for specialty.

Brett Hundley - *BB&T Capital Markets - Analyst*

Okay. And then just my second question somewhat related to my first is just on your forward growth algorithm that you guys have been communicating and certainly that includes a goal of double-digit earnings growth over time.

And is in part based on M&A, and certainly, it looks like we're seeing that this year with the addition of Penford and the mid-point of your range, that certainly yields you double-digit growth potentially. But I want to ask you a different type of question on the M&A environment and your pursuit of specialty.

There's a wide number of actors across the ingredient landscape that are basically trying to do the same thing as you and move into specialty further and some of these guys have different sets of resource capabilities, as witnessed by some of the multiples that are being paid for certain assets. We've recently seen some other competitors of yours go the reverse route and shed commodity type businesses in the pursuit of a better mix through subtraction rather than addition.

So, anyway just to wrap my question up, from my seat, it looks like it's going to be difficult to execute on specialty M&A going forward, but I wanted to get the vantage point from someone who is much closer in these types of discussions and negotiations on just your feel for the forward M&A piece.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

No. It's a good question. What I've always said is, look, improving shareholder value is always very important and the most important guide for us.

And so we've demonstrated a discipline in buying National Starch and even in buying Penford and our ability to buy businesses that will add value to our Company and that we know how to create value both on a cost and a revenue side and integrating those. And we also have a track record of embracing the talent whether it's in R&D and go-to-market from these companies, because that's what it's all about, is how do you create value for the customers.

Having said that, when I look at the landscape and I have always said our sweet spot is this $300 million to $500 million type businesses, and with our strong balance sheet, we're a player in that realm, we're looking for businesses that have features that will add value to our portfolio. Now if you take a $6 billion company, we can look at companies that may be a little bit smaller, may require a higher price ratio to buy them, but we have to have a plan on how to integrate them and there is some cost piece to it, but there is a growth scenario and we already have the basis to start to do that.

And so we're looking at those ingredients that are texturizes and adjacencies that will add value to our portfolio. We're looking geographically that those might be more core, but also have a specialty growth opportunity and we're looking also at a little bit larger that can add to the portfolio. So with our strong balance sheet and our track record of having a plan and delivering on the plan is very appealing to candidates.

Obviously people want to sell for the highest price, and it depends on who is selling, is it a family, is it private equity, is it public? But, in the long-term, it's really how are you going to create value, and we always have a plan to do that.

And so, I am not deterred, I respect competition. But we have a plan and we feel good about being able to execute against it.

Brett Hundley - *BB&T Capital Markets - Analyst*

Thank you for your thoughts.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

Jack, do you want to add something to that?

Jack Fortnum - *Ingredion Incorporated - CFO*

Maybe just one, Brett, just so the - people obviously continually talk about the algorithm and things. And I think we've laid it out fairly well. So, one of the targets that I always like to highlight is, is we also say that we'll have greater than 10% return on capital employed.

And that keeps the discipline in our organization to say that when we're doing an acquisition, it has to demonstrate that within a reasonable period of time, it's going to return a return to our shareholders.

And the other piece that I'd like to highlight is that I know people like to get their ratio up between specialty and core. But I would also like to highlight the core, if managed appropriately, can be a wonderful source of funds as we move forward. So that's one of the things that we continue to emphasize is that annuity piece of the core, which continues to generate cash for us as well.

So, it really takes both components in terms of the discipline in knowing how you can get your acquisitions up to that return on capital employed or there is no sense in doing them, as well as sustaining a strong core business, because I do believe that, that really funds a lot of the opportunities going into the future.

Brett Hundley - *BB&T Capital Markets - Analyst*

Thanks, Jack.

Operator

Akshay Jagdale, KeyBanc.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Good morning, and congratulations on a good quarter. So, I'm just trying to understand better the situation in North America. Can you help me put into context your optimism relative to your guidance range, which still is - the range is pretty large still. And, also, maybe relative to history, because everything we're hearing from your competitors, et cetera, points to a very good situation in corn, wet milling in North America, Mexico doing well, capacity came out of the market. So, a lot of good things are happening.

So, I'm trying to put that into context relative to your guidance range, and perhaps relative to North America's performance EBIT-wise historically.

Jack Fortnum - *Ingredion Incorporated - CFO*

Yes, Akshay, I guess when I look at North America, it's set up fairly well and while - when you talk about the capacity and things, I think the industry is running at a fairly high rate of capacity utilization based on our estimates. We used to say in the mid-80%s and with some of the capacity coming up, it's probably much higher than that.

And so, but some of that capacity came out a very late. So, it didn't necessarily impact contracting in the current year. So, I wouldn't get - don't extrapolate very, very large margins in there.

Some of the things that we've seen though is, is that with the higher utilizations and things, we've been able to sell out many of our specialties and continuing to drive that specialty growth in many categories. And I did mention some of our network optimization, where we were supplying more to Europe and things in the past from on our -- of our specialties and we became much more self-sufficient in Europe, which then freed up some of our specialty capacity in North America, which helps the margins there as well. And, again, Mexico continues to be one of our bright spots in terms of continued growth, as Ilene mentioned earlier.

The North American picture, it's interesting because people didn't see the growth there, but the changing food trends and things are right on target with some of the things we're trying to execute upon. And North America is one of the fastest growing economies right now. It's interesting from that perspective because for so long, we didn't see growth in North America and now we're starting to see it again.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

So, that's helpful. But can you - maybe asked another way. What will it take to get to the high-end of your guidance?

Jack Fortnum - *Ingredion Incorporated - CFO*

Sure. The high-end of the guidance will be predicated on both, in North America, it will be driven by volume improvements that we didn't have factored in and several mix improvements with more growth in our specialty category.

And then, the real high-end of the guidance comes from the fact that around the world, can we price in the devaluations that we've seen, because I still think that that's probably the - we have upside and downside in our guidance because of that. It's the timing of the pricing and how it correlates to those evaluations. Can we get those through at this point in time?

And obviously, the raw materials, there is plentiful supply of corn and things in North America. South America crops are good. And so, we don't see - we see fairly stable raw material costs going forward. So, it really comes down to those two components.

Outside of North America, it's a pricing issue in terms of can you price through the devaluation, particularly in slow moving economies, slow growth economies. And then, in North America, it's really volume growth.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Okay. And so, regarding the pricing relative to devaluations, over the last three years, including your guidance for this year, it's been like a $0.82 headwind, if this year's number comes out to what you've guided to. So, clearly, you're lagging that, right, and part of that is just the South American business, perhaps, was over-earning by $0.25 or so. But do you expect that you, over time, you'll get a large majority of that headwind in FX back?

Jack Fortnum - *Ingredion Incorporated - CFO*

Yes, I do think that - particularly, if you're looking at the South American environment, I do think that it will take some growth in the economy, because there is still a supply/demand issue there and the demand just hasn't grown as quickly as we've seen.

And so, what we've seen is, is the elections in Argentina are going to be in the fall of this year and so that's going to be another probably transitional government, into 2016 type of range. And, the Brazilian numbers, you've probably read quite a bit about the macro environment in Brazil right now being relatively soft.

They've had to increase their interest rates even today to combat some of the inflationary pressures. And so, that environment is going to be challenging in the short-term as well. And so, I would say that it's getting back those prices from a historical perspective will take us probably into that - not just 2016, but into 2017 from that perspective.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Okay. And then, just on specialty and Penford, specifically, what we've heard is, their specialty portfolio, they were on the brink of commercializing some products. Now, you obviously own - completed the acquisition on the asset fully for a little less than two months.

But can you give us some insights? The food ingredient business was over $100 million for them, right, and just trying to get a sense of the specialty portfolio that you've bought from Penford and what you're excited about there. And maybe give us some context as to how excited you might be of that portfolio?

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

Yes, no, I'll handle that. We - two months in, we continue to be very excited, and you're right, the portfolio - the food portfolio, which obviously had some corn and is very much focused on potato starch. As I said earlier, non-GMO, gluten-free, great portfolio, a lot of opportunities there to grow.

And, as I also mentioned, we're excited about the biomaterial solutions business, which there are a number of opportunities that are being funded and we're beginning to learn about those and look at different opportunities. As we said, the synergies, the $20 million of synergies that we're committed to and feel good about, will initially come from procurement, supply chain optimization, some of the overhead G&A costs from not having a public company, et cetera.

But that we are excited about the portfolio and bringing the two companies together in the R&D sense. And I'd say the other aspect is the hydrocolloids side, which is a small business that was bought by Penford a little over a year ago called Gum Tech and, again, it's a business where it's very much focused on the non-starch texturizers to deliver a different type of special ingredients to customers in the texturizing field.

So, again, it's not quite two months, but we continue to be very excited about the products and people and capabilities of Penford and integrating it and growing.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Okay. And, last one on just the overall specialty portfolio. In the past, long-term, you've said that, that business is, overall, that category is high-growth.

Can you help us understand like today, what do you think a good organic growth rate for your specialty portfolio is because it does change and move around with economic conditions, regions, so on and so forth. But what's a good organic growth rate for the portfolio that you have today, and maybe if you were to guess what the overall category is growing at too, that would be great. Thanks.

Jack Fortnum - *Ingredion Incorporated - CFO*

Okay, Akshay, this is Jack. When we look at the specialty growth rates, we've always said that it's probably in the high single-digits, which is two times our core growth rate, or more than two times of our core growth rate, I would say.

And so, I still see those trends continuing. I do see probably maybe an acceleration of some of the trends just because of them taking place. But it's still takes a fair length of time to get the products in place, and things, so the execution time is still there. So, we're -- Ilene summed it up very well is that we're trying to move our specialty portfolio to 28% to 30% of our portfolio from the 24% we have today.

And, effectively, that will - if you keep your core growing at that, let's say, one to low single-digits, that means that we have to have significant growth in those specialty ingredients. And then, I do think that that's where we're seeing the industry growing at as well.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

And if you look at some of the capacity additions that we've announced when we announced $100 million of capacity for specialty products, that's supporting the growth with the right features, where we have unique capabilities or technologies.

And so, the category, when you ask about, well, how fast is the category growing, certainly the specialty food demand by the consumers is growing two times to three times the core, but it's a new category and that's why we had to add capacity to have those specific features, but again, we're a leader in that area and certainly in the texturizing field.

Akshay Jagdale - *KeyBanc Capital Markets - Analyst*

Okay. Thank you. I'll pass it on.

Operator

Adam Samuelson, Goldman Sachs.

Adam Samuelson - *Goldman Sachs - Analyst*

Yes. Thanks. Good morning, everyone. First, maybe on that - following up on the question on Penford, Jack and Ilene, the 10% return hurdle, maybe help us think about the path and the timeline to actually exceeding that on Penford? I look at the business even post synergies based on what they earned in the past, and it looks like you're starting at about a 6% to 7% return on capital employed.

If the 10% return hurdle is going to be hit with growth in specialty, you're talking about a more than 50% increase in the profits at the company level let alone the specialty business. Help us think about the timeline to actually hit that benchmark.

Jack Fortnum - *Ingredion Incorporated - CFO*

Adam, and just a couple of clarifications on your calculations there. We commented on the cost synergies only and there is further network optimization, because we do think that some of their business was sub-optimized in terms of how they were supplying their customers and things. So that really wasn't factored into those numbers.

In addition to that, we see good growth opportunities outside of the US. with some of these product categories, which will accelerate the growth as well. And so, we have -- I'm not going to lay out exactly which year we'll be breaking the 10% hurdle rate on there, but I do think that within a two year to three year time horizon, we should be well above our return on capital employed on the valuation that we acquired Penford at.

And I think that's a reasonable perspective to take in terms of how we're going to be looking at acquisitions. They don't have to be immediately over that ROCE number, but they do have to get there within that two year to three year period. And we will share more of our action plans as we move forward with Penford, because as we integrate it in I would say with you as they get more crystallized in terms of the integration teams.

Adam Samuelson - *Goldman Sachs - Analyst*

Okay. Maybe I'll take it offline, we can follow up there. In the - maybe just back to the guidance question and South America, the expectations for flat to slight improvement. You're - through first quarter, you're down - you were down 18% in the first quarter.

The FX pressures and headwinds year-over-year get significantly worse as you go into the summer months. Seasonally, things get slower there. I don't know that the economies are actually improving yet to really give you a volume tailwind until maybe the comps ease by the fourth quarter. Help me think through the pace and cadence of some of the cost actions that would actually be driving the margin improvement over the course of the coming quarters?

Jack Fortnum - *Ingredion Incorporated - CFO*

I think that's a very good question actually, because how we're looking at that is, they're entering the winter months down there at this point in time. And so, the second quarter will be a challenging quarter for us, I believe, because of the slow volume and historically it's been like that.

During this period of time, many of the costs that we're looking at, the cost structures that we're looking at in South America will be evaluated and pushed through. And you'll probably be starting to see those in the third quarter and fourth quarter, as we get into the higher season as well. We'll get the double benefits in the second half of the year.

I would say that the second quarter is still looking a little challenged, I would say. And then, we don't give the quarterly guidance. I'm just trying to give you the layout of how we're looking at that business. And then, we're seeing some come back in the third quarter and fourth quarter from that perspective.

Some of it is contingent on Argentina staying stable in items like that as well, but we do think that it is going to be stable throughout the year at this point. And maybe, Ilene, do you have any other comments?

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

The only other thing I would add is, if you think about the Andean region and even the Pacific Coast, we do see opportunities for growth in those areas in that, we've made some cost reduction investments. We have capacity.

And the trends are very much on healthy eating in places like Peru and Chile. So, that's a nice - there's some nice momentum there.

Adam Samuelson - *Goldman Sachs - Analyst*

And just to be clear, Jack, on the second quarter. So, is the implication in the second quarter, we would expect profits to be down in South America, is that a reasonable interpretation of your comments?

Jack Fortnum - *Ingredion Incorporated - CFO*

We don't give the quarterly layout or anything like that. But I would say that the second quarter will be probably the most challenged quarter that we have versus this quarter.

Adam Samuelson - *Goldman Sachs - Analyst*

Adam Samuelson - Goldman Sachs & Co. Okay. That's helpful.

Operator

And to the presenters on the call, we have no further questions in queue.

Ilene Gordon - *Ingredion Incorporated - Chairman & CEO*

Yes, so, let me just sign off. I just want to reiterate our confidence in our business model, strategy and long-term outlook. We remain keenly focused on shareholder value creation and we're committed to delivering shareholder value.

So, that brings our first quarter 2015 earnings call to a close. Thank you again for your time today.
