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INGR - Q3 2015 Ingredion Inc Earnings Call

EVENT DATE/TIME: OCTOBER 29, 2015 / 1:00PM GMT

OVERVIEW:

Co. reported 3Q15 sales of $1.4b and reported EPS of $1.48. Expects 2015 adjusted EPS to be $5.75-5.90.

CORPORATE PARTICIPANTS

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

Ilene Gordon *Ingredion Incorporated - Chairman, President & CEO*

Jack Fortnum *Ingredion Incorporated - EVP & CFO*

CONFERENCE CALL PARTICIPANTS

Omar Mejias *BB&T Capital Markets - Analyst*

Robert Moskow *Credit Suisse - Analyst*

David Driscoll *Citi Research - Analyst*

Patrick Chen *- Analyst*

Farha Aslam *Stephens Inc. - Analyst*

Adam Samuelson *Goldman Sachs - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. And welcome to the Ingredion third quarter 2015 earnings call.

(Operator Instructions)

I'd like to turn the conference now over to Heather Kos. Please go ahead.

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

Good morning and welcome to Ingredion's third quarter 2015 earnings call. Joining me on the call this morning are Ilene Gordon, our Chairman, President and CEO; and Jack Fortnum, our Executive Vice President and Chief Financial Officer. Our results were issued this morning in a press release that can be found on our website, Ingredion.com. The slides accompanying this presentation can also be found on the website and were posted 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. I'm pleased to turn the call over to Ilene.

Ilene Gordon *- Ingredion Incorporated - Chairman, President & CEO*

Thanks, Heather, and let me add my welcome to everyone joining us today. We appreciate your time and interest. Ingredion posted another solid quarter boosted by volume growth, improved mix and good operating efficiency. I'm pleased our business model and strategic plan continue to work with continuous improvements and a pass-through pricing mitigating foreign-exchange headwinds.

As a result, North America had strong operating income. South America and Asia-Pacific were up from last year. However, EMEA was down slightly due to foreign exchange headwinds in that region. We continued to expand our ingredient portfolio during the quarter. Our acquisition of Kerr Concentrates was finalized August 3 and the Penford integration remains on track.

Additionally, we announced 2016 plans to further reduce our cost structure in South America by consolidating several plants in Brazil. Now, let's spend a moment on each region's performance in the quarter. Operating income in North America was $133 million for the quarter, up $20 million from last year. Overall volumes were up 15%. The impacts of our acquisitions, core growth, as well as strong demand for our specialty products drove the increase. And, just like the second quarter, continuous improvement programs continue to drive good operational efficiencies.

In South America, operating income was $28 million, up $1 million from last year. Pricing actions, volume growth, good cost discipline, and continuous improvement projects helped offset foreign exchange and higher input costs. Brazil volumes were up, but recall last year it was weaker as customers reduced inventories after the World Cup. Given the environment, our local leadership team continues their ongoing focus on cost optimization and price mix management.

Although the southern con economy is still challenging, operating income was in line with our expectations. And the Andean countries continue to perform as expected. We expect the remainder of 2015 and 2016 to be a challenging environment, but believe the South American business has stabilized and the underlying business fundamentals are positive for the future.

Moving along to Asia-Pacific, this region delivered $28 million of operating income, up slightly from last year. During the quarter, margin expansion offset currency headwinds. Finally, the EMEA region reported operating income of $22 million, down slightly from last year. Currency headwinds and lower volume were partially offset by good cost management through our network optimization programs.

For our Company overall, our cash flow from operations and strong balance sheet enabled us to deploy cash to advance our strategic blueprint. During the quarter, we finalized the Kerr acquisition, increased our quarterly dividend by 7% and repurchased 70,000 shares. I'm pleased to now turn the call over to Jack, who will spend time on our financials. Jack?

Jack Fortnum - *Ingredion Incorporated - EVP & 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 the Kerr operations as of August 3, and a full quarter of the Penford operations.

Net sales were down $24 million for the quarter. The majority of the decline is attributable to unfavorable foreign exchange, along with the impact of lower-priced corn, which is passed through to our selling prices. This decline was partially offset by volume growth in our core and specialty ingredients and the addition of acquisition-related ingredients.

Gross profit was higher by $32 million as a result of higher core and specialty volumes, the addition of acquisition-related volumes, margin expansion in North America, and lower corn costs. Reported operating income was $3 million lower versus last year, while adjusted operating income was $14 million higher.

The increase in gross profit was offset by higher operating expenses, driven by the inclusion of Penford, as well as the $11 million unfavorable swing in other income. If you recall, last year during Q3, we recorded a $7 million reimbursement related to an indemnification payment from a previous acquisition with the offsetting entry being recorded as higher tax expense.

This quarter, based on the final settlement, we recorded $4 million of other expense with the $4 million been recorded as lower tax expense. The impact on our net income for 2015 and 2014 periods is zero. Reported operating income was lower than adjusted operating income by $17 million. Of this, $12 million is related to Brazil restructuring announced on September 8, $3 million is for acquisition-related costs for Penford and Kerr, and $2 million is related to the severance-related charges for the sale of our Canadian facility in Port Colborne, which is expected to close in the fourth quarter of 2015. We anticipate recognizing an approximately $10 million pretax gain on the Port Colborne sale which will be excluded from our fourth-quarter adjusted earnings.

On earnings per share, reported and adjusted earnings per share were $1.48 and $1.64, respectively. For the quarter, our adjusted earnings per share was $0.04 higher than last year's earnings per share. Moving on to the net sales bridge, our sales of $1.4 billion are lower than last year by $24 million. Volume growth contributed $130 million, but was more than offset by the $157 million of foreign exchange headwinds. Overall, price mix was relatively flat.

Increased pricing for currency devaluations was largely offset with lower pricing from passing along lower corn costs relative to last year. As we look more closely by region, you can see unfavorable foreign exchange affected us across all four regions. Volume growth in North America and South America help offset volumes in Asia-Pacific and EMEA. Lower price mix in North America and Asia-Pacific was due to passing through lower corn costs. But price mix was favorable by 9% in South America as we continued to price to recover currency devaluations.

Adjusted operating income increased $14 million in the quarter. North America posted strong results due to corn and specialty volume growth, acquisition-related volumes, and lower operating costs. North American price mix was down as a result of the pass-through of lower corn costs.

South America operating income increased by $1 million. The change was driven by favorable price mix due to pricing to recover currency devaluations, higher volume, and disciplined cost management. These positives were partially offset by higher operating expenses and other costs attributed to the inflationary environment.

A-PAC was up less than $1 million, while EMEA was down less than $1 million. In A-PAC, margin expansion offset the effect of a strong US dollar. While in EMEA, good cost management only partially offset the foreign exchange headwinds.

Corporate costs were up largely due to the tax indemnification issue. We'll wrap up the quarter with earnings per share. On the left side of the page, you can see the reconciliation from recorded to adjusted. Included in impairment and restructuring is the $0.13 for the Brazil restructuring and Port Colborne severance-related costs. We also incurred $0.03 of Kerr and Penford acquisition-related costs.

On the right side, operationally, we saw an improvement of $0.15 per share. Primarily the result of margin improvement with some volume lift, partially offset by foreign exchange and other expense due to the tax indemnity swing I mentioned earlier.

The non-operational impact for the quarter was negative $0.11. Our tax rate was higher, which had a negative $0.15 per share impact. The higher rate was driven by greater earnings in higher tax jurisdictions as well as 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 partially offset by other favorable items such as financing costs, and the impact of last year's accelerated share repurchase. Despite higher debt levels due to acquisitions, financing costs were favorable by about $0.01 because of lower interest rate resulting from the rate swaps executed last year. The accelerated share repurchase from August of 2014 resulted in about $0.03 per share of benefit. We do not expect to see any benefit from the accelerated share repurchase in Q4.

I'm going to move fairly quickly through the year-to-date figures. Just as a reminder, these results include Penford operations as of March 11. Year-to-date net sales were down $84 million. The majority of the decline is attributable to unfavorable foreign exchange, along with the impact of lower-priced corn, which is passed through in our selling prices. This decline was partially offset by solid volume growth in both our organic business and specialty in core as well as the impact of Penford and Kerr acquisitions.

Gross profit was higher by $86 million as a result of higher volumes, lower energy in corn costs, and lapping North America's adverse weather effects in the first quarter of last year. Reported and adjusted operating income was higher than last year by $24 million and $66 million, respectively. Reported operating income was lower than adjusted operating income by $42 million due to acquisition-related costs of $18 million; [Brazil] restructuring costs of $12 million; restructuring charges of $10 million for Penford; and $2 million related to severance-related costs for the sale of Port Colborne.

On earnings per share, reported and adjusted earnings per share were $4.09 and $4.47, respectively. Year to date, our adjusted earnings per share was $0.58 higher than last year's earnings per share. The net sales bridge highlights the volume growth contributing $282 million, and that was more than offset by the $345 million of foreign exchange headwinds. The price mix reduction in net sales is largely due to lower pricing from passing along lower corn costs relative to last year, partially offset by pricing actions to recover currency devaluations.

On a year-to-date basis, foreign-exchange headwinds affected us across all four regions. Volume growth in North America and Asia-Pacific was positive, while volumes in South America and EMEA were flat. Lower price mix in North America and Asia-Pacific was due to passing through lower corn costs. Price mix was favorable by 8% in South America as we started to price to recover currency devaluations.

Adjusted operating income increased $66 million year to date. North America posted strong results as it had Penford volumes, corn specialty volume growth, lower operating costs, and it lapped the adverse weather from Q1 of 2014. North America price mix was down as a result of the pass-through of the lower corn costs. South America was down $1 million. Favorable price mix was offset by foreign currency, foreign exchange, higher operating expenses and other costs attributed to the inflationary environment.

APAC was up $1 million while EMEA was down $2 million. In APAC, volume offset the effect of unfavorable foreign-exchange while in EMEA operating efficiencies only partially offset the foreign exchange headwinds.

Moving to the earnings per share bridge, on the left side of the page, you can see the reconciliation from the 2015 earnings per share reported to adjusted of $0.38, which is attributable to the acquisition-related costs from the Penford and Kerr transactions as well as restructuring costs from Brazil, Penford, and Port Colborne.

On the right side, operationally, we saw an improvement of $0.64 per share, primarily margin improvement with some volume lift partially offset by the foreign exchange and other expense. The year-to-date non-operational exchanges were negative $0.26.

Our tax rate was higher which had a negative $0.26 per share impact, primarily due to greater earnings in higher tax jurisdictions, as well as the devaluation of the Mexican peso, which I explained earlier. This was partially offset by other favorable items such as lower financing costs and the impact of last year's accelerated share repurchase. Financing costs were favorable, about $0.05, due to a lower interest rate resulting from the rate swaps executed last year. The accelerated share repurchase for August of 2014 resulted in a $0.15 per share benefit.

Turning to our guidance, we expect net sales to be flat, volumes to be up from 2014, and continued growth in specialty volumes. We have raised our range for adjusted earnings per share to $5.75 per share to $5.90 per share. This includes the anticipated impact of the $0.08 to $0.12 EPS accretion from the Penford acquisition as well as the Kerr acquisition. The Kerr acquisition is expected to have a neutral effect on earnings per share this year. The guidance excludes acquisition-related and restructuring costs.

We anticipate that unfavorable foreign exchange will have a negative impact of $0.50 to $0.55 per share in our 2015 earnings per share guidance. We expect this to be partially offset by incremental pricing. As we have explained in our business model, these pricing actions typically require 3 to 6 months to take full effect. We expect corporate expenses to be up year over year to a more normalized level. Recall the 2014 corporate expenses were lower than normal due to the reclassification of the tax indemnity related to the National Starch acquisition and other small items.

For the year, we expect financing costs to be down slightly. Our financing costs are expected to be slightly lower due to interest rate swaps executed in Q3 of 2014, even though we have more debt outstanding as a result of the Penford and Kerr acquisitions. Our effective annual tax rate is expected to be approximately 32% versus an adjusted rate of 28.3% last year.

In North America, we expect net sales and volume to be up 2014. It is important to keep in mind that a large portion of our sales and costs are based in US dollars, which helps mitigate some of our foreign exchange headwinds. For the full year, we expect operating income to increase in North America. We lapped the last adverse weather effect in the first quarter of last year, expect improved product mix in margins and will include Penford and Kerr's post-acquisition earnings.

The Penford and Kerr integrations remain on track. We remain excited about the broadening of our ingredient portfolio with solutions that consumers are increasingly demanding. For the year, 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 Argentine situation remains in stagflation and we are monitoring the election environment. In Brazil, we expect some volume weaknesses offset by good cost management control. And we expect the Andean region to continue to perform well.

Throughout the region, we continue to actively manage our costs to drive efficiencies to offset inflationary pressures and we continue to look at optimization opportunities. Overall, we expect operating income to be flat in South America relative to 2014.

Asia-Pacific should continue to deliver modest operating income growth. 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 enhancements 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 down versus 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 currency headwinds to offset the improvement. Pakistan is expected to continue its effective cost management and core product growth.

Moving on to cash flow, our cash flow provided by operations for the first 9 months of the year was $481 million, which is $19 million higher than last year. We continued to deploy our cash strategically in the form of two acquisitions, capital expenditures, dividend payments and share repurchases. We have a proven track record of both reinvesting and returning capital to shareholders and we expect to continue this in the future.

We expect cash from operations in 2015 of approximately $650 million to $700 million, unchanged from last quarter. Importantly, we'll continue to deploy our cash for capital expenditures as we concurrently continue to explore M&A opportunities. Additionally, we expect to use 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. As Ilene mentioned, we raised our quarterly dividend by 7% and repurchased approximately 70,000 shares during the quarter. Year-to-date, we have repurchased 435,000 shares. 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 while also investing in the business.

That brings my section of the presentation to a close now. I'll turn it back over to Ilene.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

As we said before, our business model and strategic blueprint are working. Our underlying business is doing well, in spite of currency headwinds and economic challenges. We continue to take action to optimize our cost structure for the future.

North America is expected to continue its positive trajectory. Asia-Pacific is projecting modest growth, and South America is expected to be in line with last year despite its challenges. And EMEA is projecting a modest decline in the face of currency headwinds resulting from a strengthening US dollar.

With this year's strategic actions, which include deploying our capital for growth, optimizing our global network, making acquisitions and raising our dividend, we are confident that we will continue to deliver excellent shareholder value. And now we are glad to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Brett Hundley, BB&T Capital Markets.

Omar Mejias - *BB&T Capital Markets - Analyst*

Good morning, everyone. This is actually Omar filling in for Brett.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Good morning, Omar.

Omar Mejias - *BB&T Capital Markets - Analyst*

Congratulations on the quarter, first of all. I want to touch on North America a little bit. I want to get a little more color on what are the dynamics there? How is that market performing so well? If you guys could just give me a little more color there. And also, in the US market, in particular, is it possible for that market to perform better in 2016 in terms of margins and overall performance? Thanks.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

This is Ilene. I'll start and then turn it to Jack. First of all, we're not going to comment on 2016. I would say in terms of third quarter, we continue to do fine in all of the different segments. Now the specialty growth continues and so that is what we are focused very much on the on-trend recipes for healthy ingredients. So we are working with both large and medium and regional-type customers to develop those recipes.

GDP is still 2% to 3% in the US. Of course, as part of North America, we do talk about Mexico and the specialty growth has continued to go well there as well as the growth in the population. And the Mexico GDP is also 2.3%.So I think that we feel that it is a steady-Eddie type story and we are well-positioned for both the growth. We talked about the 2% organic growth in North America, with our specialty portfolio, as well as our ability to perform and run well in terms of operating excellence. Jack, anything to add?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I would just say, Omar, I think that, as usual, North America had a very good quarter; it performed very well. One of the things that is always a little choppy in our business, as you know, is the quarterly layout of our earnings. And so, effectively, we had a strong quarter which was in our forecasts, but sometimes there's a little bit more, through the time of the harvests, a number of different issues associated with it.

We've had a couple good quarters in a row with North America. I expect the fourth quarter to be as we anticipated in our annual guidance. I refer to the annual guidance just to make sure that people think through because we always have a little bit of movement between our quarters and it then comes down to our annual guidance that we really focus on in North America.

Omar Mejias - *BB&T Capital Markets - Analyst*

That makes sense. Following up on your comment on your annual guidance, the new midpoint of the guidance implies a weaker Q4. Can you just talk a little bit about that and what's happening there, if there's anything we should be aware of?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I wouldn't say there's anything you should be aware of. I think it is really just the layout in the quarters. I think our third-quarter came in fairly well. I think it allowed us to have confidence in hitting the top, in that mid-part of the new range, which is really lifting the bottom part of our old range up and so we're seeing more clarity into the fourth quarter. And, when you say down, I don't really look at it as being down. Maybe at the very bottom end of that range. But if you look at the midpoint we'll still be up from last year.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

I think the other thing I would add is, remember in the fourth quarter, we had been talking we've been experiencing a higher tax rate this year. And of course in the fourth quarter, we won't have any offset from that accelerated share repurchase in terms of the share count. That is why you may see a little bit of a difference. As Jack said, when you look at the midpoint, we don't see it being down.

Omar Mejias - *BB&T Capital Markets - Analyst*

That makes sense. Lastly, I just want to touch on South America. Can you guys talk a little bit more about what is being down there on the cost side and how this might be a helping to offset the currency and growth-related challenges there? Just a little more color there would be great. Thanks again for my questions.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

Sure. I'll start out and then, Jack, we'll see if he wants to add anything. Certainly in Brazil, as we announced on September 8, for next year, obviously we've announced the closure of two of the facilities. In terms of the impact this year, we have done a really good job on focusing on cost optimization. I talked about in previous calls where we have taken our best practices, let's say as an example, energy efficiency, and we've used our people and know-how and brought in [SWAT] teams to particular facilities to apply that in Brazil. We're obviously benefiting from that particular effort. At the same time, as we said in our remarks, we've also had an effort to pass through foreign exchange headwinds in the form of price and price mix in Brazil. That has gone well.

Argentina Southern cone is performing exactly as expected for the year. And then Colombia, or the Andean region, as I said, the GDP actually in Colombia is about 2.5%, forecasted to be even slightly higher in the next few years. And so we have a very good operation there and so we have been able to grow with our specialty and our core products in Colombia. Anything you'd add?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I don't really think I have anything to add to that. I think Ilene covered it well.

Omar Mejias - *BB&T Capital Markets - Analyst*

That make sense. Thanks again, guys.

Operator

Robert Moskow, Credit Suisse.

Robert Moskow - *Credit Suisse - Analyst*

Thank you. It's good to see North America performing so well. We, and I'm sure others, have written a lot about tighter capacity and stronger pricing power in corn sweeteners. I was made aware of one element of that though that where capacity might not be quite so tight and that was dextrose. That is a tougher thing for us to get any visibility on. Do you have anything you can tell us about dextrose capacity from an industry perspective?

Whether your pricing power there or ability to take price is at all compromised because of that? Also because of its tight relationship with sugar. Thanks.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Yes Robert, we usually don't comment specifically on individual products. The dextrose comes in two forms as you know. One is a liquid dextrose and one is a crystalline dextrose. I'm not aware of anything that is unusual in the environment that has changed dramatically. Obviously you have, on the liquid dextrose side, you have some swing capacity that can move into it and there continues to be a number of new products that utilize that liquid dextrose, particularly in the [biomaterial segment of the customer base. I'm not aware of anything specific that gives us any] great concern. If anything, with [energy prices being down from petroleum replacement products, it may be a little soft. I'm not aware of anything specific. Ilene, I don't think you are either?]

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

No, no.

Robert Moskow - *Credit Suisse - Analyst*

And then, just follow up on the guidance again, Jack. If I take all of the other regions, that's pretty easy to put in a model. But if I look at North America, just as a follow-up to the prior question, I believe last year there was about, maybe $13 million, $14 million, of one-time issues in North America related to co-product pricing that dampened last year's results. So, if I normalize for that, the forecast [implies very little traffic growth for fourth-quarter North America. Your pace of improvement is much better than that. Was there anything that we should be aware of and am I doing the math right?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Your memory is good. I think of it more as a $10 million type of issue and terms of the devaluation that happened in the last year pertaining to our feed a both in Canada and Mexico where we did not price through] the feed type of numbers. In terms of looking at North America, specifically, I think that what we're looking at is a pretty reasonable fourth quarter, actually.

We have a bit of a few things where we are working on pertaining to the sale of the Port Colborne facility where there are certain costs in terms of moving inventories around and things like that, but nothing of any significance that's going to impact our forecasts. As I did mention though, Rob, this is one that is a little bit more challenging, is how the corn is laid out and even the timing of the harvest. The harvest came in a little early this year. There's a few implications between this quarter and next quarter between how we look at the numbers.

But, fundamentally, I think we're looking at the fourth quarter to be a reasonable quarter in North America again. And that would be backing put that $10 million impact on the feed issues that we don't expect to repeat this year.

Robert Moskow - *Credit Suisse - Analyst*

Great. I appreciate that conservatism. Thank you.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

And then, Rob, I do want to make sure that you recall, Ilene mentioned it in her conversation too, though. The tax rate, because of the Mexican implications, in terms of being a US dollar functional currency and having US dollars down there, has impacted us and it will continue to impact us in the fourth quarter. Below the line we're being impacted, which isn't really been translated quite the same way. That will have an impact on our fourth-quarter forecast as well.

Robert Moskow - *Credit Suisse - Analyst*

It implies like a 33% corporate rate.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Yes, we are saying 32% for the full year. So that's basically there.

Robert Moskow - *Credit Suisse - Analyst*

All right. Thank you.

Operator

David Driscoll, Citi Research.

David Driscoll - *Citi Research - Analyst*

Thanks a lot. Good morning, everyone. I want to spend a little bit more time on South America. You guys have kind of addressed this. Forgive me; I think it is so important on South American pricing and I just want to make sure that I understand it. In the script I appreciate the comment, Jack, about the 3 to 6 months. I wanted to come back to that and just ask you. Because the currency devaluations are so intense right now, is there any increase in the speed of Ingredion able to affect these price increases? Or is there just something like super-structural in how people reorder stuff and customers reorder and so forth that makes it at this 6 month mark? Or can you say with some confidence that it is really more on the 3 month side? Can we start right there?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Sure, David. Can I go by region? Because it is a little different in each one of the three regions that we look at it South America. If I start at the north part in the Andean region, there the economy continues to track very well. We're passing on our prices very effectively, even though the Colombian currency is down dramatically from last year. We've managed to get people almost, I wouldn't say thinking, but at least moving almost dollar for dollar at the exchange rate in terms of some of our costs because there most of the competition is from exports and things like that, as well. So everyone is moving to pricing in dollars.

When you go into Argentina, it is a much more challenging type of environment in terms of getting the prices up, partially because of the -- if you recall, Argentina is HFCS largely dominated market and it relates to sugar, so it partially depends on the sugar pricing in that marketplace. As well as they still have some of their pricing controls in that marketplace. That is probably a bit of a lag in terms of our whole pricing model. And we've had challenges getting that pricing through, although we are getting some price increases in Argentina. But a devaluation hasn't really taken place there nearly to the extent of the Andean region or Brazil.

Then you come to the big one which is really Brazil. And I think there our team has done an excellent job in terms of pushing pricing through. Obviously, earlier in the quarter we've seen the real actually break 4 for a period of time and then come back to that 3.80, 3.85 type of range. When you see those dramatic changes in pricing, particularly when the demand is okay on our products. There is there still a lot of competition in Brazil. The economy is falling down and things like that. So, essentially, there you are still getting that lag because you have got corn prices. And Brazil is one of those countries where the energy prices are actually increasing a little bit in terms of transportation as well, because of some of the Petrobras types of issues. And so we are passing on energy costs as well as corn costs in that marketplace.

So, I would say that, a tough haul in Brazil, but I think our team is doing an excellent job on it. It is interesting, because it is always a balance between volume as well as getting the prices up. We've seen our volumes holding fairly well because of that underlying Brazilian business in terms of the food and beverage segment, in terms of the brewing segment, has been fairly steady for us.

I still think that 3 to 6 months is a reasonable timeframe, because when you look at it on a weighted average basis, sometimes it's more challenging than other times. I would say that the team is doing a great job in terms of getting those prices up where they can. So, I'm holding to the 3 to 6 months, I guess.

David Driscoll - *Citi Research - Analyst*

Jack, can I ask for a little bit of clarification, when you say they are doing a good job on pricing. On the first half of the year, foreign exchange was a negative 19% impact to business. In the third quarter itself, foreign exchange was a negative 33 point impact. So it worsened by 14 percentage points. Pricing in the first half was up 8. Pricing in the third quarter was up 9. That only gets better by 1 point. So it doesn't actually look like, proportionately, pricing got better versus what we saw. And maybe this is just a lag issue. And so the question here then just says, in the fourth-quarter, wouldn't it be reasonable for us on the outside to be looking for something like 14, 15 points of pricing coming out of South America, up from the 9 that you reported in this quarter. Is that a reasonable landscape?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I think the only dynamic that you have to also factor in is, is the corn cost in Brazil very similar to North America, where we're still seeing corn costs in Brazil, particularly in the local marketplace, as being down actually this year. So you're kind of getting a mix of lower corn costs, which would negatively impact -- push our price mix down and then also the adjustment for the devaluation. You really have to look at the ratio of those two.

You have to also understand that when we price through the foreign exchange, we can take this off-line a little bit, but when we price through the foreign exchange we're trying to lock in our margin in dollars. It's not a total impact, in terms of the exchange that we have to get back in pricing because the, obviously, cost structure changes a little bit as well. I'm actually pleased with the way they have been addressing it, given the environment.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

I was going to add, when Jack talked earlier about the balance of that versus what I call the volume equation, consumers, while the economy has slowed down in Brazil, they continue to eat food. As we said in the third quarter, the beverage or beer side was pretty robust, but that was versus a year ago, which was a little bit slow. So on a year-to-date basis, the consumption will be down. It's not a very robust volume environment. We are trying to balance both the price pass-through as well as optimizing the running of our plants.

David Driscoll - *Citi Research - Analyst*

The final part on this, is this all the reason why the guidance range remains so large? Your $0.40 range with six months to play? You're now at $0.30 range with two months to play. I'm just curious, is this South American region the principal genesis of the [whisk] within the bottom and top end of guidance?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I think we also have a couple of items on the guidance pertaining to -- let's face it. The elections just took place the other day in Argentina and there was no resolution there. So you are right. There is a little bit of comfort that we get out of having a wider range because we're not sure if there will be a major devaluation or not in our forecast. If you look at the guidance, it's really $0.15, David. So, I'm not too sure when you said $0.30. I'm not clear in terms where you meant. We keep a reasonable range on our guidance because some of the things in South America. I do think there is also the volume impact pluses and minuses in the second quarter.

David Driscoll - *Citi Research - Analyst*

Okay. I'll leave it there. Thanks so much.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

You're welcome.

Operator

Ken Zaslow, BMO Capital Markets.

Unidentified Participant

Good morning. This is Patrick for Ken.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

Good morning.

Patrick Chen - *- Analyst*

I went to go little bit further in the Argentina election. What are you modeling in terms of time of devaluation and ow quickly you can actually act to, like a 30% devaluation of peso, and what the cost implications will be?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Your 30% isn't too far off on how we are looking at it. We've kind got it of staggered, but we have a little bit coming in this year. As time progresses, it's pushed out the election results for a little bit, so there will be some pressure. I think more importantly, in terms of picking when the devaluation is going to take place, because I think there will be a devaluation at some point in time, is more the concern related to, I'll call it the tying up of corn and things where people are anticipating a devaluation and they want to hold assets.

We've been buying a little bit of extra corn ourselves, just to make sure that we have corn to run in things. You're always worried that during these transition period of a government, that there's some slowness in terms of farmers releasing their corn in anticipation of a devaluation where they could be moving on the export market later on in things. I think that right now we are still expecting our Argentine business to come in basically where we had forecasted at the beginning of the year. Given the volatility of Argentina, I think that is a fairly good number from my vantage point.

Next year when we give guidance, we'll be looking at more, I'd say we'll have more information pertaining to what the government policies will be and then we'll roll out more data in terms of how we are seeing that devaluation take hold.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

And of course, at this time of the year, if there was a major devaluation in December, the impact on this year's P&L would not be huge. So we think we factored that into the guidance. Of course, as Jack said, it's all about next year.

Patrick Chen Just one more question. Philosophically, in terms of containing costs versus long-term capacity, how does Ingredion using about cutting reactive costs for some changed capacity for long term, particularly in Brazil, given your recent plant closures?

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

I would say first of all, when I think globally, we are growing our specialty products and so we talk a lot about trading up and delivering value to customers. So, of course, we try to balance our facilities and be cost effective, because we are expected by our customers to be cost effective. At the same time we are spending capital to add features to grow our specialty products. I think as it relates to Brazil, we still believe in long-term the growth of the middle class in Mexico, as well as Brazil. We talk a lot about Mexico. In Brazil, we think that will come back, so there's a bit of a hiatus.

At the same time, we have to be efficient. That's why we announced the closure of the two smaller facilities and the ability to consolidate with a great opportunity to do that now along with other cost optimization projects like energy efficiency. Long-term we believe in Brazil. I look at the specialty growth in Mexico and I think eventually, we will be able to grow even more with specialty in Brazil because the consumers want to eat healthy. They want to eat dairy. They want healthier baked goods and so we are positioned to do that. Jack, do you want to add anything to that?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

I think the one thing I just want to make sure people recognize is that, when we closed those two facilities it drops the fixed cost of the individual facilities. But we are actually, one of the reasons why it's taking a year to execute upon the project is because we are moving some of our finishing channels into our other two facilities being Mogi Guacu and Balsa Nova. And so essentially we are getting the same type of production out in the longer term, particularly on the specialty side where we have moved the equipment back into these other facilities. So it is the consolidation of our facilities reducing our fixed costs, which is driving the process. We still believe in the longer term in Brazil is going to continue to grow and it's for us to continue to be as efficient as possible as we look at our network.

Patrick Chen - - *Analyst*

Thank you. I'll pass it along.

Operator

Farha Aslam with Stephens.

Farha Aslam - *Stephens Inc. - Analyst*

Two questions. The first one is related to competition from sugar given sugar prices have declined, while off their bottom. Particularly for Mexico and South America, do you see any impact from lower sugar?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Obviously lower sugar has some impact, particularly in Argentina. As you know, that's the only place in South America we're producing HFCS, which competes directly with sugar. The lower sugar prices have come down but so has corn as well, in terms of our competitiveness with the substitute product. As you know, the Mexican sugar prices aren't really world sugar prices and they track closer to the US, plus freight into the US type of numbers. I would say that we can be competitive in Mexico on sugar. The other thing I would add, too, is we talk about it a lot is, part of our whole repositioning is to move away from direct competition with sugar and our portfolio continues to move in that direction. So there's not nearly an impact of competitiveness with sugar on the longer term as well. So, Ilene, do you have any other comments that you would add on that one? I think that handles it.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

I think that, as Jack said, we said before that our sweetener portfolio, high fructose for beverage is trending towards under 10% of the portfolio. The growth in specialty products is much more of a focus. Not only with our organic, but even our whole MA efforts. That was what was behind the whole Kerr acquisition was to really start to enter the simple food arena where you can get sweetness from fruits and other natural ingredients, and so it is a way to really grow in healthy ingredients.

Farha Aslam - *Stephens Inc. - Analyst*

And that leads me to my second question. After Kerr and Penford, what portion of your portfolio would you categorize as specialty and what portion in core? And what do you expect each of those two to grow at in the next two or three years?

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

What I said before. We don't give quarterly numbers per se on this. For 2014, our specialty portfolio was about 24% of the total and our goal over the five years is to get that to the 30%. And what I would say is both Penford and Kerr enhance that and move us in the right direction. We'll be calculating that number again for 2015, but it's a slow move. Every acquisition has a combination of specialty and core.

What we are looking at are those acquisitions that continue to have a very robust pipeline. We're looking at those that actually are above the 24% so that we grow that percentage, because that means that the ingredients are on trend and that will be used in health and wellness type recipes, nutrition. Both of those were important as part of that criteria. Penford, of course, helped us in participating in the potato side, gluten-free, non-GMO, some nice special applications. So both Penford and Kerr really are enhancing our portfolio.

Farha Aslam - *Stephens Inc. - Analyst*

Thank you very much.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

You are welcome.

Operator

Adam Samuelson, Goldman Sachs.

Adam Samuelson - *Goldman Sachs - Analyst*

Thanks. Good morning, everyone. My first question, going back into the North American business a little bit, is trying to segregate some of the base margin improvement a little bit more. I know, in earlier comments that you alluded to an early start to the harvest and that you got a little bit of corn basis help, and just the layout of the quarters can sometimes give you some tailwinds.

That base margins when you strip out the acquisitions, what would seem to be up 200 or so basis points year-over-year. I'm wondering if you could help segregate some of the drivers there. And if it's cost and productivity, maybe provide a little more color on what's actually driving it?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

To start with, you have to appreciate that last year we did have that incident in the first quarter which was in the polar vortex which increased our costs.

Adam Samuelson - *Goldman Sachs - Analyst*

I was just referring to Q3. Frankly Q2 is the same thing.

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

As we go through you have to remember too, there are a few things that are driving the margin improvements. If you think about it, some of it is solid operations as you implied in terms of getting the margins in place. Some of it is the mix.

If you think about the specialty mix, one of the things I do want to come back to a little bit, which has helped our North American business this year, was the fact that we put capacity into Europe. And we basically, we're filling out the capacity in Europe which freed up capacity where we are moving some of our specialty products over to Europe. And those products have been actually sold within the North American environment which improved the margins in our local environment. So you're seeing a bit of a improvement from that perspective as well.

In terms of the corn layout and things like that, it is a regular type of component where you can't predict exactly when the corn is coming in, unless you get it right off the farm for a period of time, the basis drops a little bit. That is just noise in the numbers and the quarter. That's why we try to give annual guidance because we don't want to predict the months.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

I would say the three factors, as Jack talked about, the solid operations, cost improvement was positive. The specialty mix continues to grow and, as consumer trends accelerate even more in terms of people wanting healthy ingredients, more dairy, some of the regional companies really growing their demand requirements. And then the third piece, I would say in Mexico, with the growth of the middle class, a decent economy in terms of GDP, some growth in specialty and some good cost optimization in Mexico as being part of North America.

Adam Samuelson - *Goldman Sachs - Analyst*

Okay. I jumped on the call late, so I apologize if this was addressed earlier, but the FX headwinds for the year. I think it bumped up $0.50 to $0.55. I think it was $0.35 to $0.40 in Q2. How much of that increment was realized in the third quarter and how much of that spills into Q4?

Jack Fortnum - *Ingredion Incorporated - EVP & CFO*

Pardon me? In terms of what would happen, is as you think about year to date it's about $0.47 and so the remaining portion is still expected in the fourth quarter as you go look at the year-to-date number. That is kind of how it lays out. The bump up was partially caused by, and Adam, this is where I think you have to appreciate that part of it was in Brazil and South America were the big pieces. Really what we are seeing there is we are trying to get the pricing back through, so we may not feel the full impact of that as a negative on our business. The headwinds are offsetting with price increases as best as we can.

Adam Samuelson - *Goldman Sachs - Analyst*

All right. Thank you very much.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

You are welcome.

Operator

With no further questions, Ms. Gordon, I will turn it back you for any closing comments.

Ilene Gordon - *Ingredion Incorporated - Chairman, President & CEO*

Okay. Great. Thanks all for your attention. Before we sign off, I just will reiterate our confidence in our business model, strategy and long-term outlook. We remain keenly focused on value creation and we're committed, as we've demonstrated, to delivering shareholder value. That brings our third quarter 2015 earnings call to a close. Thank you again for your time today. Thank you.

Operator

Ladies and gentlemen, that does conclude your conference. Thank you for your participation. You may now disconnect.