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INGR - Q4 2016 Ingredion Inc Earnings Call

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OVERVIEW:

INGR reported 2016 net sales of $5.7b and reported EPS of $6.55. 4Q16 net sales were $1.4b and reported EPS was $1.26. Expects 2017 net sales to be up from 2016 and adjusted EPS to be $7.40-7.80.

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

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PRESENTATION

Operator

Ladies and gentlemen, thank you for your patience in standing by, and welcome to the Ingredion fourth-quarter 2016 earnings conference. (Operator Instructions) And just as a brief reminder, this conference is being recorded.

At this time I would like to turn our conference over to Vice President of Investor Relations and Corporate Communications Heather Kos.

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

Good morning and welcome to Ingredion's fourth-quarter 2016 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 a few hours ago for your convenience.

As a reminder, our comments within this presentation may contain forward-looking statements. These statements are subject to various risks and uncertainties. Actual results could differ materially from those predicted in the forward-looking statements, and Ingredion is under no obligation to update them in the future as or if circumstances change. Additional information concerning factors that could cause actual results to differ materially from those discussed during today's conference call or in this morning's press release can be found in the Company's most recently filed annual report on Form 10-K and subsequent reports on Forms 10-Q and 8-K.

During this call, we will also refer to certain non-GAAP financial measures, including adjusted earnings per share, adjusted operating income and adjusted effective tax rate, which are reconciled to US GAAP measures and note to non-GAAP information included in our press release.

Now I am pleased to turn the call over to Ilene.

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

Thanks, Heather, and let me add my welcome to everyone joining us today. We appreciate your time and interest.

Now before we begin, I'm sure most of you saw our announcement earlier this morning of Jack Fortnum's retirement. He has been a terrific business partner and tremendous asset to the Company, and he will be missed. I would like to personally thank him for his 33 years of unwavering commitment and leadership in making Ingredion the Company that it is today. On behalf of our executive leadership team, our 11,000 employees and our directors, we wish you all the best in your retirement.

Now on to the business at hand. I will give more details on the fourth quarter in a moment, but first I would like to look back on 2016. Overall, I am pleased our business model and strategic planning continue to deliver shareholder value. We ended the year with record EPS and operating income while generating record operating cash flow of $771 million. North America, Asia Pacific and EMEA had record high operating income, while South America was down due to macroeconomic and foreign exchange headwinds in the region.

Our higher value specialty ingredient sales mix grew 1 percentage point to 26% of revenues, and our continuous improvement efforts in global footprint optimization lowered our cost structure and contributed to our margin expansion. Acquisition and specialty ingredient growth were offset for the sale of our Port Colborne facility and lower volumes in South America due to macroeconomic headwinds. As a result, volumes were flat overall, and price mix finished strong for the year, up 6%.

Now our cash flow from operations and strong balance sheet enabled us to deploy cash to advance our strategic blueprint. We increased our quarterly dividend 11%, and our return on capital employed was 12.6%, exceeding our stated long-term objective of 10%. We continue to invest in our global network to increase higher value specialty production in North America and Asia. And at the end of the fourth quarter, we closed our Shandong Huanong Specialty Corn and TIC Gums acquisitions, further expanding our specialty capacity and broadening our Ingredion portfolio.

I am especially excited about expanding our texture capabilities and leadership. TIC Gums expands our offerings with non-starch hydrocolloids and builds on our work in formulating solutions for natural, organic and clean label demands. Their higher value specialty products and systems expand our reach into innovative small- and medium-sized customers. With these on-trend ingredient solutions and our global presence, we believe TIC has tremendous growth potential.

Now let's spend a moment on each region's performance in the quarter. Operating income in North America was $137 million for the quarter, up $20 million from last year. Overall volumes were down 6%, driven by the sale of our Port Colborne facility and a planned rebalancing of our North American network. Price product mix was up driven by both specialty and core ingredient sales. Continuous improvement initiatives, network optimization, tempered cost synergies, and lower input costs continue to drive good operational efficiencies throughout the region.

For the year, I am pleased with the progress we made in North America as we had record operating income of $611 million there.

In South America, operating income was $29 million, up $2 million from last year. The macroeconomic conditions continue to be challenging. Pricing actions, good cost discipline, and continuous improvement projects partially offset higher corn and other [imprint] costs and softer volumes. We continue to right-size the business as evidenced by the accelerated plant closures of two facilities in Brazil in 2016.

For the full year, South America operating income was $89 million, down $12 million. Brazil's economy continued to feel the effects of negative growth. Given the macroeconomic environment, our local leadership team continued their ongoing focus on specialty ingredient growth, price mix management, and network optimizations. The Southern Cone economy remains challenging as economic measures lowered consumer disposable income and affected our volumes. We continue our focus on all executable activities of the business, including cost containment in a high wage inflationary environment. The Andean countries continue to perform well.

In 2017, we expect South America to maintain a tight focus on cost and network optimization. In the longer term, we believe the underlying demographics are positive for the future and believe we are well positioned to take advantage of an economic recovery when it materializes.

Now moving along to Asia-Pacific, the region delivered $25 million of operating income, down $2 million from last year. Overall volume was up 3% versus last year, and specialty sales were particularly strong in Japan and Southeast Asia. However, this was offset by weaker price mix due to customer mix. We continue to focus on continuous improvement initiatives to help margin expansion, and our project to expand specialty capacity was completed during the fourth quarter. For the year, Asia-Pacific had record operating income of $111 million.

Finally, the EMEA region reported operating income of $26 million, down $1 million from last year. Currency headwinds and higher input costs in Europe outpaced improvements in price mix. In Europe, our broad specialty portfolio continues to perform well and grow, and the Pakistan economy continues to expand, benefiting both our core and specialty volumes. For the full year, EMEA also delivered record operating income of $106 million, a 13% improvement.

I am pleased to now turn the call over to Jack who will spend time on our financials. Jack?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Thank you, Ilene. Good morning, everyone. Let me start by covering the highlights of the income statement. Net sales were down $6 million for the quarter. Unfavorable foreign exchange and lower volumes in South America and North America offset a favorable product mix in both our specialty and core ingredients, as well as favorable pricing in South America and North America.

Gross profit was higher by $26 million as a result of favorable price product mix in both our specialty and core ingredients and margin expansion as a result of our optimization efforts. Reported and adjusted operating incomes were $189 million and $194 million respectively.

Reported operating income was lower than adjusted operating income by $5 million. This difference is related to employee-related severance in North America, costs associated with the execution of information technology outsourcing, as well as integration and acquisition costs.

Our reported and adjusted earnings per share were $1.26 and $1.67 respectively. $0.36 of this difference is related to the pending settlement of the matter under the US Canada tax treaty we explained last quarter, with the remaining difference attributable to impairment and restructuring charges, as well as integration and acquisition costs.

Moving on to the next sales bridge, our sales of $1.4 billion were relatively flat versus last year. Favorable price product mix contributed $56 million. This was partially offset by $12 million of foreign exchange headwinds and a volume decrease of $50 million. If you recall, we explained for the past year, that with the sale of Port Colborne, we expect our -- expected our organic volumes to be down as we shed sales of lower margin ingredients.

As we look more closely by region, you can see unfavorable foreign exchange affected us in two of the four regions, though to varying degrees. In North America, volume was down 6%, driven by our Port Colborne sale and North American network rebalancing. We shed some of our lower margin ingredients in Mexico, as well as took planned maintenance shutdowns at some of our facilities, resulting in lower coproduct sales.

Volume grew in APAC and EMEA. Price mix was favorable by 17% in South America as we continued to price to recover currency devaluations and rapid increases in Brazilian corn costs that occurred over the past three quarters.

As we have explained, given our business model, these pricing actions typically require three to six months to take full effect. Price mix was negative in Asia-Pacific as a result of the pass-through of lower raw material costs.

Reported and adjusted operating income increased $16 million and $17 million respectively in the quarter. North America posted strong results due to a more favorable price product mix in both specialty and core ingredients and lower operating costs due to both Penford and Port Colborne cost savings.

South America operating income increased by $2 million. Favorable price mix accelerating our network optimization efforts and disciplined cost management offset lower volumes due to the macroeconomic environment and higher costs for corn, energy, wages and other inputs. APAC was down $2 million, while EMEA was down $1 million versus last year. In APAC, lower price mix offset volume growth, while in EMEA, foreign exchange headwinds and higher input costs in Europe offset volume growth.

Corporate costs were up due to variable compensation, continued investments in our administrative process, and other small items.

We will wrap up the discussion in the quarter with earnings-per-share. On the left side of the page, you can see the reconciliation from reported to adjusted. On the right side, operationally, we saw an improvement of $0.17 per share, primarily the result of margin improvement with a minor amount of other income. Volume and foreign exchange were negative $0.03 and $0.01 respectively.

I do want to take a moment and talk through the margin improvement in more detail given its magnitude. For the quarter, both our specialty and core ingredients and a more favorable price product mix, if you recall, we shed some of our lower margin production with the sale of our Port Colborne facility and accelerated network optimization in Brazil.

Moving to our nonoperational items, we recognized a $0.08 per share benefit in the quarter. Our adjusted tax rate was lower, contributing a $0.12 per share benefit. The lower tax rate was largely driven by increased foreign tax credits, which were slightly offset by valuation allowances for net operating losses, our reserve for unrecognized tax benefits, and US taxes on unpermitted earnings of foreign subsidiaries. This benefit was partially offset by a higher number of shares outstanding of negative $0.03 per share, driven by variable compensation dilution and higher financing costs of $0.01.

I'm going to move fairly quickly through the full-year figures. Full-year net sales were up $83 million. The majority of the increase is attributable to the addition of the acquisition-related ingredients, a more favorable mix in both our specialty and core ingredients, as well as favorable pricing in South and North America. These factors were partially offset by unfavorable foreign exchange and volume declines attributable to the sale of Port Colborne and macroeconomic headwinds in South America.

Gross profit was higher by $160 million as a result of the addition of acquisition-related volumes. Favorable price product mix in both our specialty and core ingredients and margin expansion as a result of our optimization efforts.

Reported and adjusted operating income were $148 million and $124 million higher versus last year respectively. Reported operating income was lower than adjusted operating income by $22 million.

2016 full-year reported and adjusted earnings per share were $6.55 and $7.13 respectively. Our reported and adjusted earnings per share were $1.04 and $1.25 higher than last year's respectively.

Moving on to the net sales bridge, our net sales of $5.7 billion were higher than last year's net sales of $5.6 billion. Favorable price product mix contributed $318 million. This was partially offset by $212 million of foreign exchange headwinds and volume decline of $23 million, driven predominantly by the sale of our Port Colborne, Canada facility and the reduction of volume associated with the macroeconomic headwinds in South America.

Volume decline is partially offset by Penford and Kerr sales. And, as we look more closely by region, you can see unfavorable foreign exchange affected us in three of the four regions, but was most pronounced in South America. Volume grew in APAC and EMEA, and price mix was favorable by 22% in South America as we continued to price to recover currency devaluations and rapid increases in costs. Price mix in Asia-Pacific and EMEA was negative as a result of the pass-through of lower raw material costs.

Full-year operating income and adjusted operating income increased $148 million and $124 million respectively. North America operating income was up $131 million due to acquisition-related volumes, a more favorable price product mix in both specialty and core ingredients, lower operating costs from both Penford synergies and Port Colborne cost savings, and a milder winter than last year combined with lower energy rates and logistic savings.

South America operating income decreased by $12 million. Headwinds included foreign exchange, lower volumes due to the macroeconomic environment in Brazil and Southern Cone, and higher costs for corn, labor, energy and other inputs. These were partially offset by favorable price mix due to pricing to recover currency devaluations and higher input costs, as well as disciplined cost management.

APAC was up $4 million, while EMEA was up $12 million versus last year. In APAC, volume and margin expansion offset the effect of the strong US dollar. While in EMEA, volume and margin expansion offset foreign exchange headwinds.

Corporate costs were up for the same reason I mentioned for the quarter.

Moving to the earnings per share bridge, on the left side of the page, you can see the reconciliation from recorded to adjusted. $27 million is attributable to the US/Canada tax settlement, $17 million is employee-related severance, $2 million from restructuring charges related to last year's sale of our plant in Port Colborne, and $3 million of acquisition and integration costs.

On the right side, operationally, we saw an improvement of $1.16 per share, primarily the result of margin improvement with some volume and other income partially offset by foreign exchange. On margin improvement, both our specialty and core ingredients had a more favorable price product mix. The work on our global network optimization included our Penford cost synergies, cost savings from our Port Colborne sale, and Brazilian network optimization also contributed.

Lastly, we had a milder Q1 winter with lower energy rates, as well as logistic savings.

Our nonoperational charges were a $0.09 benefit for the year. Our adjusted tax rate was lower, contributing a $0.26 per share benefit, and financing costs were higher by $0.04. The lower tax rate was driven by increased foreign tax credits and the new accounting standard for share-based compensation, which was partially offset by evaluation allowances for net operating losses, a reserve for unrecognized tax benefits, and greater earnings in higher tax jurisdictions.

The impact of shares outstanding was negative $0.11, driven by the new accounting standard and variable compensation dilution.

Additionally, noncontrolling interest was a negative $0.02.

Turning to our guidance, we now anticipate 2017 adjusted earnings per share of $7.40 to $7.80. This guidance excludes the acquisition-related integration and restructuring costs, as well as any potential impairment costs. We don't give quarterly guidance because corn layout, maintenance schedules, and weather patterns can cause variability. If you recall during the first quarter 2016, we experienced favorable corn layout and ideal operating conditions. We expect net sales and volumes to be up from 2016, and we expect continued growth in specialty volumes.

We anticipate that unfavorable foreign exchange will have a negative impact of $0.10 to $0.20 per share. We expect that this impact will be partially offset by incremental pricing. We expect corporate costs to be up year over year due to continued investment in our administrative processes and costs to obtain other future efficiencies in our business.

For the year, we expect financing costs to be higher due to higher interest rates on our floating-rate debt and our refinanced maturities. Our adjusted effective annual tax rate is expected to be approximately 29% to 31% versus an adjusted effective tax rate of 29.4% in 2016. We expect total diluted and weighted average shares outstanding to be in the range of $74.1 million to $74.5 million for the year.

In North America, we expect net sales to be up. 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 the foreign exchange headwinds. For the full year, we expect operating income to be above the 2016 level with improved product mix and margins.

South America net sales are expected to be up versus the prior year. We anticipate continued slow economic activity in Brazil and Southern Cone, and we expect foreign exchange headwinds to persist in the Southern Cone. Throughout the region, we continued to actively manage our cost and drive efficiencies and offset inflationary pressures, and we continue to look at optimization opportunities.

Overall, we expect operating income in South America to be up relative to 2016. Asia-Pacific and EMEA should continue to deliver operating income growth. We expect the APAC business to be negatively impacted by currency headwinds associated with a stronger US dollar relative to last year, but we expect to overcome these headwinds with continued growth in our specialty ingredients and good cost management.

We expect our EMEA region to have flat net sales compared to the prior year with specialty volume growth to offset anticipated foreign exchange headwinds. We anticipate modest growth in the European business, fueled by our specialty ingredients portfolio. However, we expect currency headwinds to partially offset the anticipated improvement.

Pakistan is expected to continue its volume growth and drive for continued efficiency gains.

Moving on to cash flow, our cash provided by operations for 2016 was a record $771 million. During the year, we deployed cash in the form of capital expenditures, dividends and acquisitions. Our capital expenditures of $283 million were up slightly from last year. We expect cash from operations in 2017 to be in the range of $800 million to $850 million, and we expect to invest between $300 million and $325 million around the world in 2017 to support growth, as well as costs and process improvements.

Importantly, we have a proven track record of both reinvesting and returning capital to shareholders, and we expect to continue this in the future. We can currently explore M&A opportunities.

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, President and CEO*

I am pleased with our results this quarter and year. From a strategic perspective, our business model and blueprint for growth are working. Our momentum continues on a positive trajectory, and we continue to prepare for the future.

Our global footprint and diverse customers balance regional and sector risk. Our innovation capabilities and portfolio of on-trend ingredients give us a competitive advantage, and we continue to grow our on-trend specialty ingredients, expanding our texture, wholesome, sweetness and nutritional offerings. And our network of Ingredion Idea Labs enables us to collaborate side-by-side with customers, adapting innovations from country to country and customizing solutions to local preferences and tastes.

From our foundation of operating excellence, we continue to optimize our cost structure for the future, while investing for growth in our specialty business. Regionally, all four regions are expected to be up. With our strong balance sheet, we expect to continue deploying our capital for growth, network optimization, acquisitions, and other actions to deliver excellent shareholder value.

And now we're glad to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Rob Moskow, Credit Suisse.

Rob Moskow - *Credit Suisse - Analyst*

Hi. Thank you, everybody, and Jack, it's been great working with you. Congratulations on your retirement. Just a phenomenal job with the Company. Thank you so much for all your help over the years.

So, Ilene and Jack, I think a lot of investors are kind of trying to think through the global trade environment, especially with Mexico. What would happen if there were some kind of action taken by Mexico to block HFCS imports in response to the spat over sugar? Do you have any update for us as to -- I thought in January, there was going to be some kind of action by our Department of Commerce on our accusations of Mexico's dumping of sugar into the US. Is there any update there, or is just everything kind of up in the air right now? Thanks.

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

I will start off and then I will turn it to Jack. But there is no update, and I would say that trade is really a complex issue. And all the trade deals need to be carefully negotiated, and of course, we support fair and open trade.

But I also think about that food is a local business, and we manufacture ingredients around the world in 40 different countries and sell into 100 countries, and really the vast majority of our ingredients are made and used locally.

So while we benefit from free trade, we would probably be less impacted by changes in trade deals than some others. But I would say that there has been no update on any type of changes as it relates to the sugar industry. And Jack, I don't know if you want to add anything to that.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

No, I think you covered it fairly well, Ilene. We are obviously in a period of a little bit of uncertainty, but fundamentally I think that the -- you think about the mechanics of the North American Free Trade Agreement. We can't anticipate what changes will be made, but I think in general free trade is good. And, as Ilene said, we are well-positioned in all three countries with operations in all three countries, so we're still feeling fairly comfortable with our position.

Rob Moskow - *Credit Suisse - Analyst*

Okay. And just a follow-up about the guidance for 2017, I was trying to bridge what it implies for overall operating profit growth, and when I took into account the EBITDA contribution from TIC Gums, I didn't get very much -- something of low single-digit kind of operating profit for the core operations. And I think that's a little below your normal algorithm. Is that any kind of a -- are you setting a tone for us here about having the past two years being so strong that maybe it's time to be a little more conservative about what the base business is doing or maybe the math is different?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Rob, I think we will have to go through the math a little bit. I think we're fairly comfortable that even after coming off of a very strong 2016, we're actually looking at our algorithm and saying that we are principally sticking with it. If you look at the earnings-per-share, even at the lower end, you are in that 4% to midpoint 7% or 9% if you look at the top end. And you know we are still -- I think the one thing that we're still looking at is, while we are comfortable with where South America is, there is a lot of variability in that region, and so we're still being fairly conservative in terms of how we look at that region going forward.

So I'm actually -- I think that the long-term algorithm, it continues to work very well from our perspective. And I think Ilene probably should add a couple comments on her view of how the business is looking.

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

Yes, I also would add -- and the TIC, we said it was $0.04 or $0.05 accretive, so we are anticipating growth in earnings. And, of course, it's all about our trade up strategy to grow the specialties and we feel that we continue on the trajectory to get to the 30% by 2019.

Now I think that also, this -- we are talking about what I called the organic part of our business in this type of guidance and that we still have the opportunity with our strong balance sheet to use it -- to use that for other types of M&A. Could be early in the year, later in the year. We continue to focus on our pipeline about specialty types of acquisitions that, again, will build on broadening the portfolio, similar to how we've done with TIC with a focus on these small- and medium-sized customers.

So I think the guidance reflects the core, the base, and the trade-up in the specialty, but we continue to look for opportunities that will create shareholder value using the other part of our balance sheet.

Rob Moskow - *Credit Suisse - Analyst*

So just to clarify, is TIC adding about $30 million of EBITDA to the 2017 results?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

No, Rob, I think if you think about it, if you back in from the $0.05 a share that we had commented on, you add -- you meant to call it 4% interest on the $400 million, so that $16 million type of range. And so you are up around $22 million type of range in terms of the EBITDA and EBIT number. The difference being is we do have amortization of some of the intangibles and things like that, which actually that would take it back up into those ranges. So your number is fairly close, except for the incremental amortization of the intangibles which will come about on the acquisition accounting.

Rob Moskow - *Credit Suisse - Analyst*

Got it. That makes sense. Thanks so much.

Operator

Farha Aslam, Stephens.

Farha Aslam - *Stephens - Analyst*

Jack, my congratulations as well. It's been wonderful working with you.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Thank you.

Farha Aslam - *Stephens - Analyst*

A question on North America and, in particular, kind of your outlook for pricing in North America. Do you expect this year pricing -- we should think of it as a positive, or will the pressure of lower commodities and Mexico pressure pricing down?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Well, you know, Farha, obviously one of the things we have said is -- I don't think we really commented on the contracting. I think we're very pleased with the way contracting turned out this year. It kind of turned out as we anticipated. And so if you think about North America, we are in a good place from a go forward perspective both on our core and in our specialty business. And as we alluded to even in the past, we started up our new facility in terms of specialty ingredients here in the US, and so that should help us as well and our margin improvement as well in North America. So we're fairly good with North America at this point in time.

Farha Aslam - *Stephens - Analyst*

That's helpful. And if I could have some color on South America? You highlighted that 2017 would be better than 2016. I'm just trying to understand a little bit how much better South America could be because that is tough to call. Does it look kind of like 2013 when we had a fairly robust business, or is it kind of a more subdued recovery?

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

I will start off. South America -- of course, there's different pieces to that, and I talked a lot about Colombia that has continued to perform well in the economy and opportunities and even growing in the specialty. So we continue to be excited about that.

I also look at the GDP forecast in Brazil, and it is still positive for 2017, which is a change from the negative in 2016. So we would expect Brazil to continue on a positive trajectory, but again, it is still a challenging environment there, though our team has done very well in optimizing the footprint.

I think the big challenge is really in Argentina, and the government has taken some very good steps to do the right thing for the economy long-term. It has been a little bit painful for some of the consumers during 2016 when the government removed some of the subsidies on the utilities, and so consumers had less disposable income and they moved that around. And so we don't see it going back to the 2013 level for us for 2017, but yet an improvement over 2016.

So we do see the slow recovery coming in the Southern Cone, and I am excited about Brazil and the opportunities to grow specialties for Brazil and Colombia and eventually in Argentina and Southern Cone because I see consumers wanting these healthy solutions and are having the ability to take solutions from one part of the Company and then adapt it to the local taste. So we still see 2017 up, but not as robust as you might have seen a few years ago.

Anything you want to add, Jack?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I just want to add a bit of clarity with respect to the Southern Cone. Because, as you recall, we have already -- in 2012 and 2013, Southern Cone has been earning probably excess earnings at that point in time as we have talked to in the past. And we don't even envision over the next couple of years getting back up to that $100 million type of level that they were earning at that point in time that we commented to.

And so we are seeing modest improvement in the Southern Cone. I think Brazil and the Andean region are fine. It is just the wage inflation in the Southern Cone has been variable, which has kind of changed around our view a little bit in terms of the recovery there. Because you see the corn and the sugar prices, which Argentina primarily -- or Southern Cone primarily is a sugar and corn commodity -- core ingredient type of environment, they have kind of started to move more into what I would call international pricing. But we are still left with wage inflation, which can only be corrected through either actions and/or devaluations and/or other components, and we are working through that in terms of making sure our plans are as efficient as possible at this point in time.

Farha Aslam - *Stephens - Analyst*

Very helpful. Thank you so much.

Operator

David Driscoll, Citi.

Cornell Burnette - *Citigroup - Analyst*

Good morning. This is Cornell in with a few questions for David.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Good morning, Cornell.

Cornell Burnette - *Citigroup - Analyst*

Okay, great. So the first one is just could you go into maybe some of the pressure points that get you to the higher end of the guidance range or the lower end of the guidance range?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me start at the bottom and work up because, you know, obviously, there's a lot of concern in terms of how you're going to forecast interest in foreign exchange rates, how quickly we can price through any of those different elements.

The other component -- I guess the other two components at the lower end of the range is really volume driven. Because both in South America, will there be a speeding recovery, and our volumes have improved particularly in the Southern Cone. And even in Mexico, we put a little bit of downside on some of their volumes if required because I think that that is kind of driving some of the downside -- the bottom part of our range.

And, you know, the other thing is we have Brexit going on, and while that -- our UK sales are less than 2% of our business, essentially you still have some devaluation there that is happening a little bit faster than we would anticipate -- not anticipate, but we can correct in terms of pricing.

But as we -- I think the other thing, as you know, we're kind of moving into some different components where, when you start to look at the top side of the range, we have some volume opportunities. How quickly can we grow our specialty business in different components of the world and Southern Cone pickup in terms of some of its volume? And so that really is like on the positive side in getting up to that $7.80. And so, you know, I would say that in general, we're fairly comfortable with that range right now, and we will narrow it as the year progresses as we know more and more. And maybe I'll just ask Ilene if she has any comments in terms of --

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

The other thing I would add is, as you know, in 2016, we brought on new capacity in Thailand and the US with some of our specialty ingredients. And so 2017 is a year where you work with customers very closely to scale those up. And so that is an opportunity to be on the higher end of the range if we can bring those on faster than the middle would indicate. And so I think that that is exciting, and it's part of our specialty strategy to create these healthy, value-added ingredients.

Cornell Burnette - *Citigroup - Analyst*

Okay. And then when I look at the different components of the guidance and you talked about the different regions. I think in the slides you said EMEA would be up but just modestly. South America would be up, but given your comments, it seems like the environment there is still challenging.

So it seems just on the surface that a lot of the growth next year really is coming from North America. So, one, is that the right way to look at it? And then two, what does that speak to maybe the strength and the tightness in the North American sweetener market and kind of how contracting went?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me start by -- in reverse order. Because, you know, first of all, I would like to say that our APAC and EMEA businesses are still both looking very good. So we sometimes don't talk enough about those, but they have continued on a nice growth trajectory over the last few years, and I expect that to continue in South America.

As I said, that is probably where the widest range is on our forecast.

And then when you go to North America, as I commented earlier, I think we were very pleased with the way contracting turned out, and as you know, I think that 2017 is looking fairly good from that vantage point. I think that -- I believe looking forward, we have the TIC Gum acquisition included in our North American results, which should put those numbers up as well.

And so yes, North America is fairly good, but I think we're fairly comfortable that there is nothing in that sweetener market. I think people reflect back, and we do like to highlight: sweeteners, like the HFCS business is still less than 10% of our business. And so it's not like the major portion of our business or anything like that anymore. And so we are driving the growth in many other avenues as well.

Cornell Burnette - *Citigroup - Analyst*

And then just one more, if I could. You mentioned client shutdown, I believe, in North America during the quarter for maintenance. Just quickly, how much of the volume decline was represented by that? And then secondly, what is the impact of profits in the quarter, and does that come back sometime in 2017?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me put that into a larger framework as well, if I could. Because, as you know, last year, we sold our Port Colborne facility, and so we are reconfiguring our entire network over the course of the year. And usually some of our facilities -- we were trying to time how they would shut down at different points in time. And so we moved one of our major shutdowns to the fourth quarter this year, which is probably a better time to be taking it from a -- filling out the network and that being the slower part of our seasonality.

And so really there is probably about 1% of the volume decline in North America, which is really just attributable to that. And I want to highlight that that is just the coproducts because that's kind of the production of the coproducts that come through and we just sell it type of thing. So it's not really head product or any -- like most of our other products that weren't impacted at all.

And then you got -- you still had -- if you think about that whole 6% reduction in North America, you have about 3% coming out of Port Colborne just because of the way we ran Port Colborne to build some of the inventories for the first quarter and got it orchestrated at the end of last year to make the first quarter flow properly to our customer commitments there. And then, you know, then we had a little bit of a rebalancing and shedding some product down in Mexico as we -- we have the expansion coming on at the end of the first quarter next year as well in Mexico. And so what we're doing is trying to position our volume there a little bit so that we are all set for the products that are going to be produced in the -- after the first quarter with the expansion down in Mexico.

So there's a lot of moving pieces. So, if you think about it in big picture, about half of it is Port Colborne, maybe 1% in terms of some of the shutdown, and the rest of it is just a general rebalancing of the network.

So I hope that helps you clarify what that would -- why some of those reductions were where they were. It was well planned, and I think well executed from our vantage point.

Cornell Burnette - *Citigroup - Analyst*

Okay. Very good. Thank you.

Operator

Akshay Jagdale, Jefferies.

Akshay Jagdale - *Jefferies LLC - Analyst*

Good morning and, Jack, congratulations on your retirement. You will be missed.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Thanks, Akshay.

Akshay Jagdale - *Jefferies LLC - Analyst*

So just going back to -- or continuing on this rebalancing of the plant network, is there a way to -- that was very useful what you just said about the volumes. But is there a way to quantify that as far as EBIT impact or anything like that to give us a sense as to what the quarter would have looked like if you hadn't taken those actions?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me say it differently. That's one of the reasons why we don't give quarterly guidance a lot of times. We do take these shutdowns in different quarters in different years. This year it just happened that in the fourth quarter, we moved it from the -- what was historically a second-quarter type of event.

And so I think that -- I don't think that there is any -- if you look at the full years and things like that, there's very little difference. And that's what I'm trying to get at is we might take it in the second quarter, first quarters, and when you are looking at the comps in some difference on a quarterly basis, but that can also arise due to the fact that corn can be laid out differently. The timing of some of our sales are a little different. The utilization rates are little different in quarters. I would say we like to stay with that annual guidance. Because most of our contracts, particularly in North America are annual contracts, and you can get that different volatility between the quarters.

And so let me come back to North America because they had a record year this year. It was a fabulous year, and so I think they are well-positioned going into next year, too. So I'm kind of delighted the way that the business is operating there.

Akshay Jagdale - *Jefferies LLC - Analyst*

Yes, just, maybe a different way just to explain where I'm coming from, I think -- I agree it has been a really good year, but as part of the equity markets, you have had a beat and raise story, and then this quarter was in line with quarter relative to our expectations. So that's part of it might be our fault, but I am just trying to get a sense. It looks like from your perspective, this was an offensive move in terms of getting ready for next year, doing this change at the right time. So that's where I was coming from is people expecting you to continue to beat and raise, I guess, and the quarter came in in line, and so stock is reacting negatively. But I just wanted to make sure there is nothing fundamentally that weakened this quarter relative to the last.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I don't see anything in the quarter that would jump out at me in terms of what our expectations were or how we look at next year. As I said, even in our guidance, we have North America up again next year. We're trying to keep in line with the long-term algorithm from an organic basis. I think we are there. And so, no, I don't see anything in the quarter that is unusual in terms of thinking through the component.

In terms of beat and raise, I wouldn't say that that is a -- as the quarters get narrowed down, we have more visibility in, and we only have three months to predict and 12 months to predict, and that's why we narrow our range as we go forward as well. And so I think that is really where we are coming from as we should be more accurate as we get closer to the end of the year.

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

And I would say that I am very excited that we were able to announce and close on TIC Gums at the end of the year. We closed on our China acquisition, which is related to our vertical integration there. And so 2017 is really continuing on this journey of building our company as a specialty company and continuing that story. And I have always said, we're in the middle of the story, and so TIC became the next step in building our texture and portfolio and being focused on these small- and medium-sized customers. So I think the timing has been excellent.

Akshay Jagdale - *Jefferies LLC - Analyst*

Okay. And just two more. One on the North American contracting. Can you put into perspective -- we heard the contracting happened a lot sooner than it usually does, which is also indicative of a tighter market than even last year. And the way we are looking at it, obviously you have two very, very solid years on a 30% growth each year in EBIT in North America. So can you just put some -- give us some perspective -- when you say it was good, give us some perspective on how good, and then maybe why we are seeing a good contracting season because demand seems to be stable? Was there capacity that came out of the market again that utilization rates are up? Any color there would be useful.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

You know, I guess if you think through in the North American marketplace, you have seen in the -- prior to this -- 2016, 2015, we sold our Port Colborne facility. There was the -- one of our competitors shut down a facility. So there was, I would say, some capacity rationalization there that put the market into a relatively good balance.

The other thing that you know, like there's two major issues that are really hitting our performance. One is as our specialties continue to grow which improves our product mix, our shutdown of Port Colborne improved our core ingredients margins, and in addition to that, I think that as we look at our go to market and our pricing formulations, they have actually worked very well both on the core and the specialty. And so the combination of those components, as well as continuing to look at our network to take costs out, I think has been very favorable to us. And I expect -- I don't see anything going into the future that is going to stop those type of margins at least at this point in time.

Akshay Jagdale - *Jefferies LLC - Analyst*

Okay. I will get back in queue. Thank you.

Operator

Ken Zaslow, BMO.

Ken Zaslow - *BMO Capital Markets - Analyst*

Just a couple of questions. One is, when you do the rebalancing in North America, is that an incremental cost savings opportunity that we should think about?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Not this one, Ken. I think really this was just setting up for -- like just changing around some of what would happen in the second quarter versus the fourth quarter this year, and then also a little bit of rebalancing in Mexico where we are probably getting prepared for the increasing capacity down there in terms of some of the inventory balances.

Ken Zaslow - *BMO Capital Markets - Analyst*

Second question is, can you tell broadly how sensitive is North American utilization rates to Mexican trade? I know that high fructose corn syrup is not a big part of your portfolio and I get that, but I'm just trying to figure out as asensitivity to the North American utilization rate, is it important? Not important? Can you kind of rate this and put this in perspective for us?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

As you know, we are situated in all three countries and things like that. So we are well-positioned from a North American perspective. And it depends on -- I think we worked through a number of different models to say okay, what is the impact of some of these potential legislations? What would be the worst case scenario on different tails of the algorithms? And I just -- I guess maybe I'm just bullish on the business. I'm saying I don't really see that being a major risk at this point in time in terms of utilization. If it is, we will have to adjust accordingly in terms of how the industry deals with that. So I don't see that as a long-term issue.

Ken Zaslow - *BMO Capital Markets - Analyst*

So let me just -- when you say it's not a big risk, do you think it's not a big risk because it won't happen because the administration won't touch the high fructose corn syrup side, or if they do touch the high fructose corn syrup, it's not a big risk? Because your utilization rates wouldn't be changed and your business structure would be fine if trade was ceased? I'm just trying to figure out where you think the nonimportance is.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes, I guess when you -- if you -- when I say it's not a big risk, there is always these risks out there type of thing, but what is the probability of them happening and things. And I can't really predict what the trade issues are going to be at this point in time. I don't -- I actually think that if you think about total demand in North America, total capacity and think about it that way, I think it will always come back to be in a reasonable balance at this point in time. And there's a lot of new products, don't forget. People are still looking at trading up their product portfolio away from some of the sweeteners, and there's a lot of new products being generated in terms of that trade-up strategy. So I guess I would leave it there, and we can explore it further --

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

The other thing -- the interesting thing is the other thing I like about the assets in our business is we talk about it being capital intensive, which is a nice barrier to entry. But if you were to think about that front-end grind, and I have talked about how we have redirected some of that over time as an example to modified starches that are used in some of these more healthy ingredients in yogurt. And so there's different types of capacity utilization. There's the grind. There's the finishing channels. And finishing channels can be added in relatively quickly -- I say 18 months -- and have a nice way of utilizing the in-ground assets without making large bets. So that is a flexibility to what is considered a capital-intensive industry.

Ken Zaslow - *BMO Capital Markets - Analyst*

And my final question, just moving down to South America just quickly, your South American margins have been in that 10% range for the last couple of quarters. When you think about that, is that something you look at as a target for 2017 and beyond? Is that how to think about it as your cost structure is actually being redefined and reduced? Is that how to think about it?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes, you know, Ken, there's always some lags in terms of the numbers down there in terms of how we reprice corn, and as you know, there is very solid anticipated corn crops coming in in both Brazil and Argentina. They are probably record corn crops. So there's a little bit of positive coming out of those components as well.

But, in general, yes, I would say that that is how I would be thinking about that business because we continue -- we got the network optimization out of Brazil, which started in this fourth quarter which will continue into next year a little bit from a cost perspective. And then a lot of it is, too, if Southern Cone starts to pick up in terms of volume, that does have a fairly significant impact on the margin appreciation there. So I would say that, yes, you are not too far off with that number.

Ken Zaslow - *BMO Capital Markets - Analyst*

All right. Thank you, guys.

Operator

(Operator Instructions) Brett Hundley, The Vertical Group.

Brett Hundley - *The Vertical Group - Analyst*

I have three questions. My first one was related to Brazil and the cost savings work that you are doing there. Is it fair to assume that cost savings were in line with what you had communicated previously for Q4? And then related, any guidance on how cost savings might flow through in 2017? Might they be more front-end weighted or kind of equal across the year?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Brett, this is Jack. Obviously, I think we -- the numbers came out very close to what we anticipated. It was just around a couple million dollars a quarter, and I would expect that to continue throughout the entire year. So that you will see all -- you think of quarter one, two and three is kind of there, and then Q4 will have overlapped it.

Brett Hundley - *The Vertical Group - Analyst*

Yes. Okay. Perfect. And then just on quarterly progression of earnings, I know you guys don't guide by quarter, but Jack, you kind of called out Q1 2016, and I'm wondering if Q1 2016 is just a quarter that gets really tough to compare against, and then Q2 through Q4 are much easier to compare against when we look at 2017. How might you grade that statement?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes, like I say, we don't give the quarterly guidance, but then one of the reasons why we mention it is that you got to remember that there's a lot of positives particularly in North America in the first quarter last year. So it makes a more challenging comp, I think. That's why we give annual guidance, and that's why I think we are comfortable with annual guidance.

Brett Hundley - *The Vertical Group - Analyst*

Okay. And then the last question I have for you, Jack, it's kind of an oddball, but I wanted to ask you about North American tolling dynamics and really just visibility related to that business. I have never really talked much with you guys about that, but I'm just curious as it relates to your tolling business, is it very similar to the business that you have in-house that you sell where the volume side of the tolling contract is really locked up and understood for one year as well, or might those contracts be longer or shorter relative to your other business? And I'm trying to understand if your tolling business is normal, and as expected right now, if there is anything changing within those dynamics?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes, Brett, I think without getting into too much detail, as we have commented before is, 50% of our business, particularly in North America, is grain-related polling type of agreements, and those agreements can lock in for -- because of the fact that you are not taking corn risks or anything like that because the corn just passes directly through to the customer, they can be staggered in periods longer than one year. I think most of the contracting comes up one, maybe two years and things like that.

And so yes, I would say that that is the only anomaly there, and I would say it's kind of a nice format from my viewpoint because it sets the floor in terms of how pricing will manifest even in the fixed pricing business. And so it's a nice business from that perspective.

Brett Hundley - *The Vertical Group - Analyst*

And it's business as usual you would characterize it?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes, okay.

Brett Hundley - *The Vertical Group - Analyst*

All right. Thanks so much.

Operator

Adam Samuelson, Goldman Sachs.

Adam Samuelson - *Goldman Sachs - Analyst*

Maybe just going back to North America, thinking about 2016 a little bit more holistically, what it implies for next year. Your North American margins this year were up 340 basis points. Can you talk about the specialty volume growth, and within that as well, kind of I would struggle to think how your core margins weren't up pretty in line with that segment average, thinking about both the drivers of the core between price and the cost actions that you've taken specifically?

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

I will talk about some of the specialty trends, and then I will turn it back to Jack on some of the financial dynamics. But the specialty growth in North America continues to happen because the -- as the population -- the millennials, which are now at the same size, I think, as the baby boomers, want these healthy configurations, and they will pay more for gluten-free, non-GMO healthy ingredients.

And so we even have alliances on vegetable -- protein and vegetables. And so we are working on these recipes, and North America being a more mature economy population continues to have opportunities in this area.

So I think it's an area where we use our product development and R&D out of Bridgewater, and then we localize it in the different North America countries. So I see the excitement and opportunities to grow our specialty. So that is a -- the growth of specialty and almost like a trading up within specialty and then as Jack talked about the trading up of the core. So I don't know, Jack, if you want anything to say in the margins?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Maybe if you think about this year in particular, we filled our Port Colborne facility at the end of 2015. That allowed us to trade up our product portfolio, which helped our margin expansion there. We also had the Penford cost synergies that really played in very nicely into our equation as we drove those forward on a run rate basis. We continued to have, I would say, excellent logistics and energy cost savings throughout our facilities, and the market in general and our core ingredients, including our sweeteners, has actually improved.

And so I would say that it was a good year and it sets the base for the -- for going into the future. Most of those things exist in the base, and they will continue to exist going into 2017. And so then the question is how much of our specialty growth will continue to trade up our mixes in terms of our product mix, which gets us back on to our long-term algorithm, which will show an improvement of our margins through that trade-up of our portfolio mix.

And so we continue to take these, I will say, one-time actions improving our business, and then in addition to that, moving -- still continuing with our growth in terms of our algorithm, which continues to drive margin improvements to the trade-up strategy. So it works very well. Thank you.

Adam Samuelson - *Goldman Sachs - Analyst*

So maybe against that, Jack, I'm trying to just rank order some of those pieces, and they are helpful between -- Penford, some of the network optimization at Port Colborne, moving some of that low-margin business, the mix shift to specialty, which I would guess was 100 to 200 basis points of sales, and then base pricing. Is there any way to rank order that in terms of the contributors to either margin expansion or year-on-year EBIT growth that you would be willing to share? I'm just trying to disaggregate a little bit how much is more market supply/demand dynamics that were certainly in your favor this year versus some more specific Company actions that really do reduce either what you can think of as the fixed cost base of the Company?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I don't think we really want to break it out in that level of detail because then you start getting into, okay, well, how is your core versus your specialty? You've got to remember we have shared facilities. Each one of these actions impact -- if I talk about Port Colborne shed, for example, it impacted about four or five facilities where you changed around the manufacturing configuration of those.

If you talk about Penford, we are moving production from one facility to another facility to rationalize some of our freight and logistics savings. So it's almost impossible to disseminate it all, and I don't think that really adds value. I think what you've got to do is to say that is in your base now and let's move forward.

Adam Samuelson - *Goldman Sachs - Analyst*

Okay. I will pass it on, thanks.

Operator

Sandy Klugman, Vertical Research.

Sandy Klugman - *Vertical Research - Analyst*

I understand that Mexico could prove to be a nonevent, but if high fructose does get backed up into the US, how should we think about the wet mill cost curve and where capacity might have to come out of the system?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I think that's a real industry question. I think in the -- if you think about capacity coming out of the system, it can happen in a number of different ways in terms of utilization rates or looking at facilities going down. I don't see it as that big of an issue. Maybe I'm -- maybe 2%, 3% of the telephone industry is. So I'm not seeing it in quite the same way as other people are looking at it. I don't mean to dismiss it because we go through these type of potential issues all the time, and I just don't see that as one of the ones that is either likely and/or -- I shouldn't say likely. I shouldn't even comment like that. But I just don't see it as -- I can't foreshadow where that will end up, I guess, is what I would say.

Sandy Klugman - *Vertical Research - Analyst*

Okay. Thank you. And then in Mexico, I know the majority of your sales are US dollar denominated, but are there any concerns regarding consumer demand from the depreciation of the peso?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

You know, I think it's interesting because consumer demand still seems fairly solid. I would say that we are always concerned with the slowdown in the economy more than just the distribution and wealth in Mexico because I would say that, if there's trade actions between the US and Mexico that slow down that economy, it can obviously impact consumption. But I would say that our ingredients -- one thing that is nice about being in the food and beverage segment is these things are going into some of the core things like breweries, soft drinks, food and some of the specialty food ingredients, and they don't usually slow down that dramatically in terms of -- unless there's a real slowdown in the economy. So I think that we should be fine from that perspective.

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

Yes, I think people like to eat and drink. They need to and maybe they change what they consume. But we've seen with the rise of the middle class, especially in Mexico, there is a demand for some of these healthy ingredients. And, as I have talked about, we also have our focus on what we call save money where we are able to substitute higher price ingredients for lower priced for affordable solutions. So we see a lot of opportunities there.

Sandy Klugman - *Vertical Research - Analyst*

Great. Thank you very much, and best wishes to you, Jack.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Thank you very much.

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

I think we're at the end here, so I would just say that before we sign off, I would reiterate our confidence in our business model, strategy and long-term outlook. We remain keenly focused on value creation and delivering that value to shareholders.

So that brings our fourth-quarter 2016 earnings call to a close, and thank you, again, for your time today. Thank you.

Operator

Ladies and gentlemen, that does conclude the conference for today. We do thank you very much for your participation and using our Executive Teleconference Service. You may now disconnect.
