REFINITIV STREETEVENTS

EDITED TRANSCRIPT

INGR.N - Q2 2021 Ingredion Inc Earnings Call

EVENT DATE/TIME: AUGUST 03, 2021 / 1:00PM GMT

OVERVIEW:

Co. reported 2Q21 net sales of $1.762b, reported operating income of $222m and reported EPS of $2.62. Expects 2021 net sales to be up low double-digits.

CORPORATE PARTICIPANTS

James Derek Gray *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

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

Tiffany Willis *Ingredion Incorporated - VP of IR & Corporate Communications Officer*

CONFERENCE CALL PARTICIPANTS

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

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

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

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

Seth Goldstein *Morningstar Inc., Research Division - Equity Analyst*

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Ingredion Inc. Q2 2021 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Tiffany Willis, Vice President of Investor Relations and Corporate Communications Officer. Please go ahead.

Tiffany Willis - *Ingredion Incorporated - VP of IR & Corporate Communications Officer*

Thanks, Joelle, and good morning, everyone, and welcome to Ingredion's Second Quarter 2021 Earnings Call. I'm Tiffany Willis, Vice President of Investor Relations and Corporate Communications Officer.

On today's call are Jim Zallie, our President and CEO; and Jim Gray, our Executive Vice President and Chief Financial Officer. We issued our results today in a press release that can be found on our website, ingredion.com, in the Investors section. The slides accompanying this presentation can also be found on the website and were posted today 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. These statements include expectations and assumptions regarding the company's future operations and financial performance, including the impact of the COVID-19 pandemic. Actual results could differ materially from those predicted in the forward-looking statements, and Ingredion assumes no obligation to update them in the future as or if circumstances change.

Additional information concerning factors that could cause actual results to differ materially from those discussed during today's conference call or in this morning's press release can be found in the company's most recently filed annual report on Form 10-K and subsequent reports on Forms 10-Q and 8-K.

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

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

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

Thank you, Tiffany, and good morning, everyone.

We delivered exceptional second quarter performance, demonstrating the strength and breadth of our customer base and the resiliency of consumer demand for the range of food products that use our ingredients. In every region, we saw double-digit growth from demand recovery across all customer segments as well as very strong specialties growth.

Our strong sales execution and price management in the face of robust and fluctuating demand contributed to our 31% net sales growth. Adjusted operating income for the quarter was up 64% versus prior year and marks our strongest quarter since 2017. All 4 regions performed extremely well, with South America delivering another remarkable quarter driven by favorable price mix.

Shifting to our strategic pillars. We've made meaningful progress against each of our strategic pillars throughout the quarter, and these continue to provide execution focus for creating long-term shareholder value. Beginning with specialties, we continue to drive sales of these higher value ingredients and systems, and we are pleased to share that they are now an even larger portion of our total net sales at 33% as of the end of the second quarter. We experienced strong demand across our entire specialties portfolio, which led to healthy double-digit growth in all 4 regions.

Moving to commercial excellence. Our teams are working exceptionally closely with customers as consumer demand recovery has created pressures throughout the entire supply chain. We are supporting increased food service demand as well as solid demand for packaged foods. This quarter, we also enhanced our digital capabilities for customers by completely renovating and integrating many independent websites into one global, user-friendly, content-rich customer destination.

I'll speak to Cost Smart details momentarily, but I'm excited to share now that we have already actioned and captured $135 million in run rate savings year-to-date as our teams have been relentlessly executing against our program targets. Our purpose, culture, values and talent pillar is the foundation of our strategy. Accordingly, our employees' health and safety remains our top priority. Right now, we are monitoring closely the increased COVID infection rates in Asia Pacific and our COVID project management office is working to accelerate vaccination availability to all of our employees around the world.

In support of our diversity, equity and inclusion efforts, I'm also proud to highlight that we stood up 2 more employee business resource groups in the quarter in support of our Latinx population and employees with disabilities. This now brings Ingredion's total number of business resource groups to 7 with 33 chapters operating around the world.

Also this quarter, we reimagined the future of work for our company and recently communicated our approach to agile ways of working, detailing the operating parameters of our hybrid model. This is centered on providing employees flexibility within a framework, balancing the needs of the business, while nurturing a culture of spontaneous learning and development, collaboration and innovation.

Now let me highlight our specialties performance for the quarter. We delivered exceptionally strong double-digit specialties ingredients growth in Q2. Demand was strong across all 5 of our growth platforms, reflecting a strong comeback for food service and the importance of our starch-based texturizers and clean and simple ingredients for these formulations. We also experienced strong demand for specialty sweeteners and sugar-reduction solutions, and our plant-based protein sales more than doubled in the quarter from prior year. Sales of specialty ingredients have now increased to represent 33% of the company's sales.

As we recently shared at CAGNY, we are well positioned with a 4-year plan to have specialties meet our target of 38% of sales by 2024. South America led our growth this quarter with 46% specialties growth driven by volume and price mix. Asia Pacific also performed exceptionally well with 41% specialties growth in the quarter, led by growth from the sugar-reduction platform, which included acquisition growth from the inclusion of PureCircle. Excluding PureCircle, Asia Pacific delivered 12% specialties growth. EMEA delivered 35% specialties growth in the quarter, which includes 2 months of sales from KaTech. Excluding KaTech, EMEA delivered 25% specialties growth. North America's 18% specialties growth was driven primarily by foodservice recovery.

And now let me provide an update on our recent strategic growth investments. We are very pleased with PureCircle's net sales growth, which is ahead of our first half expectations. Most importantly, PureCircle's project pipeline continues to expand and new customer wins are being led by breakthrough bioconverted Reb M sales and flavor blends. The Amyris partnership and collaboration on Reb M from fermentation is progressing well, and initial customer feedback for this great tasting product has been very positive.

Now, sharing a few highlights from the plant-based proteins platform. We received food-grade certification for our Vanscoy, Saskatchewan facility, and the team reached a new record level of production for protein flowers and concentrates in June. With respect to our South Sioux City facility, the team continues to optimize its operations to meet anticipated increasing customer demand in the second half of 2021.

Within our Food Systems growth platform, our recently announced KaTech acquisition is being integrated well into our EMEA business. While early days, we are pleased to see sales growth ahead of our business case.

Now moving to ESG, In the second quarter, we published our tenth Annual All Life Sustainability Plan, which contained updated and expanded 10-year ESG commitments. This report highlights our sustainability accomplishments and progress, and I could not be more proud of our team who continue to identify ways to improve our operations to benefit all stakeholders. Given the importance of ESG, we are committed to highlighting our progress on a more frequent basis, which will be both annually in our sustainability report as well as biannually in our shareholder updates.

One aspect of our ESG strategy is working closely with customers. One important element of our All Life plan speaks to Connected Life, and I'm pleased to update you on the progress specifically related to sustainable and regenerative agriculture, which is very important to our customers and growers. We committed to sustain -- sustainably source 100% of our global waxy corn needs, a critical crop for us, by the end of 2022. As of the second quarter, we are sustainably sourcing 95% of our global waxy corn needs and expect to achieve our goal ahead of schedule.

We also remain committed to sustainably source 100% of our Tier 1 priority crops, including corn, tapioca, potatoes, pulses and stevia by 2025. These crops collectively continue to represent about 99% of our global crop sourcing by volume, and we are already 25% of the way toward meeting this goal. And in addition, our commitment has been unwavering to educating growers and implementing pest management into over 70% of our agricultural supply by the end of 2027. As of the second quarter, we have reached a milestone of 57% penetration of our agricultural supply.

The progress we have made in sustainable and regenerative agriculture has already made a meaningful impact, and we are committed to ensuring this continues to contribute to our Connected Life goals.

I'll now close my section with an update on Cost Smart. When we introduced our Cost Smart savings program in 2018, we set an initial run rate savings target of $125 million over 3 years. We subsequently increased the savings target twice, first, to $150 million in 2019 and ultimately to our current stretch goal of $170 million by year-end 2021. Our team's resourcefulness and perseverance resulted in our second quarter closing with a solid $135 million of run rate cost savings, and we are well positioned to deliver the full Cost Smart savings program target as many of the initiatives currently underway reach completion by year-end.

Now let me hand it off to Jim Gray, who will provide a financial review.

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Thank you, Jim. North America net sales were up significantly for the quarter when compared to the prior year. This was driven by volume recovery from the pandemic impacts on consumer mobility in the same quarter last year, the pass-through of higher corn costs and continued specialty ingredients growth. These increases were partially offset by the cessation of ethanol production at our Cedar Rapids plant.

North America operating income was $149 million, up 48% versus the prior year. The increase was driven by favorable price mix, volume recovery and volume growth, and favorable corn margins due to higher-than-expected co-product values.

South America net sales were up 47% versus prior year. The increase was driven by favorable price mix, including the pass-through of higher corn costs and volume growth. Absent foreign exchange, sales were up 45%. South America operating income was $33 million, up 154% versus prior year as favorable price mix more than offset higher net corn costs. Excluding foreign exchange impacts, adjusted operating income was up 149% in the quarter.

Moving to Asia Pacific, net sales were up 33% in the quarter, which includes PureCircle results. Excluding PureCircle, Asia Pacific net sales were up 17% and benefiting from volume growth and favorable foreign exchange. Asia Pacific operating income was $24 million, up 9% versus prior year. Excluding PureCircle, first quarter operating income was $26 million, up approximately $2 million from the year ago period, driven by higher volumes and favorable foreign exchange.

In EMEA, net sales increased 35% for the quarter. The increase was due to higher volumes and favorable foreign exchange. EMEA operating income was $32 million, up 52% for the quarter. The increase was driven by lower raw material costs, favorable price mix and higher volumes.

Let me turn to the quarter's income statement highlights. Net sales of $1.762 billion were up 31% for the quarter versus prior year. Gross profit margin was 20.8%, up 70 basis points. Reported operating income was $222 million and adjusted operating income was $208 million, the most profitable quarter for the company since 2017. Reported operating income was higher than adjusted operating income due to a favorable decision from the Brazilian Supreme Court related to indirect taxes collected from 2015 to 2018 which resulted in a net income gain of $15 million. Our quarter 2 reported earnings per share was $2.62, and adjusted earnings per share was $2.05.

Turning to our Q2 net sales bridge. A sales volume increase of $230 million was driven by higher volumes in all four regions and the inclusion of PureCircle and KaTech results, partially offset by the cessation of ethanol production at Cedar Rapids. Favorable price mix of $144 million was largely attributable to the pass-through of higher corn costs in North America and South America.

Turning to net sales variance by region. In North America, net sales were up 26% versus prior year, driven by volume recovery and growth and favorable price mix driven by the pass-through of higher corn costs. South America net sales were up 47%, driven by a price mix increase of 33% due to the pass-through of higher corn costs as well as strong volume growth. In Asia Pacific, net sales were up 33%, driven by the inclusion of PureCircle sales, which we show as an addition attributable to volume sales gains. EMEA net sales were up 35%, driven by higher volumes, which includes 2 months of KaTech's results and favorable foreign exchange.

For the quarter, reported operating income increased $109 million, while adjusted operating income increased $81 million. The increase in reported operating income versus adjusted operating income is primarily due to a favorable decision from the Brazilian Supreme Court related to indirect taxes from 2015 to 2018 and investment-related credits, which were partially offset by restructuring costs related to Cost Smart. As Jim highlighted, operating income was up in all four regions.

Corporate costs for the company were flat for the quarter versus last year, driven by the timing of current year investments in global operations and commercial capabilities.

Turning to our earnings bridge, on the left side of the page, you can see the reconciliation from reported to adjusted earnings per share. On the right side, operationally, we saw an increase of $0.88 per share for the quarter. The increase was driven by margin improvement of $0.40, higher volumes of $0.38, favorable foreign exchange of $0.07 and other income of $0.03.

Moving to our nonoperational items, we saw an increase of $0.05 per share for the quarter, primarily driven by a lower tax rate of $0.04 per share. I will briefly cover year-to-date results.

Year-to-date net sales of $3.376 billion were up 17% versus the prior year. Gross margin was 21.3%, up 80 basis points. Year-to-date reported operating income was $52 million, and adjusted operating income was $409 million. Reported operating income was lower than adjusted operating income due to the held for sale impairment charge related to the Arcor joint venture in Argentina. Our year-to-date reported earnings per share was a loss of $1.01, and adjusted earnings per share was $3.90.

Turning to our year-to-date net sales bridge, a sales volume increase of $223 million was driven by higher volumes in all four regions and the inclusion of PureCircle and KaTech results, partially offset by the cessation of ethanol production at Cedar Rapids. Favorable price mix of $220 million was largely attributable to the pass-through of higher corn costs in North America and South America. Reported operating income decreased $214 million, while adjusted operating income increased $115 million versus prior year. The decrease in year-to-date reported operating income versus adjusted operating income is primarily due to the held for sale impairment charge related to the Arcor joint venture in Argentina. Operating income was up in all four regions. Year-to-date, Corporate costs for the company were down slightly versus last year.

Turning to our earnings bridge, on the left side of the page, you can see the reconciliation from reported to adjusted. On the right side, operationally, we saw an increase of $1.24 per share year-to-date. The increase in earnings per share is attributable to the same drivers as mentioned for Q2. Moving to our nonoperational items, we saw a decrease of $0.06 per share year-to-date, driven by an increase in net income attributable to noncontrolling interest of minus $0.05 and a higher tax rate of minus $0.03 per share, which were partially offset by a decrease in shares outstanding of plus $0.02 per share.

Moving to cash flow, year-to-date cash provided by operations was $129 million. Cash provided by operations decreased versus prior year driven by the impact of higher net sales on accounts receivable and higher corn costs on inventory values. Capital expenditures were $102 million, down $73 million from the prior year period due to the timing of payments for investments in our growth projects. At quarter-end, cash and cash equivalents were $542 million.

While there remains some uncertainty around the degree of economic recovery in the second half of the year, given the emergence of new COVID variants, our strong first half financial results, combined with our team's proven ability to navigate a difficult environment, gives us confidence to reinstate guidance for the full year.

Turning to our income statement outlook, the layout of corn in the year will balance first half favorability with second half corn margin compression to deliver full year growth. Our adjusted EPS guidance for 2021 is in the range of $6.45 to $6.85.

We expect net sales to be up low double digits driven by the pass-through of higher corn costs, strong price mix and volume recovery. We expect full year adjusted operating income to be up mid-single digits to high single digits versus last year. We expect corporate costs to be up low single digits. 2021 financing costs are expected to be in the range of $80 million to $85 million. Our adjusted effective annual tax rate is expected to be between 27% and 28%.

Cash flow from operations is expected to be in the range of $500 million to $600 million, which includes an increase in expected working capital due to higher expected net sales and corn costs.

Capital investment commitments are expected to be between $330 million and $350 million, of which more than $100 million is being invested to drive specialty growth. We expect total diluted weighted average shares outstanding to be in the range of 68.0 million to 68.5 million for the year.

Turning to our region outlook, North America net sales expected to be up 10% to 15%. Operating income expected to be up low to mid-single digits, driven by higher volumes and lower operating expenses. In South America, we expect net sales to be up 10% to 15% and operating income to be up in line with net sales increase. This reflects the contribution of our Argentina business to the joint venture with Arcor. In Asia Pacific, we anticipate net sales to be up 25% to 30% versus the prior year, including PureCircle results. We expect operating income to be up high single digits, driven by higher volumes and favorable foreign exchange. Finally, for EMEA, we expect net sales to be up 15% to 20% and operating income to be up low double digits driven by higher volumes and favorable foreign exchange.

Let me turn it back to Jim.

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

Thanks, Jim. As mentioned in my opening, we are very pleased with our strong second quarter financial results. Our results are particularly noteworthy when recognizing that we have been able to react to the sudden snapback of exceptionally strong customer demand as our teams work closely with customers to meet their changing needs. Furthermore, our strong top line growth is evidence of the breadth and diversification of both our product line and customer base and the importance of the ingredient solutions we provide across many different sectors of the food and beverage spectrum.

As highlighted previously, our driving growth road map serves as our compass for creating value for customers and shareholders. This most recent quarter provides further evidence of just how much value can be created when the components of the road map all performed well together and concurrently.

In closing, we look forward to sharing more about our long-term plan for shareholder value creation at our 2021 Investor Day, which is scheduled for Friday, November 12, 2021. We plan to hold our Investor Day in person, and more details related to the location and time will be forthcoming.

Now let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ben Bienvenu with Stephens.

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

Congrats on the quarterly results. I wanted to ask, the first half of the year has been exceptionally strong, I think stronger than any of us expected. The full year guidance, I think -- if I just think about operating income relative to your prior operating income guidance, is higher. But it does look like things will slow in the back half of the year. So I think, Jim Gray, you made some comments around net corn costs. I suspect that's a meaningful component of it. I'm wondering if you could tease out the other puts and takes embedded in the guidance relative to how you were thinking about it previously?

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Yes. Sure, Ben. As I mentioned in my remarks, when we begin -- let's take North America as a region, but higher corn costs are impacting I think all of our regions somewhat equally. Within North America, as we enter a year in our contracting season, we're setting price and about half of our revenues come from contracts that have a flat price throughout the year. We're laying on hedges and covering the gross cost of that corn. More so of those hedges are placed in the first half. And as we go through the year, we place hedges to fill the second half corn risk coverage. And we're largely covered on our corn risk.

Obviously, corn has moved up significantly in second half versus the second half last year. Corn will be up more than $1, $1.50 a bushel, as you can see through looking at CBOT futures. Co-products have also moved up. But generally, what we're having is we have a price that's fixed on our contracts, we've had a move up in our raw material costs in the second half, and that leads to the compression in the corn margins. And so hopefully, our guidance is just helping you with the favorability in the first half due to the -- how we've laid on our hedges and higher co-product values. As we move into the second half, we have higher corn costs. Yes, we still have some higher co-product values, but we really have flat pricing, which then we'll look to that inflation and how we look to the '22 season.

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

I do think it's also noteworthy, Jim, to highlight the fact that we started to see the uptick in quarters three and four of last year and quarter four was our highest sales quarter last year. So from a comparator standpoint, I believe quarter four net sales were up 4% on prior year, which was 2020-'19 pre-pandemic. So -- and South America, in particular, had a tremendous quarter in quarter four last year. So we're up against some tighter comparisons or really very good comparisons, which is just showing the momentum, I think, that's in the business that actually picked up in the second half of the year and just continues onward. And I don't think it's just all about the corn compression in North America necessarily. You've got to look at it related to the comparisons in the second half and especially quarter four last year and the momentum that continues in the business.

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

Yes. Okay. That makes sense. Thank you. My second question is as we think about PureCircle and the continued integration there, if we just pan out bigger picture, I'm curious to hear your thoughts on the broader adoption rate of stevia. And you talked about the receptivity to the fermentation-based Reb M. I'd be curious to hear how big you think these categories within the sweetener category overall can get in your mind and just the long-term view of that business.

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

Yes. So if you remember, at CAGNY back in February, we talked about the size of the total addressable sugar reduction ingredient market was estimated at $5 billion by 2026. And the size of the global stevia market, we estimate it by 2028 to be $1.6 billion. So we think there's a tremendous headroom for growth with these products. And what we are particularly excited about is the fact that when it comes to a natural sweetener or a perceived natural sweetener, a high-intensity natural sweetener and alternative to artificial high-intensity sweeteners, that our product offering is the broadest in the industry when you think about PureCircle's leaf extract stevia.

The success that we're seeing and the investments we'll be making to expand capabilities in bioconverted Reb M, which is taking a leaf and enzymatically converting it into the better tasting Reb M, and then the fermented Reb M, which has just tremendous benefits from both a cost and sustainability platform, and we couldn't be aligned with a better technology partner in Amyris, a leader in synthetic biology.

So all three of those capabilities are coming together at the same time. And different customers have different preferences when it comes to labeling, when it comes to the nuances of how to formulate a sugar reduction solution for a particular product. And so we just think this gives us a palette of capabilities to choose from to solve sugar reduction challenges. And we're seeing that right now, and we're very excited about the prospects.

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

That's great. Thank you so much for the questions and the answers. And best luck in the back half of the year.

Operator

Our next question comes from Robert Moskow with Crédit Suisse.

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

Jim and Jim, when I look at the math implication for the back half of 2021, I think it's an EBIT margin below 10%. And totally understand how the timing of the net corn costs flow through. But as you look to pricing in 2022, is this margin structure in the back half reflective of a new base, like a lower base of the business because it's never really been below 10% before? Or is it just kind of like a reset year in 2022 where you'll take pricing to the extent that the market affords it and supply-demand conditions afford it? And then I have a follow-up.

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

I don't think it's a new structural level of profitability. I think that these evolutions in a year happen in our industry from time to time just related to the way that the corn cycle has moved in this particular case and the way our business model tends to operate, but we are right now related to inflationary increases that everyone is experiencing, moving up prices where we can now, even precontracting. And certainly, when you have inflationary increases in freight and manufacturing costs, that's an example right now of where our operating model allows us to pass through the majority of freight increases, and we're doing that right now, passing those on in accordance with our contract terms.

In addition, when it comes to other inflationary type inputs of chemicals and packaging, contracting will address that, and we intend to pass those through in pricing this year. But right now, it's early, obviously, to talk about 2022 contracting terms. Jim, do you want to comment?

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Rob, just to also kind of level set. Last year, early November, we were largely completing our contracting within the U.S. Canada, North America market, and there wasn't any light at the end of the tunnel with regard to an effective vaccine. And there was impacts on particularly syrup volume in U.S. and Canada with regard to food service, quick-serve restaurants as well as other food service establishments being down. Move forward 12 months, and we've seen kind of a rapid change and bounce back both in overall food service in the last quarter but also obviously, quick-serve restaurants are significantly up, both in traffic as well as dollar sales. You're seeing a pull for fountain drinks, you're seeing a pull for beverages which is largely leading to improved volume recovery in some of those syrups. So that's having an industry impact, right? There's just better utilization in the industry as we head into the second half.

So I think with better utilization and the fact that many of our customers are seeing and taking price increases themselves, I think the environment sets well -- sets up well for us to recapture in our price -- our increase in our corn costs.

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

I got it. I got it. And then maybe a deeper dive into -- you said half your business is fixed, half is kind of variable. Is there a difference in that mix for specialty versus the rest of the business? Is your specialty business also half fixed, half variable?

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

No.

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

Not at all. Majority is fixed.

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Yes.

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

Vast majority. Vast majority is fixed.

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Higher price points per ton and higher value add and tend to be more of a flat price.

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

Yes.

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

Okay. And so most of it is fixed, but you also said that there's some freight costs kind of riders in the contract where, if your freight costs are rising higher, you can price up for that this year?

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

Yes. If you remember, Rob, 2018, we got caught in relationship to a sudden spike in freight and all of that has been corrected. So what we're saying is right now, we're passing through the majority of those freight increases to customers in accordance with our contract terms.

Operator

Our next question comes from Adam Samuelson with Goldman Sachs.

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

So I guess, first question, just making sure we're clear on the corn cost side and the layout, especially in third quarter, I'm just trying to think about the cadence between the two periods. And you provided some comments on South America having a particularly challenging comp. But in North America, on corn, is basis a bigger issue in third quarter that we've got to be mindful of as we think about the layout of the op income for the second half in the North America segment?

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Yes. Adam, just for everybody, there's just -- there's a couple of components when we think about what the net cost of the corn to us. Obviously, the gross cost of the corn, plus or minus the hedges, the basis which is really the cost from the farmer that's paid to the intermediary to get the corn to our facilities, and then the value of the co-products that we sell. So we've spoken to the fact that we've hedged most of our gross corn. We think our hedge program is working well. I do see a bit higher basis in Q3 than in Q4. I do think that second half basis is elevated relative to the first half. And then you can see, and we've all seen that we've had higher co-product values. And we think that those will -- they've come down a little bit from their peaks, but those will continue to contribute, I think, positively offsetting some of the higher gross corn costs that we're experiencing in the second half as well as part of the basis. But the basis is one of the factors, Adam, that's impacting Q3, a bit more than Q4.

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

All right. That's really helpful. And then on specialties, I know you gave the global growth for the second quarter, and that did have the impact of PureCircle and the KaTech in there. What was organic specialty volume in the second quarter? And maybe as we think out into '22, given the ramp-up on plant protein, some of the maturing of PureCircle within the portfolio, any way at this point to frame incremental year-on-year kind of contribution from those businesses next year?

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Yes. I mean, just real quick in the notes, as Jim was speaking, our PureCircle sales are highlighted in my notes in the region performance for Asia Pac, so we break out the net sales there and so all of PureCircle has been the Asia Pac dated number, and then we've talked to it excluded. And then KaTech, it's early days. It's at about 5 points, a little bit more positive to the EMEA specialty performance for Q2.

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

We had very strong double-digit volume growth in specialties across all platforms. And a lot of that was the drive -- the pullback of -- or the demand increase for foodservice. And the fact that our products find their way into those products as well as packaged foods at retail.

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

Okay. And then as we're thinking about '22 with some of the plant protein capacity that's now -- that's in ramp process now kind of year two of PureCircle where the EBIT contribution of that business has been pretty modest to date. Just help us think of kind of reasonable baseline step-up in contribution there?

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

I think we see steady increases in both sales and profitability from PureCircle, and we have a goal by the end of this year to be exiting the year at breakeven for that business. And so the momentum -- and that excludes, obviously, any contribution from the partnership that we have with Amyris. So we anticipate going into 2022 that we're going to see incremental both sales and profit contribution coming from sugar reduction and PureCircle and especially when it comes to plant-based proteins. That's one of the big toggles that should drive incremental price mix as it relates to specialties in 2022. And I guess we're going to be able to communicate a lot more related to that specific question at the 2021 Investor Day in November.

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Yes. I mean, Adam, we firmly believe that PureCircle, as it continues to drive that revenue growth in the top line, along with the mix, the very favorable mix that Jim highlighted in his comments that that's going to be on an op income margin basis, very attractive and relative and similar to what our specialty op margins -- op income margins look like. So we're progressing that. As Jim mentioned, we'll get to breakeven here by the end of 2021. We'll see a step-up in 2022, well on our way, I think, in '23, '24 to that type of specialty op income margin.

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

Got it, that's very helpful. I'll pass it on, thanks.

Operator

Our next question comes from Ken Zaslow with Bank of Montreal.

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

Your South American profitability is coming back to -- I wouldn't quite say back to the good old days, but it's definitely moving in that direction. Can you frame -- I know a couple of years ago, you kind of framed how you thought it would kind of get back to a certain level relative to the history. You seem like you're getting closer to the number. Can you talk about the long-term opportunity that's there? And how big that operating profit growth can get to, say, in the next two to three years? Or is it kind of peter out over the next couple of years? Is this -- just kind of give that framework for that, that's a hard business to kind of frame.

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

Yes. Well, Ken, first of all, thank you for the question about South America. It's worth to note that this is the fourth consecutive quarter of year-on-year operating income growth, and it's the second highest quarter performance in nearly a decade in South America. And as I've been saying in prior calls, we're very proud of the work that has been done by the team in South America over the last three years to get their cost structure in line, eliminate waste as well as increase efficiency. Our manufacturing, our operations there are running exceptionally well, and also get close to customers to drive specialties growth which, again, we called out South America specifically for specialties growth as the highest performing region this past quarter. So as it relates to the quarterly results, the net sales in South America were driven primarily by pass-through of higher corn costs and also benefited from higher volumes in Argentina and Brazil for beverage and brewing ingredients, respectively.

I've commented in the past also, just in relationship to foreign exchange devaluation and our ability to price through price increases. And this quarter, again, was another example of those pricing muscles and the center of expertise around pricing in a region that really calls for it and being able to deliver. South America's first half operating income benefited from really well executed contract management and corn hedging as well as higher co-product recoveries. And they're just doing a very good job down there. And so I think the prospects for a team that knows the region exceptionally well has gotten closer to customers positions us to continue to find pockets of growth, continue to innovate and be a very strong player down there in the future. But thanks for the question because we're very proud of the performance in South America.

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

So the idea of how that is going to grow in the future, how are you thinking about that? That's -- again, I think that your performance is good. I'm just trying to figure out maybe a little bit more in duration. Do you think this is -- the growth rate is still sustainable? Do you think as you get more specialty, are we thinking that one day we can get to that $200 million level in like four, five years? Just kind of framing that is kind of what I'm trying to get at.

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

Yes. Yes. No, I think that what we see is steady year-on-year progress building on what's already been achieved from a standpoint of increasing the mix more towards specialties, which again is a major strategic area of focus and continuing to find ways to renovate our position in the core and grow with increased food service consumption. And remember, we all have to remember that these results are in spite of a region that's been hit very, very hard by the pandemic. So when that begins to lift, I believe we'll see even more opportunity for continued sustained growth there based on the strength of our market position and based on how the team has learned to execute under very difficult circumstances.

So I think that we can expect steady year-on-year long-term growth, I would call out again the exceptional comparison that we're going to see in quarter four of where South America performed in quarter four last year to this quarter four, that's an extremely tough comparator. So but long term, the growth prospects for South America, I think, for incremental steady growth is still quite positive.

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Hey Ken, I just want to add, though, that when you look back historically, that 2011, 2012 era, you had some performance in Argentina that really contributed to that overall $200 million number that you're referencing. And Argentina has had, as a country and economically, along with the value of the peso, has had a set of challenges, obviously, which we've highlighted over the last couple of years. If you net that out, the remaining business, so Brazil and all of our countries in the Andean, that business is net-net, much better, much stronger than kind of where we've been.

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

And that's a really good point, Jim. And so what Jim is calling out is back in the high watermark of 2011 in South America. Argentina's net corn was virtually 0, just related to the export policy, an export tariff policy of the country at the time. So in a sense, they were anomalously high profitability coming out of Argentina at the time. And then, of course, we have the Arcor joint venture right now, which will be another factor to consider as it relates to the rebasing of our South America outlook. And again, it's another thing that I think will bring clarity on as we go into the 2021 Investor Day.

Seth Goldstein - *Morningstar Inc., Research Division - Equity Analyst*

Okay, thank you very much.

Operator

And our next question comes from Seth Goldstein with Morningstar.

Seth Goldstein - *Morningstar Inc., Research Division - Equity Analyst*

Good morning, everyone. I appreciate the question. Just one quick one on plant protein sales. So they more than doubled in the quarter. Has your near term outlook changed for the capacity ramp-up and the speed that you can do that? And do you see an opportunity to hit the $200 million sales target earlier than expected?

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

So what we said at CAGNY was we expect net sales of $130 million by 2024 with operating margins of 11% to 13%. We have -- an internal stretch target would be even larger than that. But right now, we're very pleased with the progress with pulse-based flowers and concentrates and the sales ramp up there, particularly from our Vanscoy, Saskatchewan facility. And we're still very bullish on the prospects for the pea protein isolate and the whole formulation capabilities that the suite of plant-based protein type ingredients offers for alternative dairy and alternative meats and our pipeline for customer projects just continues to be very strong. And we anticipate sales to continue to develop in the second half. So we're remaining very bullish on the prospects for plant-based proteins.

James Derek Gray - *Ingredion Incorporated - Principal Accounting Officer, Executive VP & CFO*

Yes. And Seth, as we've mentioned, as we start a new facility up and we really plan for that capacity to be taken up over kind of a four-year period, I think one of the important things to recognize is that as our technical solutions team and our sales teams are working with customers, they're making sure that the ingredients and the specs around the ingredients are really fitting into what the customer wants. So that -- so we're not getting customer churn. We're really actually meeting and exceeding customer expectations early on. And then we have the ability to continue to supply that same quality and spec of an ingredient into our customers. And so we want to make sure that we're taking each of these opportunities in our pipeline, and we're building that so that we're building good, really solid customer relations into novel ideas where we think the isolates, the concentrates and the flowers will play a key role in that ingredient formulation, that recipe for those products going forward.

Seth Goldstein - *Morningstar Inc., Research Division - Equity Analyst*

I appreciate the detail. Thanks for taking my question.

Operator

I'm not showing any further questions at this time. I would now like to turn the call back over to Jim Zallie for closing remarks.

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

Okay. I want to thank everybody for joining us this morning. We look forward to a time when we can see each of you again in person. And until then, thank you for your continuing interest in Ingredion, and we hope you and your families remain safe.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.
