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INGR.N - Q3 2021 Ingredion Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 02, 2021 / 1:00PM GMT

OVERVIEW:

Co. reported YTD net sales of $5.139b, reported operating income of $224m and reported EPS of $0.74. 3Q21 net sales was $1.763b, reported operating income was $172m and reported EPS was $1.75. Expects 2021 net sales to be up low double digits and adjusted EPS to be $6.65-7.00.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Ingredion Third Quarter 2021 Earnings Conference Call. (Operator Instructions)

Please be advised today's conference is being recorded. (Operator Instructions)

I would now like to turn the conference over to your speaker host today, Mr. Jason Payant, Vice President of Corporate Finance and Interim Vice President of Investor Relations.

Jason Payant - *Ingredion Incorporated - VP of Corporate Finance and Interim VP of Investor Relations*

Thank you. Good morning and welcome to Ingredion's Third Quarter 2021 Earnings Call. I'm Jason Payant, Vice President of Corporate Finance and Interim Vice President of Investor Relations. 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 and 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 estimated in the forward-looking statements, and Ingredion assumes no obligation to update them in the future as or if circumstances change.

Additional information concerning factors that could cause actual results to differ materially from those discussed during today's conference call or in this morning's press release can be found 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 presentations appendix.

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

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

Thank you, Jason, and good morning, everyone.

We delivered outstanding third quarter top line performance of 17% net sales growth. This reflected well-managed sales execution to meet strong customer demand. In every region, we achieved double-digit sales growth by managing price/mix and partnering with customers to meet changing demand requirements as a result of global supply chain constraints.

In a challenging environment and against previously anticipated high, double-digit corn cost inflation, we kept pace with higher input costs to deliver adjusted operating income down 9%.

As you recall, in the first half of this year, we delivered significant year-over-year EPS growth, absorbing higher gross corn costs while benefiting from higher co-product values. Taken together, as we balance first half favorability with higher net corn costs in the second half, we are still on track to deliver significant operating income growth for the full year.

Now I'd like to highlight a few of our sales achievements.

As mentioned, we grew net sales by double digits across all regions driven by strong specialty demand and actively managing the terms of our customer contracts, including the pass-through of higher-margin corn and freight costs.

EMEA led our growth this quarter with strong specialty demand in Europe and the positive impact of the KaTech acquisition. Asia Pacific also performed exceptionally well, driven by contributions from PureCircle and strong overall specialty demand. South America and North America benefited from strong customer demand and the pass-through of higher corn and freight costs.

Now I'd like to comment on the current supply chain environment that we're all reading about.

As everyone knows, supply chains globally are currently constrained by ocean container availability, rail congestion, labor shortages and continuing impacts of the pandemic. In addition, as economies continue to open, strong international consumer demand has made the current supply situation very challenging.

To put the impact of the supply chain challenges into perspective on our business, as a reminder, the majority of our volume is sourced locally and delivered locally within region. However, for a portion of our specialty food starch business, we have an interregional supply chain.

For example, about 5% of our U.S. sales are imported from Asia Pacific, of which most are specialty food starches. Therefore, in the first half of this year, we resourced our global supply chain center of excellence to actively manage interregional sourcing and work closely with customers to identify opportunities to best service their needs.

In some special circumstances, we've had to exercise agility to meet customer demand for tapioca and rice-based starches by air-freighting product to meet new product launches or assist with product reformulations. We anticipate the supply chain to remain constrained through the end of this year.

Now moving on to our strategic pillars.

We continued to make solid progress against each of our strategic pillars throughout the quarter, executing on key initiatives to advance our strategy.

Our specialty ingredients platforms continued to be a catalyst for significant growth, achieving high-teens net sales growth for the quarter and exceeding the company's net sales growth.

Among the highlights, our sugar reduction and specialty sweeteners growth platform contributed the most sales dollar growth in the quarter. Additionally, consumers' heightened focus on nutrition and wellness underpinned the robust demand in Q3 for our clean and simple texture and plant-based protein solutions.

Moving to commercial excellence. Our sales teams around the world responded early in the quarter to the challenge of increasing input costs through pricing actions and by managing commercial terms which helped us mitigate inflationary impacts to our business. While margins were pressured, on a dollar basis, we recovered nearly all of the cost inflation that we faced in the quarter.

Cost Smart continues to deliver benefits and have a transformational effect across our company as we continue to find ways to reinvent how we work and deliver increased efficiencies and savings. This quarter, we extended our shared service capabilities, implementing a major change management program within our global human resources function that will provide better and more cost-efficient HR services. Overall, we remain on track to deliver against our 3-year Cost Smart savings program of $170 million, which we've increased twice since it was introduced in 2018.

All of this progress is underpinned by our purpose and values-driven, people-centric culture. As I'll speak about in more detail shortly, this quarter, we are particularly proud to have released our first diversity, equity and inclusion report, where we shared our DEI progress to date and our commitments for the future.

Before discussing this, let me first provide some important updates on the progress we're making in our specialties portfolio.

First, turning to sugar reduction. PureCircle continues to be a catalyst for growth in our sugar reduction and specialty sweeteners platform. During the quarter, PureCircle net sales were up more than 200% year-over-year and operating losses decreased by 60% with both metrics well ahead of our integration plan. Additionally, I'm happy to share that the acquisition is now cash accretive. With a number of recent customer wins and a robust new project pipeline, our sugar reduction and specialty sweeteners team is energized about future growth prospects.

Now moving on to plant-based proteins. We continue to see strong demand for plant-based protein innovation from both existing and new customers. And albeit off a small base, our net sales doubled for the second consecutive quarter, and our project pipeline remains robust.

We are intensively focused on increasing supply and ramping up our facilities in South Sioux City, Nebraska and Vanscoy, Canada. Our dry milling production in Vanscoy has reached new monthly production records, and we've just commissioned our specialty concentrates production line in September, which will increase our available supply of these differentiated products by year-end.

In South Sioux City, our start-up continues to make steady progress with production advancing and increases in batch size and consistency. We estimate we are two-thirds through commissioning and process stabilization and are targeting a steady-state process that is able to meet a ramp-up in customer demand early next year. We are laser focused on beginning to load this facility and absorbing the costs associated with a new plant start-up.

Our team is also actively managing yellow pea costs and availability as the drought in Canada has negatively impacted crop size and prices. We are confident we have secured our yellow pea requirements for next year and are assessing the impact of increased raw material costs on next year's financial projections.

Before I hand it over to Jim, I want to spend a moment discussing our diversity, equity and inclusion agenda.

We view our purpose and values-driven, people-centric culture as an important growth enabler. At the heart of this is a deep commitment to diversity, equity and inclusion.

Our inaugural report entitled, Everyone Belongs, in recognition of one of our 5 values, not only celebrates the accomplishments we've made on our DEI journey thus far but sets new goals like achieving 100% on HRC's Corporate Equality Index, reaching industry benchmarks for inclusion and belonging, improving representation of women in management positions to 50% by 2030 and improving representation of black, indigenous and people of color at the management level.

With these goals, we are intensifying our commitment to creating an environment where diversity is celebrated and inclusion is embraced. We know how important this is for us to attract the most talented employees and foster an inclusive and innovative culture that delivers sustainable growth for shareholders.

We've included a link in our earnings presentation where you can download our new DEI report, and it is also available on our website.

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

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

Thank you, Jim, and good morning to everyone. Starting first with our Q3 regional performance.

North America net sales were up significantly when compared to the prior year. North America operating income was $120 million, down 9% versus the prior year. The decrease was driven by higher corn and input costs as well as cost absorption related to the ramp-up of operations in our plant-based protein facilities.

South America net sales were up 16% versus prior year. The increase was driven by favorable price/mix, including active contract management to reflect higher corn costs, partially offset by a volume decline due to the contribution of our Argentina operations to the Arcor joint venture in August. South America operating income was $35 million, up 21% versus prior year as favorable price/mix more than offset higher corn costs. Excluding foreign exchange impacts, adjusted operating income was up 20% in the quarter.

Moving to Asia Pacific, net sales were up 18% in the quarter. The increase was driven by favorable price/mix and higher volumes primarily from PureCircle. Asia Pacific operating income was $21 million, up 17% versus prior year as higher volumes from PureCircle and better price/mix were partially offset by higher corn, freight and input costs in the region.

In EMEA, net sales increased 22% for the quarter. The increase was due to higher volumes, including our KaTech acquisition, as well as favorable price/mix. Absent foreign exchange, sales were up 20%. EMEA Operating income was $23 million, down 8% for the quarter. The decrease was driven by higher corn and energy costs in Pakistan that more than offset higher volumes.

Moving to our income statement. Net sales of $1.763 billion were up 17% for the quarter versus prior year. Gross profit dollars were relatively flat year-over-year, while gross margin was 18.3%, down 340 basis points due to increased revenue reflecting the pass-through of higher corn costs.

Reported operating income was $172 million and adjusted operating income was $163 million. Reported operating income was higher than adjusted operating income primarily due to a favorable final adjustment to the net asset impairment related to the contribution of Argentina assets to the Arcor joint venture, partially offset by restructuring costs related to Cost Smart.

Our third quarter reported earnings per share was $1.75 and adjusted earnings per share was $1.67.

Turning to our Q3 net sales bridge. Strong price/mix of $212 million was largely attributable to the pass-through of higher corn costs in North America and active contract management in South America. The sales volume increase of $39 million was driven by higher volumes in EMEA and Asia Pacific, including the sales volume impact of PureCircle and KaTech, partially offset by the contribution of our Argentina operations to the Arcor joint venture.

Turning to net sales variance by region. In North America, net sales were up 17% versus prior year driven by favorable price/mix as well as higher specialty ingredient mix.

South America net sales were up 16% driven by strong price/mix primarily due to active contract management to address higher corn costs, which was partially offset by a decline in volume from the contribution of our Argentina operations to the Arcor joint venture.

In Asia Pacific, net sales were up 18% driven by favorable price/mix and higher volumes primarily from PureCircle.

EMEA net sales were up 22% driven by higher volumes as demand in Europe for specialty ingredients was robust. Sales volume also includes KaTech, which contributed 8 points of net sales growth in the quarter.

For the quarter, reported operating income increased $19 million while adjusted operating income decreased $16 million. The increase in reported operating income versus adjusted operating income is primarily due to the finalization and completion of the Arcor joint venture net asset impairment, partially offset by restructuring costs related to Cost Smart. Corporate costs for the company were up for the quarter versus last year driven by investments in global capabilities and centers of excellence.

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 a decrease of $0.18 per share for the quarter. The decrease was primarily driven by operating margin decline of $0.26, partially offset by higher volumes of $0.07 and favorable foreign exchange of $0.02 per share.

Moving to our nonoperational items, we saw an increase of $0.08 per share for the quarter primarily driven by the impact of lower adjusted effective tax rate of $0.12 per share, partially offset by higher financing costs of $0.05 per share.

For our year-to-date income statement, the company delivered net sales of $5.139 billion, up 17% versus prior year. Gross profit margin was 20.3%, down 60 basis points.

Year-to-date reported operating income was $224 million and adjusted operating income was at $572 million. Reported operating income was lower than adjusted operating income due to the completion and finalization of the Arcor joint venture net asset impairments and restructuring costs related to Cost Smart, partially offset by income related to the favorable decision from the Brazilian Supreme Court related to indirect taxes collected from 2015 to 2018.

Our year-to-date reported earnings per share was $0.74 and adjusted earnings per share was $5.58.

Turning to our year-to-date net sales bridge, we see that all drivers of revenue contributed to growth. Favorable price/mix of $433 million was largely attributable to the pass-through of higher corn costs in North America and South America. Sales volume increase of $261 million was driven by higher volumes in Asia Pacific, North America and EMEA, including the additions of PureCircle and KaTech. These increases were partially offset by a decrease in South America sales resulting from the completion of the Arcor joint venture.

For our year-to-date operating income bridge, reported operating income decreased $195 million, while adjusted operating income increased $99 million versus prior year. The decrease in year-to-date reported operating income versus adjusted operating income is primarily due to the net asset impairment charge related to the Arcor joint venture in Argentina. Operating income was up in all 4 regions. Year-to-date corporate costs for the company were up versus last year driven by investments in global capabilities and centers of excellence.

Turning to our year-to-date earnings bridge. On the left side of the page, we show the reconciliation from reported to adjusted. On the right side, operationally, we saw an increase of $1.07 per share year-to-date. The increase was driven by margin improvement of $0.47, higher volumes of $0.44, foreign exchange of $0.10 and other income of $0.06 per share.

Moving to our nonoperational items, we saw an increase of $0.01 per share year-to-date.

Moving to cash flow. Year-to-date cash provided by operations was $259 million. Cash provided by operations decreased versus prior year driven by the impact of higher net sales, including higher corn costs, on accounts receivable and inventory values. Capital expenditures were $186 million, down $64 million from the prior year period due to the timing of spend. During the quarter, we repurchased $44 million of outstanding shares, increasing our total year-to-date share repurchase to $68 million.

With more clarity regarding how demand, pricing and input cost inflation are playing out for the second half of 2021, we are increasing our full year 2021 adjusted EPS range to $6.65 to $7 per share, up from the previously provided full year outlook 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 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 $78 million to $83 million. Our adjusted effective annual tax rate is expected to be between 25.5% and 27%.

Cash flow from operations is expected to be in the range of $450 million to $550 million, which includes an increase in expected working capital due to the impact of higher net sales as well as the impact of higher corn costs on accounts receivables and inventories.

Capital investment commitments are expected to be between $320 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 67.5 million to 68 million for the year.

In terms of our regional outlook, North American net sales are expected to be up 10% to 15%. Operating income is expected to be up low single digits to mid-single digits driven by higher volumes and lower operating expenses.

For South America, we assume the deconsolidation and contribution of our Argentina operations for 5 months of the year. We expect net sales to be up 10% to 15% and operating income to be up 20% to 25%.

In Asia Pacific, we anticipate net sales to be up 20% to 25% versus the prior year, including PureCircle. We expect operating income to be up high single digits driven by higher volumes.

For EMEA, we expect net sales to be up 15% to 20% and operating income to be up high single digits driven by higher volumes, which will be partially offset by higher input costs.

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

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

Thanks, Jim.

Overall, we are very pleased with both the financial performance in the quarter as well as the strategic progress we continue to make to strengthen our portfolio. Right now we are focused on supporting our customers as we manage through complex supply chain bottlenecks, which are impacting the entire food supply chain. And, just as importantly, we are leveraging the expertise developed in our pricing centers of excellence that were built up over the last 2 years as we work to offset input cost inflation for the remainder of this year and next year.

We will continue to shape our portfolio towards specialties and look for opportunities to invest in new capabilities and businesses that will strengthen the value propositions inherent in each of our on-trend, consumer-focused growth platforms.

Lastly, we will continue to bring the potential of people, nature and technology together to make life better for all stakeholders.

Now let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question coming from the line of Ben Bienvenu with Stephens Inc, your line is open.

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

I want to ask and focus on the specialty business. You noted the global specialties contributed high-teen sales growth, continuing to drive strong growth across a lot of your products within that segment of your business. You also talked about improvement in the integration of PureCircle. Could you provide some color on what sort of EBIT contribution we're seeing from specialties relative to that sales growth that we're seeing and what you think the maturation of that contribution will look like over the next year or so as that portfolio continues to mature?

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

Sure. Jim, do you want to take that?

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

Hey, Ben, maybe I'll lead on that. We've characterized our specialty ingredients portfolio both from a gross margin and from an operating income margin perspective as being greater than the remainder of our portfolio. Traditionally, we see specialty margins in our products in the 30%-plus range, and it can be -- for some niche products, it can be significantly more than that on a gross margin basis.

And generally, what we're seeing is that as we have moved through this year in terms of various input costs, they generally have less of an impact on our specialties because the raw material is a lower portion of our cost of sales. And so as specialty continues to grow both on a volume basis, on a market share gain basis and, therefore, on a revenue basis, we're seeing that EBIT growth is somewhat in line with how we talk to the top line growth.

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

Yes. I think in our strategic plan, for example, the majority of our gross profit increase over that time period is coming from specialties. And I think when you saw the most recent 4-year outlook that we had provided, that the percentage of operating income coming from specialties is projected to increase about 4 percentage points, I think, over that period from the standpoint of the weight of the overall portfolio.

The other thing...

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

The total mix.

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

The total mix.

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

Yes.

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

The other thing that I would add is, part of our strategy is to continue to invest in one of our 5 growth platforms, which is called food systems, which is leveraging the ingredients that are in those other 4 platforms, starch-based texturizers, the clean and simple ingredients, sugar reduction and plant-based proteins, from a formulation capability standpoint to develop more complete systems for our customers which typically are higher gross margin. And those -- we have projected that those will grow at a higher rate as well.

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

Okay, I see. That's great. Thank you. Secondly, I'd like to ask about just capital allocation. You look like, based on the way things are going, you'll probably continue to build cash on the balance sheet even as you've accelerated to some extent your buyback activity, you've got a steady dividend at a nice yield. You're further along in integrating PureCircle. You noted that the pipeline is interesting and attractive. Could you talk about, when we think about rank-ordering your use of cash over the next year or so, what are the most versus least likely outlets to deploy that cash into?

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

Sure. Yes, Ben, I'll tie your first question to your second question, right, which is that as we grow the specialty portfolio, we're really looking for that contribution in terms of operating income growth. So how can we get operating income growth mid-single digits to high single digits? We do that by looking around the globe at where we have capital investments, organic capital investments that our team identifies.

And that's really one of our first priorities in terms of capital investment after what I would call our stay-in-business capital. And the reason why is that those opportunities are -- they're near in and they're adjacent, they're strategic. And our whole team can really operate on our value chain and on the go-to-market opportunity.

So for example, we're investing in a modified food starch expansion in China. And China is a tremendously underserved market for modified starches, and we can bring great, differentiated product that's sourced locally and made locally and sold into a massive market. So that's the type of opportunities where we first prioritize.

I think secondarily then, we're really looking at -- we're very conscious about the dividend and dividend growth. We've raised the dividend 7 years in a row.

And then third, we still have excess cash to deploy strategically. And really, it's a choice between what M&A is there available to us that we think we can prudently go after and do so with a disciplined approach towards ROIC. I think we've proven that we can get synergies out of the acquisitions that we've executed in the past. Still some of that evidence is for us to show. I mean we highlighted here on the call PureCircle and the progress we're making on PureCircle going into next year.

So M&A, tuck-in M&A, M&A in general is very much a focus for us. And if not, then we'll go after some share repurchase and be very disciplined about total shareholder return.

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

That's great. Thank you Jim and Jim, good luck with the rest of the year.

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

Thank you Ben.

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

Thanks Ben.

Operator

And our next question coming from the line of Robert Moskow with Crédit Suisse, your line is open.

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

A couple of questions. One is on -- in Asia Pac, it looks like you lowered your sales guidance for the year. Is that related to PureCircle? Or is that related to just the challenge of global trade in a tight supply chain environment?

And then also, can you elaborate a little more on the yellow pea crop and what that means for your operations? What was your -- what's your going-in assumption for profitability of that new pea protein business for 2022? And what do you think the potential outcomes are if the crop turns out to be much more expensive?

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

Yes. I'll let Jim take Asia Pac, and I'll take the yellow pea question.

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

Yes. Hey Rob, on -- with regard to Asia Pac, really as we looked at what we thought the recovery was in -- from last year in terms of volume, really if you look at Q3 South -- Southern Asia, right, whether it's Thailand and ASEANI type of regions or even China with its kind of intermittent lockdowns, there's just been kind of some ups and downs in terms of the volume growth as we've had just starts and stops in various food supply chains as well as kind of ins and outs on foodservice.

So I think that, that's now -- we're see that -- we see COVID rates coming down. We see consumer mobility up, thinking a bit more positively on Asia Pac for Q4. So really, when we just take kind of Q3 and what maybe that slight pause had into effect, I think that's impacting our full year outlook. And its -- it really has nothing to do with PureCircle. PureCircle growth is still strong double digits.

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

And as far as the plant-based protein investment in yellow pea, we continue to remain very bullish on the growth prospects from both South Sioux City and the Vanscoy investments. We absolutely believe that plant-based proteins are going to represent a sizable portion of our specialty portfolio over the next 3, 4, 5 years.

We're very encouraged by the progress our manufacturing and engineering teams have made to commission two entirely new production facilities in a completely new ingredient category to Ingredion. And the Vanscoy facility, as we indicated, continues to produce at record rates in comparison to previous months. Right now, the focus is on South Sioux City, completing that process stabilization and ramping up that supply to meet customer demand.

Our plant-based protein sales in 2021 will be 2 to 3x what they were last year. That said, they will be behind our first year forecast. And that's why we're laser focused on loading the facility and absorbing the costs associated with the new plant start-up. So while this will result in a larger operating loss than we had projected this particular year, we're confident in the long-term prospects for the category and for the return on those investments.

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

Yes. And generally, Rob, I mean, to add, as we see yellow pea cost or the cost of the raw material going up, the first indications are -- is that it's such a value-added product that raw material pricing can be put through on the higher-end protein isolates in the marketplace.

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

Okay. So when you say that the loss is larger than expected, is that because the crop is weak? Or is it because of other types of delays?

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

No. No, no. So again, we are just commissioning these facilities this calendar year, so the yellow pea cost is not related to that at all. So it's just related to the merging of the commercial ramp-up of the facilities tied to sales in the first year literally of commissioning both facilities.

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

Okay. Is it easy to catch up in year 2 then, Jim, like as far as...

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

We've got a very strong customer pipeline. We're having very strategic discussions with some of the largest users and projected users of, for example, pea protein isolate and pulse-based concentrates across food and other applications. And so we're feeling very good about the prospect going into 2022.

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

Yes. Rob, maybe just to help, on South Sioux City, there's just more fixed costs with that facility just given the complexity of the process. And so the more volume you get through, you absorb the fixed costs and then you get right back on plan.

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

Okay. Last question. In the quarter, gross profit margin was below consensus. Was it in line with what you thought internally or was a little light?

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

No, I think it was in line with what we were expecting, recognizing look, in our business, quite a bit of it is in terms of -- as we mentioned, in North America, a portion is variable price, so it's a fee-type contract. Revenue is going to go up as the course -- the cost of corn goes up, and we're really securing kind of our dollar profit per ton for the value-add service that we provide. So I think in terms of gross profit dollars, looking at the various corn cost inflation, which was probably 3/4 of our change in our cost of sales for the quarter, that was very in line with expectations.

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

Got it, thanks.

Operator

Now our next question coming from the line of Adam Samuelson with Goldman Sachs, your line is open.

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

Thank you. Good Morning everyone.

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

Hey Adam.

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

Hi Adam.

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

So first question, maybe just to clarify, just as we think about the layout for the fourth quarter, I think the full year guidance implies that adjusted operating profit in 4Q is down 20%-plus year-over-year. And then maybe just help us with where the incremental year-on-year pressures are coming through in 4Q relative to where you were in the third quarter. And I know corn costs are more burdensome in the second half of the year broadly, but it does seem to imply a bigger step-down sequentially, and I'm just trying to make sure we're clear on the drivers.

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

Sure. Thanks, Adam. So in the first -- first, I just want to bring us back to the first 9 months of the year. Gross corn costs were in line with our business plan, and we benefited from higher co-product values. In addition, volumes, particularly specialties, were stronger than anticipated due to the snapback of the global economies opening up, inclusive of really very strong foodservice sales.

And in the third quarter, we kept pace with higher input costs to deliver operating income in line with our expectations against, again, previously anticipated high double-digit corn cost inflation, and we also delivered very strong price/mix. In quarter 4, we're anticipating further inflationary cost increases and some supply chain constraints, limiting volume upside.

And we're obviously imposing price surcharges in-year, which is what we've been doing, and they will just lag some of the increase in input costs. But we're taking all that into account as we go into our contracting and pricing for next year with momentum on the pricing side.

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

Yes. And Adam, just to remind, right, Q3 is usually a bigger quarter than Q4 and that, as we had previously discussed and as Jim just mentioned, just still managing through higher corn costs year-over-year. I mean that's the primary impact that we're seeing in terms of Q4.

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

Okay. All right. That's -- yes, that's helpful. And then follow-up question, and you kind of alluded to it a little bit in that answer just now, Jim. But also, throughout the call today, you made several allusions to actively managing customer contracts and pricing and being considerably more proactive on that than maybe Ingredion had been historically.

I'd love to hear you reflect a little bit about what you're actually doing with the -- on the pricing side to really make sure you're getting that inflation recovery. And is that both in the -- more in the base commodity business than specialty? Is it both -- if it's commodity, is that a better supply environment with volumes improving? Or just help me think about how maybe Ingredion's kind of pricing discipline is maybe different today than it might have been a couple of years ago.

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

Yes. We've been emphasizing our -- what we call pricing centers of excellence for the last year-plus. And the best evidence of that is in South America. So South America has developed very strong pricing muscles that have been demonstrated in relationship to the magnitude of price/mix vis-a-vis forex devaluation over each successive quarter over the last 2 years, so much so that I think it was last quarter and this quarter it's almost a complete neutralization without even the lag. That's one example.

So we've shared best practices across the globe and staffed. And we're fortunate we did so prior to inflation rearing its head. That's why we're feeling very good. And this particular year, as it relates to extraordinary times call for extraordinary measures, when you're living through inflation in-year, even though we're contracted, we're looking at each and every contract, where possible, where we can in-year exercise the terms that are in those contracts to put through freight increases of an order of magnitude that offsets those cost increases, surcharges where necessary and any other inflationary increases. So we're doing that in each region based on those pricing centers of excellence.

And just if I could comment a little bit just on pricing as it relates to the go forward. The increased economic activity and increased industry capacity utilization, we believe, will be favorable to pricing next year. Corn prices are, as we all know, trending in the mid-$5 range for next year, which would imply substantial increases in corn costs. And the industry is contending with the increases in chemicals, packaging, fuel, freight. And all of that's going to need to be offset by pricing.

And consistent with our operating model, we expect to pass through higher corn freight input cost to our customers, and that's really been the primary focus to our customers since early summer.

And equally, the pace of contracting is likely to be impacted by customers' concern for supply as well as the uncertainty around continued inflationary pressures. And I can say for those customers who we have agreed to 2022 commitments at this time, we're seeing substantial price increases year-over-year. And we'll provide a readout on 2022 contracting during our year-end earnings call in February.

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

Ok, great that color is really helpful. I will pass it on. Thanks.

Operator

Our next question coming from the line of Ken Zaslow with BMO Capital Markets, your line is open.

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

Good Morning everyone.

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

Hi Ken.

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

Hi Ken.

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

Just one bigger-picture question. Your cash flow from -- your cash flow guidance came down a little bit, but you're obviously taking up expectations and your CapEx is going down. What is that in reference to? Just kind of giving that a little color. That'd be helpful.

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

Sure. Hey, Ken, just as you have higher corn and raw materials, just working from the raw material to the WIP to the finished goods, and then we're selling those to customers, so your volume may be up low single, mid-single digits. The price on that ton is benefiting from the pass-through of that higher corn cost. And so, therefore, the invoice that goes to the customer is more.

And then, as you just work through the various terms with the customers in terms of their payables as sales grow, we have to put a little bit more money into accounts receivable. And then as that higher raw material cost is passing through our inventory, be it WIP or finished goods, and we're holding it, while the number of units may be similar or even slightly more constrained or down year-over-year due to demand, the value per unit, the value per ton is up. And so that's just reflecting in our balance sheet.

I really think this is -- as this globally higher corn cost has moved through the balance sheet in 2021, we'll be back to kind of a more normalized investment in working capital in 2022 and beyond.

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

Okay. And then in terms of Europe and the energy costs, how transient is that? And do you expect to be able to start passing it through that we would start to see a different trajectory in 2022?

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

Yes. I mean -- and one significant item as it relates to input costs that we are putting through as far as price increases go, Europe accounts for 55% of our sales in EMEA. And in accordance with our risk management strategy, we hedge for Europe our natural gas needs, and we're covered well into next year. So we're monitoring the situation, and we are intending to put through increases to offset the inflationary increases with energy as well as other raw materials and other input costs for contracting for next year in Europe.

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

Okay. And my final question, and we've all kind of beat around the bush on this. I'm just going to go right after it. Have you finished contracting in the U.S.? And do you expect your prices to offset the corn prices going forward? And then I'll leave it there. And I...

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

It's just too early. We're in the midst of contracting, as we always are, at this point in time. But what I would repeat is that the market, given how tight supply-demand is related to very strong demand -- so that's what we're seeing, very strong demand. And we could sell everything that we make, and our plants are running very hard. And there's acknowledgment, if not acceptance, in relationship to the need for price increases to offset inflationary increases, and we're seeing that receptivity. And it's just too early to say how it's all going to net out, but right now, where we sit, we're feeling good about the market's understanding and the receptivity for price increases to offset inflationary increases.

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

Yes, yes. I think, Ken, just to add, it's November. We're about 1/3 of the way through, I think, our kind of flat contracting. And on that, we have seen substantial price increases year-over-year. So to Jim's comment, right, there's still 2/3 of our customers out there who are looking at their contracts and I think -- honestly, I think customers are working through budgeting for next year, and they're working through how does that fit into what their overall price increases need to be on their goods.

So we expect it to pick up. This should be the time of the year when it should be really kind of closing out prior to Thanksgiving and the holidays.

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

And that percentage that Jim cited is totally in line with historical. So it's not anything that's unusual.

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

Great, I really appreciate it guys. Thanks.

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

Thank you Ken.

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

You got it Ken.

Operator

(Operator Instructions) I'm showing no further questions at this time. I would now like to turn the conference call back over to Mr. Jim Zallie for any closing remarks.

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

Thank you for joining us this morning, everyone. We look forward to a time when we can see each of you again in person. Please note that we are targeting our Investor Day for the first half of 2022 when we expect to be able to accommodate in-person gatherings. And until then, we want to thank you for your continued interest in Ingredion.

Operator

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