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INGR - Q1 2016 Ingredion Inc Earnings Call

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OVERVIEW:

INGR reported 1Q16 sales of $1.36b and reported EPS of $1.73. Expects 2016 net sales to be in line with last year and adjusted EPS (excluding certain items) to be $6.45-6.75.

CORPORATE PARTICIPANTS

Heather Kos *Ingredion Incorporated - IR*

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

Jack Fortnum *Ingredion Incorporated - EVP and CFO*

CONFERENCE CALL PARTICIPANTS

David Driscoll *Citigroup - Analyst*

Farha Aslam *Stephens Inc. - Analyst*

Rob Moskow *Credit Suisse - Analyst*

Adam Kendrick *Morningstar - Analyst*

Akshay Jagdale *Jefferies LLC - Analyst*

Ken Zaslow *BMO Capital Markets - Analyst*

Adam Samuelson *Goldman Sachs - Analyst*

Brett Hundley *BB&T Capital Markets - Analyst*

Sandy Klugman *Vertical Research Partners - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Ingredion first-quarter 2016 earnings conference call. For the conference, all participant lines are in a listen-only mode. There will be an opportunity for your questions; instructions will be given at that time. (Operator Instructions). As a reminder, today's call is being recorded.

I will turn the conference now over to Miss Heather Kos. Please go ahead.

Heather Kos - *Ingredion Incorporated - IR*

Good morning and welcome to Ingredion's first-quarter 2016 earnings call. Joining me on the call this morning are Ilene Gordon, our Chairman, President and CEO, and Jack Fortnum, our Executive Vice President and Chief Financial Officer. Our results were issued this morning in a press release that can be found on our website, ingredion.com. The slides accompanying this presentation can also be found on the website and were posted a few hours ago for your convenience.

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

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

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

Thanks, Heather, and let me add my welcome to everyone joining us today. We appreciate your time and interest. I am pleased to announce Ingredion ended the quarter with record adjusted operating income and adjusted earnings per share. Volumes grew by 4% driven by the addition of Penford and Kerr. As expected, organic volumes were down 2% given the sale of our Port Colborne Canada facility. It truly is a North America story where our price, product mix was favorable driven by specialty sales and a favorable trade up of our core ingredients sales.

Our focus on continuous improvement and optimizing our global footprint has supported our margin expansion. Overall, I'm pleased that our business model and strategic plan continue to deliver shareholder value.

North America had record high operating income; APAC and EMEA were up for the quarter and South America was down due to macroeconomic and foreign exchange headwinds in the region.

For our Company overall, our ongoing cash flow from operations and strong balance sheet continue to enable us to deploy cash to advance our strategic blueprint. The acquisitions of Penford and Kerr Concentrates have broadened our Ingredion portfolio and improved our mix. We now expect to exceed our Penford acquisition synergy target and our pending acquisition of Shandong Huanong in China should enhance our capacity in the Asia-Pacific region. This acquisition is expected to close later in the year pending regulatory approval.

Now let's spend a moment on each region's performance in the quarter. Operating income in North America was $149 million for the quarter, up $47 million from last year. Overall volumes were up 8% driven by our Penford and Kerr acquisitions. As you recall, we closed the Penford acquisition on March 11 and Kerr on August 3 of last year. Price/product mix was up driven by specialty sales and margin expansion in our core ingredients. Continuous improvement programs, network optimization and lower input costs continued to drive good operational efficiencies throughout the region. Jack will spend more time on that a little later.

In South America, operating income was $18 million, down $7 million from last year. Pricing actions, specialty volume growth, good cost discipline and continuous improvement projects unfortunately were more than offset by foreign exchange, higher corn and other input costs and softer volumes due to the macroeconomic environment in Argentina and Brazil.

Brazil continued to feel the effects of a slowing economy. Volumes were down impacted by an accelerated decline in GDP and domestic corn cost increased as corn exports rose beyond expectation.

Given the macroeconomic environment, our local leadership teams continued their ongoing focus on specialty ingredient growth, price mix management and network optimization including our planned closures up to facilities this year. Although the Southern Cone economy is still challenging, we feel positive about some of the free market policies that have been implemented by the Argentine government which bodes well for the longer-term outlook. We expect to have continued short-term volatility through the first half of this year.

A significant devaluation took place late in the fourth quarter of last year and prices haven't fully adjusted yet. As the economy adjusts, we expect a second half stronger than the first. The Andean countries continued to perform well as specialty growth and cost discipline expanded margin. We expect 2016 to be challenging for South America and we will maintain a tight focus on cost and network optimization.

In the longer-term, we believe the underlying business fundamentals are positive for the future and believe we are well-positioned to take advantage of an economic recovery when it materializes.

Moving along to Asia-Pacific, the region delivered $28 million of operating income, up $2 million from last year. During the quarter, margin expansion offset currency headwind.

Finally, the EMEA region reported operating income of $26 million, up $4 million. Higher volumes and margin expansion offset currency headwinds. In Europe, our strong specialty portfolio continues to perform well and grow and the Pakistan economy continues to drive good core ingredient growth.

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

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Thank you, Ilene. Good morning everyone. Let me start by covering the highlights of the income statement. Net sales were up $30 million for the quarter. The majority of the increase is attributable to the addition of the acquisition-related ingredients, a more favorable mix in both our specialty and core ingredients, as well as favorable pricing in South and North America. These factors were partially offset by unfavorable foreign exchange.

Gross profit was higher by $58 million as a result of the addition of acquisition-related volume. Favorable price product mix in both of our specialty and core ingredients, and margin expansion as a result of our optimization efforts. Reported operating income was $60 million higher versus last year while adjusted operating income was $44 million higher. The increase in gross profit was partially offset by higher operating expenses driven by the inclusion of Penford and Kerr.

Reported operating income was lower than adjusted operating income by $1 million related to acquisition and integration costs for Penford and Kerr. Our reported and adjusted earnings per share were $1.73 and $1.74 respectively. For the quarter, our adjusted EPS was $0.44 higher than last year.

Moving on to the net sales bridge, our sales of $1.36 billion were higher than last year by $30 million. Volume growth contributed $60 million driven predominantly by a full quarter of Penford and Kerr sales. If you recall, we explained last quarter with the sale of Port Colborne we expected our organic volumes to be down as we shed lower margin ingredients. Favorable product mix contributed $83 million. These impacts were partially offset by $113 million of foreign exchange headwinds.

As we look more closely by region, you can see unfavorable foreign exchange affected us across all four regions. Volume grew in North America and EMEA and price mix was favorable by 22% in South America as we continued to price to recover currency devaluations and rapid increases in corn costs in Brazil.

Adjusted operating income increased $44 million in the quarter. North America posted strong results due to acquisition related volumes, a more favorable price product mix in both specialty and core ingredients, lower operating costs due to the timing of both Penford and Port Colborne cost savings, a milder winter than last year combined with lower energy rates, logistics savings and some timing associated with the layout of our corn costs.

South America operating income decreased by $7 million. Headwinds included foreign exchange, lower volumes due to the macroeconomic environment in Brazil and Argentina and higher costs for corn and other inputs. These were partially offset by favorable price mix due to pricing to recover currency devaluations and higher input costs as well as disciplined cost management.

APAC was up $2 million while EMEA was up $4 million versus last year. In APAC, margin expansion offset the effect of the strong US dollar while in EMEA, volume and margin expansion offset foreign exchange headwinds. Corporate costs were up due to continued investment in our IT infrastructure and other smaller items.

We will wrap up the quarter with earnings per share. On the left side of the page, you can see the reconciliation from reported to adjusted. On the right side, operationally we saw an improvement of $0.41 per share, primarily the result of margin improvement with some volume lift partially offset by foreign exchange and other expense.

I do want to take a moment and talk through the margin improvement in more detail given the magnitude and point out that we have timing favorability that is being recognized in the quarter.

For the quarter, both our specialty and core ingredients had a favorable price product mix. If you recall, we shed some of our lower margin production with the sale of our Port Colborne facility at the end of the year.

Not to be ignored is our extensive work on our global optimization of our network. We were able to identify an additional $5 million of annual Penford cost synergies bringing our total Penford acquisition cost savings run rate to at least $25 million. Additionally, we had cost savings from Port Colborne, from the Port Colborne sale. We realized higher utilization during the quarter and fixed cost absorption as we rebalanced the network.

Lastly, we had a milder winter combined with lower energy rates, some favorability in our logistics area and some timing favorability given the layout of our corn costs.

Moving to our nonoperational charges, we recognized a $0.03 benefit for the quarter. Our tax rate was lower contributing to a $0.05 per share benefit and financing costs were flat. We expect full-year financing costs to be impacted by anticipated refinancing of our 2017 maturities later in this year.

The lower tax rate was driven by lapping of the income tax impact of the devaluation of the Mexican peso during the year-ago quarter. Additionally, noncontrolling interest was a negative $0.01 per share.

Turning to our guidance, we now anticipate 2016 adjusted earnings per share of $6.45 to $6.75. This guidance excludes acquisition-related and integration costs and any potential restructuring costs. We expect net sales to be in line with last year. We also anticipate volumes to be slightly down from 2015 given the sale of our Port Colborne Canada plant. However, we expect continued growth in specialty volumes.

We anticipate that unfavorable foreign exchange will still have a negative impact of $0.30 to $0.40 per share. We expect this impact will be partially offset by incremental pricing.

As we have explained in our business model, these pricing actions typically require three to six months to take full effect. We expect corporate expenses to be up year-over-year for continued investments in IT infrastructure and other efficiencies in our business.

For the year, our financing costs are expected to be slightly higher due to higher interest rates on our floating-rate debt and our plan to refinance our 2017 maturities during 2016.

Our effective annual tax rate is expected to be approximately 30% to 32% versus an adjusted rate of 31.8% in 2015. Total diluted weighted average shares outstanding for the quarter was 73.3 million and we expect that number to be between 73 million and 74 million for the year.

In North America, we expect net sales to be up but volume to be down from 2015 given our network optimization associated with the sale of the Port Colborne, Canada facility. It is important to keep in mind that a large portion of our sales and costs are based in US dollars which helps mitigate some of our foreign exchange headwinds. For the full-year, we expect operating income to increase with improved product mix and margins.

As mentioned earlier, the Penford acquisition is poised to achieve at least $25 million in cost synergies and the current integration continues is on track.

We remain excited about broadening our ingredient portfolio with on trend solutions that consumers are increasingly demanding. For the year, South American net sales are expected to be down versus the prior year. We anticipate slow economic growth and foreign exchange headwinds to continue in the region. We expect some short-term volatility in Argentina during the first half of the year but expect improvement in the back half and going forward.

In Brazil, we expect some volume weakness partially offset by good cost management. And we expect the Andean region to continue to perform well. Throughout the region, we continue to actively managing our costs to drive efficiencies and offset inflationary pressures and we continue to look at optimization opportunities. We are on track to close and consolidate two of the Brazilian facilities this year which we expect to net savings of $7 million annually starting in 2017. Overall, we expect operating income in South America to be modestly down to 2015.

Asia-Pacific and EMEA could continue to deliver operating income growth. We expect the APAC business to be negatively impacted by currency headwinds associated with a stronger US dollar relative to last year but we expect to overcome these headwinds with continued growth the specialty ingredients and good cost management. We expect our EMEA region to have higher net sales compared to the prior year as volume growth offsets foreign exchange headwinds and the passthrough of lower input costs. We anticipate continued growth in the underlying European business fueled by our specialty ingredients portfolio and investments in the region. However, we expect currency headwinds to partially offset the improvement.

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

Moving on to cash flow, our cash provided by operations for the first quarter was $96 million. Our capital expenditures of $59 million were in line with last year as well as our expectations. We expect cash from operations in 2016 to be in the range of $700 million to $750 million. Additionally, we expect to allocate around $300 million to capital investments in 2016 for growth as well as cost and process improvements around the world. Importantly, we have a proven track record of both reinvesting and returning capital to shareholders and we expect to continue this in the future as we concurrently explore M&A opportunities.

Our expectation for strong cash flows allows us to target a dividend payout ratio of 25% to 30% as our intention to evaluate annual dividend increases.

That brings my section of the presentation to a close. So now I will turn the time back over to Ilene.

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

I am pleased with our results this quarter and we are off to a good start for the year. From a strategic perspective, our business model and blueprint for growth are working and our momentum continues on a positive trajectory. Our underlying business is solid and performing well and our acquisitions and other deployments of cash are driving improved shareholder value. In fact, we are pleased that our investment in Indianapolis to enhance our specialty capacity is progressing well and is running start-up trials as we speak.

We continue our strategic journey to become a leading global ingredient solutions provider with a portfolio, R&D capability and people to help customers innovate in line with growing consumer trends. Additionally, we continue to take actions to optimize our cost structure for the future.

Regionally, North America is expected to continue its positive trajectory. Asia-Pacific and EMEA are projecting operating income growth and South America is expected to be modestly down versus last year given the macroeconomic headwinds. With our strong balance sheet, we expect to continue deploying our capital for organic growth, network optimization, acquisitions and other shareholder friendly actions.

Now we are glad to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). David Driscoll, Citi.

David Driscoll - *Citigroup - Analyst*

Great, thank you and good morning. Congratulations on the results. Terrific stuff. Wanted to ask two questions. The first one was on North America and the operating income up $47 million. So there is a lot of effects here, guys. Pricing, network rebalancing, cost savings and then the movement to specialties. I attempted to put them in order of magnitude but I was really hoping that you could do it for us and the reason being is because I think some of these factors are maybe confined to the first quarter, notably that network rebalancing. But it feels like the strength of pricing is something that should persist into Qs 2, 3 and 4. So if operating income is up $47 million and let's say half of it is from pricing then maybe that is really helpful to us on the outside to think about the numbers going forward. So could you just give us your ranking of the impact of these factors for North America?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes, David, I will cover that. This is Jack talking. I think first of all, we were very pleased with the quarter in North America to start with. I would like to highlight one thing too is that don't forget that 47% improvement, we also have the Penford acquisition which we lapped. So we have that volume coming through as well. I just want to make sure people recall that we didn't close Penford until March 10 last year, March 11 last year.

So then let me put it in sort of our order in terms of how we looked at it. First of all, our run rate and our Penford synergies we said that they are running, tracking at about $5 million higher than we anticipated. And so right away on the quarter and that will continue during the year if you think about last year we recognized about $10 million of the synergies, this year here we will be tracking at about $15 million. So that was a very strong positive.

The network optimization is one which I think had a disproportional impact in the first quarter which will not carry into the remaining portion of the year. There will still be benefits throughout the remaining portion of the year but as you know some of our volume particularly on the sweetener side is seasonal with the summer months being where our facilities have historically run at full utilization rates. What the network optimization allowed us to do was actually run a little bit higher utilization rates in the first quarter, we will continue to run well in the second and third quarter which has historically been the pattern. And then we will have to see what the inventory balance in the fourth quarter, how that materializes. And so that is a benefit that will probably will not go into the prior quarter.

I think the other thing that is a little from when you are looking at year-over-year, we did have some very good efficiencies in our facilities with the milder winter this year and I know we talked about extremes a couple of years ago in terms of polar vortex and things. Last year was a relatively normal winter. This winter was a little bit improved and so it really did help us drive both efficiencies in terms of both energy, in terms of both rates as well as utilization and our logistics costs as well in this quarter.

And then the other piece is that is probably critical to understand is that even within our core, we had a trade up of our portfolio where when we were selling our Port Colborne facility and optimizing our network, we traded up the margins in our core business as well as continuing to trade up those specialty businesses. Those will be ongoing type of items.

And then last and as usual, that is why we don't break out the quarter. To a large extent it is just the layout of the corn. Like every year we have a slightly different layout in terms of when contracting was done and how it is done and so on an annual basis, I think the forecast is pretty solid on some of our fixed-price business but we can always get slightly differently layout in our net corn complex and so I think that is the other portion which kind of helped us in the quarter.

David Driscoll - *Citigroup - Analyst*

So maybe just same question different way, can you then just explain, it is like a $0.35 beat versus the consensus but yet the top end of guidance goes up by $0.15. Why don't you flow it all through?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Why doesn't it not flow all through? As I mentioned, some of it is the layout of the corn and some of it is that I think it was just the way that the quarter was staggered. The other thing is don't forget the tax rate impacted us by about $0.05 in the quarter positively and then our South American numbers are kind of coming down a little bit as we have looked at the business in South America. We kind of thought we were kind flat and now we are kind of calling it down slightly and so that is the other element that is impacting us.

David Driscoll - *Citigroup - Analyst*

Okay, I will pass it along. Thank you so much.

Operator

Farha Aslam, Stephens.

Farha Aslam - *Stephens Inc. - Analyst*

Good morning. Again, my focus is South America. Could you share with us some color around corn availability, if that is going to be a problem for you with the weather down there balanced by the strengthening of the Brazilian real? Is that going to help you out a bit?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me take that one too. Actually the corn issue started in Brazil and essentially what happened was there was a lot of exports of corn out of Brazil partially because of the devaluation I believe is part of what partially triggered it. And it did make corn a little tight in Brazil and we have seen a run-up in the local corn market dramatically. And if you think about the original devaluation taking place last August, we were passing through the devaluations very well but then when we also had to pass through the corn increases, it actually compressed our margin somewhat as we are chasing those throughout the quarter.

And then now we are faced with a little bit of a heavy rain in Argentina which is impacting the crop harvest there. That is impacting more soybeans. I don't really see that being a major impact in Argentina at this point in time.

So in terms of availability, I don't think we will have any problem with that. It is just a timing issue in terms of getting those corn cost passed through into the environment there.

The Brazilian real, I will say I don't know where it is going to end up. It was up at 4, now it has appreciated back to that 3.5, 3.6 type of range and so that is one of the reasons why we have some downward push in South America and upward actually in the upper side of the range. It will depend on where that Brazilian real lands and that is why we keep that range in place because if it strengthens or stays where it is there is probably some upside on the South American numbers. If it actually devalues, it probably covers some of the bottom part of our ranges and so I can't predict the currencies. So that is why we believe that gap in those ranges there.

Farha Aslam - *Stephens Inc. - Analyst*

That's helpful. And just as a follow-up, this is a terrific year that you are having. But of course we are always looking forward into next year and the sustainability of your earnings growth because you are targeting that 10+% EPS growth. Do you think that is achievable for next year given the very strong year you are having this year?

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

Certainly we are not going to give guidance for 2017 yet. But I would say that we are on track with our long-term algorithm that we have been laying out over the past few years and it is working. And when I think about our growth in specialty, very much focused on these consumer trends that are accelerating, we have terrific R&D solutions to work with our customers to become more important to them as we broaden our portfolio. So we see the growth in specialty continuing to be successful and at the same time, we have continuously embarked on cost optimization. And as an example, South America is one place where we have been focused on it for a number of years, energy efficiency, yields and cost optimization and in fact as we have said, shuttering two of our facilities in South America will have an impact in 2017 because they both happen later in the year.

So we feel very good about our algorithm for continuing growing as a global ingredients specialty type company and continue to focus on -- continue to add shareholder value, use the balance sheet to drive that whole algorithm.

Farha Aslam - *Stephens Inc. - Analyst*

That is very helpful. Thank you.

Operator

Rob Moskow, Credit Suisse.

Rob Moskow - *Credit Suisse - Analyst*

I am also trying to figure out of the benefits here in North America, how much of it is sustainable? And maybe I am just misunderstanding some of the terminology about rebalancing the supply chain but wouldn't rebalancing the supply chain be a sustainable benefit? Like that doesn't go away. But Jack, I thought you kind of said that that was something that was pulled forward into first quarter and therefore kind of a one-time thing? Aren't you continuing to get that benefit going forward?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Rob, let me just clarify that comment slightly differently. It is the fact that when I said, it is sustainable year over year. So I think that is there. I think the issue you have is that there is always a little bit of seasonality in our business in North America and so therefore, when you are running the plants at higher utilizations in the first quarter, you keep your network balanced. Then in the second and third quarter, you were already running them at high utilization rates and so it is just more of the gain of that higher utilization in the first quarter than you will see in the second and third quarter. Does that help you?

Rob Moskow - *Credit Suisse - Analyst*

I think so. I mean your sales seasonally though in first quarter tend to be below the rest of the year but you are saying you run your plants more during the first quarter to get ready for the summer?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes, this year we ran them a little bit harder because of the fact that we were utilizing that capacity to build a bit of inventory for the summer months.

Rob Moskow - *Credit Suisse - Analyst*

Okay. I think I will bounce off of that one. And then also has anything changed regarding your expectations for Argentina in the back half? I think you were talking of more optimism about what the sugar markets might do for your pricing power. Are you still expecting sugar to leave the country and therefore improve pricing power for HFCS?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes, our expectations remain the same in Argentina. I would say that the only thing that we are trying to track is timing there. I think that there you've got until May some time that price controls should be coming off and then essentially what we will see is whether the sugar is leaving the country and rebalancing. Because it makes sense for it to leave the country with the world price of sugar today. And that Argentina is primarily that HFCS market. That is why we are talking about sugar there. And so it is just a timing issue is whether it happens -- we have it planned kind of in the second half of the year but if it comes a little bit later, closer to the fourth quarter, it could push down our pricing a little bit. But I don't see it as a major concern to us and it is covered in our range right now.

Rob Moskow - *Credit Suisse - Analyst*

Can I ask a follow-up for Ilene? This year is coming in above expectations, last year also did. Have you thought further about your CapEx spending plan and your specialty starch kind of longer-term expansion plans? Would you consider increasing it based on how well things are going or is it just your existing CapEx budget is what you are going on?

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

We always look at spending our capital in the optimal way and making choices and so of course maintaining our plants is important for quality and reliability. Cost reduction is one thing there. But what I love about our business and our footprint is that in order to satisfy growth and demand for let's say specialty products in different parts of the world, we can redirect capital towards our finishing channels and redirect the grind that might come off of core type products by adding a finishing channel.

So it is not so much of having to make a decision whether to raise the capital, I mean these are approximate numbers, but rather the priority of how we spend it. And so we can and have the capability to add capacity for these finishing channels to be able to have the capability to satisfy these consumer trends that are growing.

So as an example when I mentioned the Indianapolis project that we mentioned of specialty capacity in the starch area coming online, we had announced that investment about 18 months ago and now we are in the startup mode and it is coming into fruition. So it is those type of investments. We have a similar one going on right now in Asia that will come online later in the year as part of that announced addition. So again, these are investments that can come on quite quickly. I think 18 months is quite quickly. As a result because we do have the front-end grind available in different parts of the world.

So we could raise the capital if the demand was growing but I think at the same time, we have to have the features but we also have to be efficient in what we are doing.

Another example is in Europe. One of the results of adding capacity to our starch where we treat the starch with heat instead of enzymes focused on the clean label, capacity that we added a couple of years ago, we are able to get out more capacity than originally thought and so we are more efficient and we are able to grow with the market without spending capital.

So there's all sorts of ways to think about and be efficient about investing that capital.

Rob Moskow - *Credit Suisse - Analyst*

Great. Thank you very much.

Operator

[Adam Kendrick], Morningstar.

Adam Kendrick - *Morningstar - Analyst*

Good morning. I would like to circle back on the very big jump in the margins. And if you could maybe give us some indication of how the split between specialty and core went. So if you can actually tell us what percentage of sales were specialty and core in Q1 compared to Q1 2015? Was there a very substantial jump in the share of sales taken by specialty? Is that what is behind one of the reasons for the very big margin jump?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me take that question. First of all, we don't break out our specialty and core ingredients splits or anything like that and last year as we know we said we were around 25% specialty. And if you think about our specialty growth, we have commented that they should be in the mid to high single digit type of ranges and I think we are tracking fairly well in the first quarter with those type of components.

In our core ingredients, what you have seen is that as the growth was -- as we exited our Port Colborne facility through that sale, what we have seen is the trade up within some of our core ingredients as well which improved our profitability or improved our margins there as well particularly in North America. So we were very pleased with both the margin improvement in both specialty and core this year and most of the growth is coming out of our specialty ingredients as we move those forward.

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

The thing I would add is that also recall that those acquisitions that we announced last year, we really did not own first quarter last year so it is not a huge piece but it is certainly important that added to our margin and our specialty mix. Penford would be potato starch, gluten-free non-GMO and then the Kerr Concentrates again fruit type products also a non-GMO focused on different types of smoothies and frozen novelties.

Adam Kendrick - *Morningstar - Analyst*

I was aware of the -- I mean there is a very big difference in the sizes of these two acquisitions. Obviously we have cycled Penford already. But if you look for the next nine months we will still have some impact from Kerr but Kerr is only 15% of the sales of Penford so that is not really going to be very much of a driver in the remaining three quarters.

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

Penford, you are right. This was I call it a free quarter because by closing March 11 it wasn't in first quarter, you are right, Kerr is small but of course our organic portfolio, our R&D investment of $40 million, $42 million is going towards developing solutions for our customers with these on-trend investments and capacity that we are bringing on to satisfy this specialty mix certainly will be a factor as we build on our growth algorithm.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Just one other point of clarification as well and I just want to make sure because we have commented on this in the past and sometimes it is good to reiterate some of our comments. Is when we are looking at the valuations in our core ingredients, our raw material increases and things, effectively we usually price through to keep a constant dollar margin. And so while we had foreign exchange headwinds in the quarter, we passed most of those through but at a margin level, not at the sales level. And that has a tendency of improving the margins as a percentage as well. And so there is a little bit of lift on those margins as a percentage of revenues just from that component as well.

Adam Kendrick - *Morningstar - Analyst*

Sure. Then I have another question -- well a related question actually on slide 10 because you show the operating income bridge. But correct me if I am wrong, but I understand that this is actually at current exchange rate so the gap between $157 million of Q1 adjusted and $201 million we have this year is based on different exchange rate. So I am just wondering -- I mean obviously if you look at slide eight, obviously foreign exchange had a very negative impact on your sales and had a very negative impact on the bottom line so I am guessing it must have had a very negative impact on the EBIT bridge. And so the $43 million improvement would have been even bigger had exchange rates not moved at all so we are looking at an even bigger underlying boost to your margins in Q1. Is that correct?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me just reiterate a couple of comments that we have stated in the past as well. When there is a devaluation particularly in our South American region, if you look on chart 9, there is about a 22% price increase there. Some of that is to offset that devaluation because given the input of both our investments, the raw material being corn which is a US denominated commodity principally and energy costs being principally US denominated to a large extent although there's local issues associated with it, we are pricing through those devaluations to a large extent. That is one of the things that I think makes our business somewhat unique is we always talk in US dollars, we always maintain it there. I'm sure in Europe maybe a completely a euro zone where people thinking euros, and raw materials are in euros but to a large extent we actually think in terms of dollars and try to get our pricing back and getting the margins there.

And even in North America, I commented in the script that a large part of our revenue base whether it be in Mexico or Canada is in dollars as well and so therefore, I don't want to say that the earnings would go up dramatically without the devaluation. The thing we do indicate is that usually is about a three to six month lag before we can get those evaluations passed through in terms of our margin. And I think that is a very important thing for people to recognize as they evaluate our business which is somewhat unique to some other people who try to restate based off of just constant exchange rates.

Adam Kendrick - *Morningstar - Analyst*

Sure, that is helpful. Thanks.

Operator

Akshay Jagdale, Jefferies.

Akshay Jagdale - *Jefferies LLC - Analyst*

Good morning and congratulations on strong results. So just wanted to touch on North America in a different way. Clearly the results there are great. I just wanted to ask a longer-term question on the core business in North America if I may. So corn prices are at multi-year lows and utilization rates are about as high as they have been for corn wet millers or so it seems. Can you just talk long-term about the long-term sustainability of the core business margins here? That is my first question.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Thank you very much for that question. I think if I look at North America and as you mentioned, it is in fairly good balance in terms of supply demand. I think the demand is moving fairly well and think there's a lot of growth opportunities even in the core ingredients area and the utilizations in the industry are quite high. Corn being below $4 means that a substitute type of products whether it be sugar, whether it be soy or anything else or wheat types of starches, are very competitive with our corn refined type of products, can be very competitive in those marketplaces.

THOMSON REUTERS

So the outlook, assuming that there is --I'm always worried about the meteorite that could hit someplace in the business but fundamentally I would say that the industry itself is in a fairly good balanced position. Maybe I will ask Ilene to just make a couple of comments.

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

The other thing I would add is that you know the way that we are set up with our footprint that we are able to redirect our capacity to specialty products and so if you take North America with a growing Mexican economy, the growth in specialty in Mexico driven by the awareness of Mexicans to eat healthy, some obesity taxes. But even in North America, the consumer is wanting healthy food and ingredients that we can redirect our capacity by adding finishing channels that we talked about a little bit earlier.

So you know you are asking questions about core in the future but I think of the whole system and that our strategy is really to grow the specialty and so our goal is really to satisfy the customers' needs with a portfolio of products and growing specialty continues to be the primary importance and we have the footprint and manufacturing capability to do that.

Akshay Jagdale - *Jefferies LLC - Analyst*

That is helpful. So just another way to I guess comment on sustainability. So to really derail the long-term algorithm for North America from an EBIT growth perspective and nobody can predict shocks but really for that to happen you would have to see somebody put up a big plant, a corn wet milling plant which I don't think has happened in multiple, multiple decades. In fact, we have seen closures. Is that sort of in terms of to significantly alter North America, that would be the biggest risk, you are adding specialty capacity and the mix is improving every, single year. And you've got the Mexico becoming a bigger piece as well. So is that sort of one of the biggest risks that you would say could alter potentially the long-term algorithm in North America?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Obviously we can't comment on what our competitors are thinking in terms of capacity or anything like that in the industry. But my guess is though if you had it on placement value basis, returns probably wouldn't justify a new facility in the industry or anything like that. So I just think if the demand is relatively in balance with supply, I don't see any reason that would drive further changes in that type of area.

I guess obviously there is a lot of competition in the specialty area and there is continuing changing trends in the food industry and there is a lot of competing products in this business. And so therefore, I think that the industry itself is faced with continuing to innovate to continuing to drive new growth opportunities. I think that is the biggest stress that we are trying to deal with and that is why we continue to invest in our R&D and some of those capabilities for our future so that we can develop products that are on trend.

Akshay Jagdale - *Jefferies LLC - Analyst*

And just one on specialty. Can you give us an update on Penford specifically, the specialty portfolio? I know there were some products in the pipeline when you bought it that were close to commercialization. So you have held it for almost a year now so over a year now so can you give us an update on that specialty portfolio for Penford? And it seems like Kerr's margins are slightly lower than the 2 times core that you generally talked about. So maybe you can comment on that. And lastly, just on this China deal, how does that fit into the whole specialty portfolio? I don't really know much about that business so any color there would be greatly appreciated. Thanks.

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

Sure. We are one year into Penford probably just over six, seven months for Kerr. But Penford, the portfolio is terrific in terms of having potato starch as a manufacturer as part of our portfolio. We are excited about the specialty portfolio. We are still learning and integrating that and certainly the incremental synergies that we talked about today came from the cost synergies in the areas of supply chain and procurement that we talked about before.

But our focus on potato as gluten-free and non-GMO continues to be an exciting part of the portfolio. As I've talked about before, there were some biomaterials dilutions that Penford was very focused on like in liquid natural polymers and bio-adhesives and we continue to bring those to market.

So we are excited about the specialty portfolio of Penford. Kerr, again, it is still early days but we see the whole berry side enhancing our portfolio and so our ability to formulate with starches and take berries and create recipes for our customers is again non-GMO very, very exciting.

The China part of your question, this acquisition that is pending regulatory approval is exciting because this company has been a supplier to our totally focus of specialty food in China. And so it will enhance our capability to grow that business. And so again, we are very much focused on the specialty foods side of the business and this will be an enabler to have the capability to have the front end supply side. And so we are excited about being a more important supplier to food companies in China where they are looking for solutions as an example on the dairy side of the business, starches for dairy that are healthy. This will enhance our capability to grow that even more with our capacity.

Akshay Jagdale - *Jefferies LLC - Analyst*

Thank you.

Operator

Kem Zaslow, BMO Capital Markets.

Ken Zaslow - *BMO Capital Markets - Analyst*

Good morning, everyone. So let me just ask you on the guidance, you kind of give us with each of the segments a little bit up, a little bit down and but North America you would say is going to be up. Can you give us an order of magnitude because obviously going from 102 to 150 or 149 is a big difference between up and up. So can you give us a little bit more color on how you are thinking about North America in terms of the 2016 up number?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I would say that first of all, the quarter itself I want to reiterate we had Penford lapping this quarter so therefore we were advantaged through that so that was what Ilene said was a give me type of thing. The quarter itself had a few one-time benefits in it. But we do see North America having a very strong year. I think that the year is basically predicated on North America. It continues to grow in terms of its specialty business, it continues to execute extremely well on its cost management throughout the segment. So it is going to be up very solidly this year.

Ken Zaslow - *BMO Capital Markets - Analyst*

In terms of Mexican exports were exports in the US to Mexico in terms of high fructose corn syrup, that seemed to have been strong. Do you know how much that contributed to utilization rates and how you think about that going forward?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

You know, I think for us, Ken, one of the things with our network optimization is many of the other participants are actually supplying more into Mexico than we are at this point in time. If you recall, we have our own local production down in Mexico which is really servicing that marketplace.

And you are right, the exports into Mexico have gone up. I haven't been tracking it nearly as closely as I used to but they have been up by the USDA numbers and so my expectation is that will continue as well. Utilization is fairly tight within the industry.

Ken Zaslow - *BMO Capital Markets - Analyst*

And just making sure on North America, there was nothing in the quarter -- when you talk about the distribution around the year filling it in and out of second quarter, I get that but there is nothing in the quarter that goes away in 2017, is that fair?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I would say that the only thing that could potentially go away is the mild weather that we had in the first quarter. There is always a whether issue and a few things like that or energy rates could move around on us. But fundamentally the fundamentals basically should be the same next year.

Ken Zaslow - *BMO Capital Markets - Analyst*

If you got higher pricing in 2017, you would get an increase -- and if you did cost savings on that 149 number would go higher in 2017?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

We don't give guidance on 2017 yet. I would say that fundamentally at this point in time, I can't see major changes in the quarters.

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

And I would say that we talked about the capacity coming on in 2016 in the specialty area and so our expectation is to grow in the specialty area continue along that trajectory for 2016 and 2017.

Ken Zaslow - *BMO Capital Markets - Analyst*

And my last question is, in terms of Argentina, you alluded to it but just making sure, you still expect that business to get to how big and is there any change in the expectation of that?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I think this year we said it would be relatively flat to last year which is in that $25 million to $30 million range of EBIT. What we have said is it we will return back to a more normalized profitability but we are kind of watching those government policies and how sugar gets exported and things like that to give better timing on that. It could be pushed a few months as it starts to move forward and then the real issue is does that economy really stabilize for the longer term? Because I would like to reiterate that it is a very good corn position in terms of raw material sourcing. It should have a good position against sugar for its HFCS demand and it is really getting the cost under control in terms of the environment there because it is still a heavy inflationary environment.

So I'm not going to predict when exactly that economy will return whether it is 2017 or 2018 at this point in time.

Ken Zaslow - *BMO Capital Markets - Analyst*

Great, I appreciate it.

Operator

Adam Samuelsson, Goldman Sachs.

Adam Samuelson - *Goldman Sachs - Analyst*

Thanks, good morning everyone. A lot of ground has been covered this morning. Wanted to maybe follow-up though on the idea about the competitive landscape. And, Ilene, you referenced opportunities to change finishing channels and direct more of your starts into specialty arenas. And I am trying to think about why your competitors wouldn't be targeting some of the same opportunities as you are especially as you think they should be more HFCS heavy than yourselves at this point. You would think that more starts that they have opportunities to redirect and thinking about in terms of the competitive landscape over the medium-term wouldn't be something you are maybe more worried about?

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

Look, we have some great competitors but we have a great R&D portfolio with technology and people and know-how with many years of experience and great customer relationships that have been built up over many years. And so as Ingredion combination of corn products, national starch, we have become even more important to our customers working on different challenges that they have brought to us. So we use our R&D know-how and capability to develop those solutions and work closely with our customers that competitors do something where they have expertise but we are the texture leader and have many years of experience in that area. And now that we are broadening our portfolio with other raw materials to solve the problem, we have been in non-GMO for 10 years. We have capability to modify starch with key [set of] enzymes. That type of technology and know-how is very valuable to address the consumer trends like clean labels. We continue to build on that.

Adam Samuelson - *Goldman Sachs - Analyst*

And then maybe switching gears to capital allocation, maybe just a comment on the M&A landscape as you see it today? And second, I think you referenced in the guidance the share count this year 73, 74 which could actually imply some share creep and I am wondering given the cash and cash flow position why you wouldn't at a minimum offset dilution this year?

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

I will start with M&A and then I will turn over the share count to Jack. Look, the pipeline continues to be robust and I've talked about this before and I spent a lot of time looking and meeting with different candidates and again, we look at M&A around the world, the priority being to broadened the portfolio and what are the features that we could acquire for the right value proposition as we bring it on and we are more important to our customers, we can create these solutions. And several of these companies, some of them are publicly traded, many of them are divisions of larger companies or privately held so we want to do the right thing in terms of building the relationships over time.

So we continue to work that but again, we have a track record of making them at the right value proposition, valuing people and technology and bringing it into our portfolio even as evidenced today as talking about Penford how it has gone well and we are very methodical about how we analyze the opportunity.

So I am excited. We have a great balance sheet but we also are patient and want to do the right thing and so while we have done some bolt-ons, this China one for Shandong Huanong is a bolt-on. There are other bolt-ons that we look at and again, the sweet spot being the $300 million to $500 million. Jack, do want to address the other part of the question?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Just to address the share count, one of the things we look at all the time is how we buy back tat dilution over a period of time where executives get share compensation and we monetize it. And it is a timing item where it obviously depends on the days outstanding and all those type of areas so there may be a little bit of creep in one year and we will make up for the following year or at the appropriate time.

I do think that we continue to look at shareholder friendly ways to return money to our shareholders and that is one of the reasons I commented also on the dividend policy as we continue to look at say as our earnings grow, we should be looking at those annual increases of our dividend to reflect that payout ratio as well. And so we are very comfortable with our cash flows at this point in time and so we anticipate that as we look into the future we will continue to look to keep that dividend payout ratio very solid.

Adam Samuelson - *Goldman Sachs - Analyst*

All right. Thank you.

Operator

Brett Hundley, BB&T Capital Markets.

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

Thanks for taking my questions. I wanted to go back to North America, Jack, and maybe if I look at the strength in Q1, so the $47 million increase in EBIT year on year. If I think about quote unquote one-time benefits in that quarter relative to the rest of this year, can you maybe give us a sense of what percentage of that $47 million increase might have been more one-time-ish in nature versus what we might want to flow through the rest of the year?

And maybe underneath that dynamic, can we maybe isolate Penford synergies and Port Colborne? You talked on your Q4 call about expected savings around $8 million from Port Colborne. Did you realize the majority of those savings in Q1? And then with Penford looking for maybe $15 million in synergies this year, did a majority of those synergies come in Q1? That would be helpful.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me start with the synergy question and we are actually -- what we are seeing is we are getting up to that $25 million run rate of synergies compared to the prior year. So it will depend on when we recognize them last year in terms of the comp but they will be fully recognized as we move forward at those type of rates. So you can think of it as a couple of million dollars a month of synergies that we are getting out of there.

In addition, Brett, just to remind you that we didn't have the comps for the Penford earnings in the first quarter so the full $47 million won't be delayed -- every quarter or anything like that.

And then let me just explain, I do want to address this Port Colborne issue because I think it is important. When we talked about $8 million, it was really the fixed cost we were taking out of Port Colborne on an annualized basis and we are moving some of the volume obviously where we are shedding and things like that as well. I think that we are still going to see some of that benefit spread into the other quarters. What really transpired was is we were able to get the utilization of the other facilities up in that first quarter which will not be repetitive particularly in the second and third quarter. It may happen again in the fourth quarter depending on supply and demand at that point in time.

So some of that was even additive I would say to the $8 million and that is my we moved our guidance up a little bit because I think when we originally looked at that business, we were thinking about just setting that $8 million and getting the benefit of the fixed cost and really what we found is that the incremental logistics cost and things like that did not set the volume that we were able to run through the facilities. And so we did get some uptick in terms of that in addition to the $8 million. So I hope that helps your thoughts there.

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

Yes, I appreciate it. Just a final follow-up for you on the region. Going back to Farha's question and she was asking about possible continuation of double-digit earnings growth off of what is becoming a really strong base here. And I think at least in the way I think about it, North America should be able to remain strong and then you potentially have South America coming back. But for those of us that have followed the Company for awhile, we have seen North American margins go from 11% up towards close to 18%. And if others are like me, I have a really hard time trying to figure out the range in between there and what is quote unquote normalized. And so maybe, Jack, can you give us a sense of what normalized margins might be today? Have you run those scenarios within North America and can margins be sticky closer to the 17%, 18% rather than the 11%, 12% that we might have seen in prior years?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Brett, first, I would like to highlight the fact that we do talk in terms of absolute dollars versus percentages because sometimes when that denominator comes down, you've got to remember when you're talking about the 11%, we had much higher corn costs and that is principally a pass-through from our perspective. And so there is some of that component going on as well where your denominator is shrinking.

The other component is that just in general, we were seeing our Mexican market very, very strong in terms of growth opportunities. The business is staying strong, we continue to look at that network of facilities that we have to say how do we optimize our freight and our production processes within North America to drive costs out? And so if you hold off the exchange, raw materials constant, the real thing we have is the continual trade up of our product into specialties which is obviously going to continually improve those margins.

So I would say that I don't see any dramatic changes except for that trade up strategy to our margin improvement in North America at this point in time. I think that is how I would answer that question.

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

The other thing I would add is if you think about our long-term algorithm of growing specialties to 30% or so, North America, the Western economies are certainly trending and our goal is to be at that number if not more. South America, while it is growing from a very small base, Europe is a much higher percent and places like China which are smaller are also a higher percent.

So as we become more of a specialty ingredient company, North America's percent specialty is going to grow. So we feel good about that and having more capabilities to formulate help us do that and then therefore that helps the whole product mix trade up that Jack has been talking about.

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

I appreciate that. Quickly, do you guys think that you are being as aggressive or as focused on network optimization in North America as you are within South America?

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

I would say yes as evidenced by selling the Port Colborne facility. It is just part of our job to constantly look at those opportunities. We were successful, we brought on National Starch. As we talked about some of the synergies, we are moving specks around. We took a small piece of capacity outside off of Indianapolis a number of years ago. So we are constantly looking at ways to optimize that absolutely. In fact, North America was leading and now South America is basically consistent with the factors in the different regions.

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

Thanks, Ilene.

Operator

Sandy Klugman, Vertical Research.

Sandy Klugman - *Vertical Research Partners - Analyst*

Good morning, thank you. Outside of the impact on the currency, is there any insights into how the current political climate and potential changes in Brazil could impact the business going forward?

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

I think it is still early. We continue to hear about local consumption of food. I think beer is down a little bit though I heard in April, the consumption was okay in food in different products. So we don't really know politically what the impact will be but we do know for our business in food, that is one of the things we love about the business is that people eat and drink no matter what is happening in the economy. Jack, anything you want to add?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I think the Mayor in Rio de Janeiro has kind of taken control of the Olympics and so that seems like it is progressing very well. And it is kind of always interesting to me the underlying economy still seems to function and even though it is challenged with headwinds in terms of the individuals who you see the GDP continuing to fall partially because of the energy complex, but the real has strengthened. I don't know that is because of the fact price of oil went up or because of the political situation, there's a lot of different dynamics working on it.

I do think in the longer-term though that if you look at Brazil, the fundamental population is still very young, it is a very industrious population and we are very optimistic in terms of the longer-term growth view in Brazil and we do think it will return to its growth days, maybe not the go-go days of a few years back but certainly a very growth and high consumption type of marketplace for us.

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

We see some growth in specialty products in Brazil. Again, it is small but focus on dairy, even gluten-free and other sweeteners, low-calorie sweeteners are growing there. So there is a large interest in healthy food.

Sandy Klugman - *Vertical Research Partners - Analyst*

Okay, great. And then a follow-up on Argentina, the valuation obviously provides some great benefits to the business. But do you see any potential offsets evolving over the long-term from wage inflation or are there any other issues that we should take into consideration when looking at the region?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I would say that is one of the things we are tracking very closely there is we are seeing the original devaluation and a continual devaluation of that currency. We have also seen inflation particularly driven by the fact that it is one of the few places in the world we have seen energy prices actually rising at the consumer level partially because they are taking off subsidies of the past.

And so there is a lot of dynamics going on in that marketplace. We continually watch our wages in terms of -- where we are having negotiations down there with our unions and things like that. And so the cost equation in Argentina has not quite equalized where I always think of the valuation and inflation kind of getting back in check. It is not quite there yet. I think the policy that Macri is putting in place kind of lead to that movement.

I would like to see it happen faster from my viewpoint but he has made right steps and kind of reconciled to some of the bondholders and things like that. So the trajectory is right but there will be a lot -- that is why we say the volatility in Argentina will still exist for the next little while.

Sandy Klugman - *Vertical Research Partners - Analyst*

Thank you very much.

Operator

I will turn it back to the Company for any closing comments.

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

Before we sign off, I will reiterate our confidence in our business model, strategy and long-term outlook. We remain keenly focused on value creation and delivering that value to shareholders. That brings our first-quarter 2016 earnings call to a close. Thanks again for your time today.

Operator

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