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INGR.N - Q4 2021 Ingredion Inc Earnings Call

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OVERVIEW:

Co. reported 2021 net sales of $6.894b, reported operating income of $310m, adjusted operating income of $685m, reported EPS of $1.73 and adjusted EPS of $6.67. Also, reported 4Q21 net sales of $1.755b, reported operating income of $86m, adjusted operating income of $113m, reported EPS of $0.99 and adjusted EPS of $1.09. Expects 2022 net sales to be up high single-digits to low double digits, reported EPS to be $6.85-7.45 and adjusted EPS to be $6.85-7.45.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q4 2021 Ingredion Inc. Earnings Call. (Operator Instructions)

I would now like to turn the call over to your host, Jason Payant, VP of Corporate Finance. You may begin.

Jason Payant - *Ingredion Incorporated - VP of Corporate Finance*

Good morning, and welcome to Ingredion's Fourth Quarter and Full Year 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 presentation's appendix.

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

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

Thank you, Jason, and good morning everyone. For the full year, we delivered very strong top line performance with 15% net sales growth. This reflected well-managed sales execution by our pricing centers of excellence to manage price mix and address higher input costs, while we responded to strong customer demand. As a result, full year adjusted operating income grew 4% versus the prior year.

Now I'd like to highlight a few of our sales achievements. For the full year, we grew net sales by double digits across all 4 regions by actively managing the terms of our customer contracts, including the pass-through of higher corn and input costs. As you'll see on the next slide, this applies to not only our specialty ingredients, but also our core sweetener and starch portfolio.

Our stable, cash-generating core sweeteners and starches are used in a broad range of applications that saw strong demand growth in 2021. For example, industrial starches used in paper making and corrugating saw increased demand related to economic recovery. In addition, pharmaceutical grades of dextrose and starches experienced strong demand related to healthcare applications. As a result, net sales of these and other core products grew 14% versus the prior year.

In line with our strategy, we reduced the overall percentage of high fructose corn syrup sales in our portfolio from 12% to 10%, as a result of our announced joint venture in Argentina.

Now turning to specialties net sales. Specialty net sales grew strongly in each of our 4 regions last year and now represent 33% of global net sales. Asia Pacific led our specialties growth driven by our sugar reduction growth platform, with PureCircle performing exceptionally well. Tapioca and rice-based starch texturizers also contributed to the strong performance in the region.

In EMEA, we also delivered excellent specialties growth with food systems contributions from KaTech and strong starch-based texturizer demand. South America and North America benefited from strong food service demand and the pass-through of higher corn and freight costs.

Now I'd like to comment on the global supply chain environment. The global supply chain constraints we discussed during our last earnings call, which were driven by reduced ocean container availability, rail congestion, truck driver shortages, and the continuing impacts of the pandemic, intensified in the fourth quarter with the emergence of the Omicron COVID variant.

As a result, we experienced higher-than-expected supply chain costs in the quarter, as we prioritized service and switched from lower cost to higher cost modes of transport as necessary, to meet customer commitments. We foresee the exceptional circumstances we experienced in the fourth quarter steadily improving throughout the first quarter of this year.

Additionally, the contracted pricing actions that took effect at the beginning of 2022, will address the most recent increase in input cost inflation that we experienced in the fourth quarter.

Moving on to our strategic pillars. This year and during the quarter, we continued to execute on key initiatives to advance each of our strategic pillars. As discussed previously, global specialties net sales grew nearly 17% in 2021, driven by increases across all of our growth platforms. PureCircle continues to perform very well and finished the year with positive operating income in the fourth quarter.

Moving to Commercial Excellence our sales teams around the world finished the year upbeat as they continue to drive top line momentum and expand our new project and product pipelines with customers. We successfully completed our 3-year Cost Smart program delivering $170 million of cumulative savings beating our original $125 million target by 36%. We will now carry forward the momentum and learnings as part of a rebranded strategic pillar, Cost Competitiveness, to continue to drive efficiencies across our business and reinvent the way we work.

All of this progress continues to be underpinned by our purpose and values-driven growth culture. We continue to make excellent strides and I will comment later on recent accomplishments and recognitions we received in a number of areas.

Now let me turn to a few specific specialties highlights, starting with sugar reduction. PureCircle finished the year with net sales up over 60% versus 2020's results and continues to be a catalyst for growth in our sugar reduction and specialty sweeteners platform. Notably, we concluded the fourth

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quarter with positive operating income and were cash and EPS accretive. This has been a wonderful turnaround story in its first full year under Ingredion ownership with excellent execution against the integration plan, a reinvigorated customer base, and a strengthened R&D pipeline. We expect continued strong double-digit growth from our sugar reduction and specialty sweeteners growth platform in 2022.

In plant-based proteins, we continue to be bullish on the many opportunities ahead. Despite the ups and downs in plant-based food demand during the pandemic, the plant-based protein category overall continues to grow double digits, and this growth is expected to continue well into the future. Our existing customer pipeline remains robust across many food categories such as alternative dairy, alternative meat, protein-fortified bakery, snacks and supplements. Our 2021 net sales doubled off of a modest base.

However, our production volume ramp-up has been slower than expected at South Sioux City, as we optimize quality and yield to maximize batch sizes and extend up time. The team has made excellent progress, though, in recent months, and we are building inventory of high-quality food grade product in anticipation of accelerated sales development throughout 2022.

In Vanscoy, our startup was impacted by COVID-related labor shortages and equipment delays, as we executed on our transition from pet food applications to consumer food products. Today, our protein flour and specialty concentrate production lines are performing exceptionally well and sales development is accelerating. The slower South Sioux City production ramp-up, Vanscoy delays and higher pea costs, due to the drought in Western Canada, drove higher-than-expected start-up costs resulting in an operating loss of approximately $40 million in 2021.

Going forward, we remain optimistic in the long-term growth prospects for this exciting product category and expect year-over-year operating losses to decrease by approximately $10 million in 2022, and we expect to reach breakeven by late 2023. We are actively managing yellow pea costs and are confident we've secured our yellow pea requirements for 2022.

And now let me hand it over to Jim Gray for the financial review.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Thank you, Jim, and good morning to everyone. Starting first with our Q4 regional performance. North America net sales were up 13% when compared to the same period in 2020. North America operating income was $84 million, down 35% versus the prior year. Most of this decrease year-over-year was previously anticipated since we expected higher corn costs and higher energy and supply costs.

As Jim alluded to, we also incurred higher costs to move products. Some of these were expected and passed through to customers, but a portion was unexpected due to disruptions and outages in our preferred transportation lanes. In response, our team assessed the best way to serve our customers and purposefully opted for a higher cost and more expedient delivery solution when appropriate.

Finally, our cost absorption related to the production ramp-up of our plant-based protein facilities was higher year-over-year.

South America net sales were down 7% versus prior year. The decrease was primarily driven by the contribution of our Argentina operations to the Arcor joint venture in the third quarter, partially offset by higher pricing mix. Absent foreign exchange, sales were down 4%. Excluding Argentina, net sales would have been up 18% versus prior year.

South America operating income was $30 million, down 32%. Two-thirds of the decrease was driven by onetime impacts. First, lapping of an indirect sales tax benefit in Brazil and second, the contribution of Argentina to the Arcor JV. The combined impact of these items represent $9 million of op income decrease. The remainder was due to higher net corn and input costs in Brazil. Excluding foreign exchange impacts, adjusted operating income was down 29% in the quarter.

Moving to Asia Pacific. Net sales were up 17% in the quarter. The increase was driven by higher volumes across the region, including PureCircle, and by favorable price mix, partially offset by negative 5 points of foreign currency impact. Asia Pacific operating income was $17 million, down 15% versus prior year, as higher raw material and utility costs outpaced price mix improvement primarily in Korea. During the quarter, PureCircle reported positive operating income for the last 3 months of the year.

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In EMEA, net sales increased 15% for the quarter. The increase was due to higher volumes from KaTech as well as favorable price mix. Absent foreign exchange, sales were up 19%. EMEA operating income was $20 million, down 31% for the quarter. The decrease was driven by higher manufacturing costs, primarily energy costs in Pakistan, that more than offset higher volumes and favorable price mix.

Moving to our income statement. Net sales of $1.755 billion were up 10% for the quarter versus prior year. Gross profit dollars were lower year-over-year, while gross margin was 16.5%, down over 500 basis points due to higher corn and input cost inflation. Three-quarters of the margin decrease was driven by North America's gross margin change, which was down over 600 basis points.

Reported operating income was $86 million and adjusted operating income was $113 million. Reported operating income was lower than adjusted operating income primarily due to restructuring costs related to Cost Smart.

Our fourth quarter reported earnings per share was $0.99 and adjusted earnings per share was $1.09.

Turning to our Q4 net sales bridge. Strong price mix of $182 million was largely attributable to the pass-through of higher corn costs. The sales volume increase of $4 million was driven by volume increases in PureCircle and the addition of the KaTech acquisition, partially offset by the impact of the contribution of our Argentina operations, to the Arcor joint venture.

For the quarter, reported operating income decreased $77 million, while adjusted operating income decreased $73 million. The decrease in reported operating income versus adjusted operating income is primarily due to 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 $0.78 per share for the quarter. The decrease was driven by operating margin decline of $0.90 and unfavorable foreign exchange of $0.03, partially offset by higher volumes of $0.09 and other income of $0.06 per share.

Moving to our nonoperational items. We saw an increase of $0.12 per share for the quarter, primarily driven by lower financing costs of $0.07 per share and the impact of a lower adjusted effective tax rate of $0.05 per share.

For the full year, the company delivered net sales of $6.894 billion, up 15% versus prior year. Gross profit margin was 19.3%, down 190 basis points.

Full year reported operating income was $310 million, and adjusted operating income was $685 million. Reported operating income was lower than adjusted operating income due to the Arcor joint venture-related net asset impairments and restructuring costs related to Cost Smart, partially offset by the income related to the favorable decision for certain Brazilian indirect taxes.

Our full year reported earnings per share was $1.73, and adjusted earnings per share was $6.67.

Turning to our net sales bridge. You can see that all revenue drivers contributed to growth. Favorable price mix of $614 million was largely attributable to the pass-through of higher corn costs in North America and South America. Sales volume increase of $265 million was driven by higher volumes in Asia Pacific, North America and EMEA, including incremental sales year-over-year of $90 million from PureCircle and $35 million from KaTech. These increases were partially offset by a $65 million decrease in South America resulting from the contribution of Argentina to the Arcor joint venture for the last 5 months of 2021.

In North America, Net sales were up 13% versus prior year, driven by favorable price mix. South America net sales were up 15%, driven by a 26% increase in price mix in Brazil and Colombia, partially offset by the volume impact of the Arcor joint venture and 3% of foreign exchange weakness.

In Asia Pacific, net sales were up 23%, driven by higher volumes, primarily from PureCircle and other favorable price mix.

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EMEA net sales were up 19%, driven by higher volumes in Europe, including KaTech sales for 9 months of the year, as well as favorable price mix in Pakistan. KaTech contributed 5 points of net sales growth for the year.

As Jim mentioned, we are concluding our Cost Smart program, with a cumulative savings exceeding $170 million, beating our original target by 36%. Cost Smart was a global effort that touched every function in the organization. Our objectives were to reimagine how we operate to improve effectiveness and efficiency, and reinvest a portion of the savings we achieved to support future growth. We delivered these significant savings by rationalizing production assets to optimize our manufacturing network, expanding global shared services to all regions, redesigning our global human resources support, and creating global operation centers of excellence.

We carry this momentum into cost competitiveness. Our strategic initiative to continuously improve our cost to serve. For our full year operating income bridge, reported operating income decreased $272 million, while adjusted operating income increased $26 million versus prior year. The decrease in full year reported operating income versus adjusted operating income is primarily due to the $340 million net asset impairment charge related to the Arcor joint venture in Argentina.

Operating income was up in South America, Asia Pacific and EMEA. Operating income was flat in North America, including approximately $40 million of ramp-up costs associated with our plant-based protein facilities. Full year corporate costs for the company were up versus last year, driven by investments in global capabilities and centers of excellence.

Turning to our full year earnings bridge. On the left side of the page, we share the reconciliation from reported to adjusted. On the right side, operationally, we saw an increase of $0.29 per share for the full year. The increase was driven by higher volumes of $0.53 and other income of $0.13, and foreign exchange of $0.07, partially offset by $0.44 per share of margin decrease.

Moving to our nonoperational items. We saw an increase of $0.15 per share year-to-date, primarily driven by lower adjusted effective tax rate of $0.14 per share.

Moving to cash flow. Full year cash provided by operations was $392 million. Cash provided by operations decreased versus prior year, driven by higher working capital usage. Working capital balances were impacted by the increase in net sales. Higher corn costs reflected in inventory values and higher input costs reflected in accounts payable balances.

Capital expenditures were $300 million, down $40 million from the prior year period due to the timing of spend. We were in line with our expectations for new capital commitments in 2021. During the year, we paid $172 million of dividends to Ingredion shareholders and repurchased $68 million of outstanding shares.

Turning to our expectations for 2022. Our full year 2022 reported and adjusted EPS range is $6.85 to $7.45. This excludes the impact of acquisition-related integration and restructuring costs as well as any potential impairment costs.

We expect net sales to be up high single digits to low double digits, driven by strong price mix, the pass-through of higher corn costs and volume growth.

We expect full year reported and adjusted operating income to be up 7% to 9% versus last year.

2022 financing costs are expected to be in the range of $72 million to $77 million.

Our adjusted effective annual tax rate is expected to be between 27% and 28.5%, which assumes unfavorable impact due to changing U.S. tax rules.

Cash flow from operations is expected to be in the range of $600 million to $680 million. We expect modest investment into working capital as net sales growth.

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Capital investment commitments are expected to be between $300 million and $335 million, of which nearly $100 million will be invested to drive specialty growth.

We expect total diluted weighted average shares outstanding to be in the range of 67.5 million to 68.5 million for the year.

In terms of our regional outlook, North America net sales are expected to be up 10% to 15%. Operating income is expected to be up high single digits to low double digits, driven by higher volumes, and favorable price mix, and increasing plant-based protein sales.

For South America, when we compare the 2021 segment results to our expected results for 2022, we would anticipate net sales to be down mid-single digits and operating income to be down lower single digits, which reflects the contribution of Argentina to the Arcor joint venture.

In Asia Pacific, we anticipate net sales to be up 10% to 15% versus the prior year. We expect operating income to be up high single digits, driven by higher volumes.

For EMEA, we expect net sales to be up 10% to 15%, and operating income to be up low single digits, driven by higher volumes, which will largely be offset by higher costs.

For first quarter 2022, we expect operating income to be down high single digits to low double digits versus prior year.

Our outlook for the quarter recognizes in South America that we have an approximate $7 million lap from Argentina's contributions in 2021.

Furthermore, we anticipate the layout of corn costs and co-product values will present a timing lag for margin recovery in Brazil, Korea and Pakistan.

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

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

Thanks, Jim. As I mentioned earlier, our purpose and values-driven growth culture underpins all that we do. We were once again honored to be named to Fortune Magazine's list of the World's Most Admired Companies for the 13th consecutive year.

In addition, as we continue to advance our diversity, equity and inclusion agenda, with a culture where everyone belongs, we're proud to have been included on Bloomberg's Gender-Equality Index for the fifth consecutive year. We also achieved a near perfect score on the Human Rights Campaign Foundation's Corporate Equality Index for the second year in a row.

In terms of sustainability, consistent with our commitments outlined in our 2030 All Life plan, we made significant progress towards our goal to be 100% sustainably sourced by 2025 for our 6 priority crops, reaching 32%, which surpassed our 2021 target.

As an example of sustainable sourcing, we advanced our regenerative agriculture program through the soil and water outcomes fund by partnering with PepsiCo and Nutrien to incentivize growers to choose more sustainable practices for corn grown in Illinois. As part of this program, we shared the cost of direct payments to farmers to transition to more sustainable planting practices. Our pilot program enrolled over 20,000 acres and reduced CO_2 emissions by 14,500 metric tons.

And now I'd like to close with a few summary comments. The second year of the pandemic was every bit as challenging as the first year, but in different ways. What remained constant, though, was the way our teams continued to persevere and display agility to meet strong customer demand and deliver another year of significant growth. We overcame nearly $900 million of input cost inflation, successfully integrated 2 acquisitions, entered into 2 strategic joint ventures, and continue to invest almost $100 million of capital in organic specialty growth.

All of these achievements would not have been possible without the dedication of our talented employees worldwide. Their efforts continue to position us well to create long-term shareholder value.

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And now let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Ken Zaslow with Bank of Montreal.

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

Hi Good Morning Guys.

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

Good Morning, Ken.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Good Morning.

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

I have 2 questions. One is when I think about the cadence of the year. Can you talk about the difference between the first half and the second half and how that sets you up for the long-term goal?

And then the more important question that I have is, you set out a long-term growth goal of 6% to 9% over the long term. 2021 was 4%, 2022 is going to be in that 7% to 9% EBIT. So how do you make that up? Or do you think that you're goal for 6% to 9% EBITDA growth over the long term to get to 2024 numbers was too aggressive? Or how do you make that up?

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

All right. So let me ask Jim to take the phasing question first.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes, sure. Ken and to everybody, as we looked at 2021, the first half, simply, while the cost of corn was going up, we had hedged and we benefited from some co-product values, which I think helped boost the first half margins in 2021. As we got into the second half of 2021, and as we had discussed with you and others, was that we knew that we were going to be more exposed to the corn that was staying elevated as well as we had left some of that open. So that impacted us in -- some in Q3 and mostly in Q4, and that's reflected, I think, in the Q4 year-over-year.

Now as we go forward and primarily in North America, where within our U.S. Canada business, a little bit less than half of our contracts were flat priced, we're now pricing in the change in the cost of the corn to those customers. And so what you'll see in 2022 is that pricing went into effect, and we still have elevated gross corn, we just have a lap of the co-product value benefit in the first half of 2021.

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As we get into the second half of 2022, we really should see the pricing stick. The corn will still remain there, and we should see a lot of margin expansion in the second half.

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

Okay. And then regarding the second question, Ken, regarding the long-term profit outlook mid, high single digits and the last year and then this year. I think it depends on where we finish in 2022, first of all, from a standpoint of whether we finish at the high end of the guidance or not.

But I would remind everybody about the significant growth investments that we have made and the promise that they still hold as it relates to the investments we've made in China, for example, which is the largest specialty food starch market in the world and that investment commissioning in the second half of this year.

The investments in plant-based proteins where we still are very bullish in regards to the commercial prospects for that. The investments that we are making in PureCircle to continue to grow more differentiated stevia products and the momentum that we have in that business. The investments we've made in rice, the investments we've made in tapioca, all of those bode very, very well.

And then the other thing is the core business continues to provide an engine of cash for the business. But this past year, the core sweetener and starch business did grow 14%. And there are dynamics occurring in that segment of overall core business that also could lead to more stability than we have seen in years prior.

And I think the combination of all of that, I think, makes us still feel very good. I would say we are going to obviously expand upon that, Ken, from a standpoint of more outlook at CAGNY. So we'll be able to engage with you and give you even more color on that at CAGNY.

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

Okay. How much of the cost in fourth quarter 2021 and then the first quarter of 2022, would likely not recur in 2023, 2024? And is that a component of maybe the reason that you could actually get to your long-term growth rate? And I'll leave it there.

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

Yes. I mean that's obviously a key question as it relates to what happened in quarter 4 and how do we view that. What I will say is that a portion -- a portion of the impact is already being priced through in quarter 1 of this year. And if I had to just maybe answer your question very comprehensively. If you reflect again on the fact that a little less than half of our revenue on fixed-price contracts in U.S., Canada is fixed priced. And we knew going into the quarter, that we had higher net corn costs and the chemical and energy costs were going to be higher, but to a certain degree higher.

I mean, that was all implied in our guidance. What was unanticipated in the quarter was the emergence of the Omicron variant, which the news broke on that literally in the weeks after our earnings call in November. And we experienced, again, incremental costs associated with that. And the majority of the impact that we experienced was in December. And so the ability then to price through in quarter 1, a portion of that impact, is already happening and will flow through in quarter 1.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Ken, to summarize as well and -- or add on to what Jim had said, right, as we experienced those unexpected costs, those are due to where you had a preferred carrier, and that particular truck driver or truck wasn't available, so you buy on spot for that particular load. You get a pretty significant rate increase on that.

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If you don't have Omicron, you don't have labor shortages and you have to -- I think a normal person would have to assume that supply chains return to what we've seen historically as our expectation for on-time deliveries at rates that are more reflective of a balanced either dry van market or an ocean freight market. So a lot of the costs that we actually incurred, I do think, are transitory and would not be reflected in 2023.

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

Great. I appreciate it.

Operator

Our next question comes from Ben Theurer with Barclays.

Benjamin M. Theurer - *Barclays Bank PLC, Research Division - Head of the Mexico Equity Research & Director*

Perfect. Good Morning, Jim & Jim. So actually, to follow up on what you've just said around the supply chain and the cost throughput and what you've been seeing as well on pricing into 1Q. How difficult or easy is it to pass on these short-term cost headwinds that just came up on the logistics side to your customers? And is that something you would also assume to at least stick a bit?

Or shall we expect that this is more of a short term, you pass that through, gives it a little bit of a bump into top line, but ultimately, it's not something to stick throughout the year, and we should just think about the cost easing -- the cost pressure easing over time to be the most relevant driver of operating income growth and not so much the pricing you got through at the very beginning?

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

Yes.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

How about if I...

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

Sure. You take a shot at and I'll talk about the commentary.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

To go back, I would look at Q4 and say that within Q4, in total, we probably had about $20 million of unexpected costs. Half of that was related to, I'm going to call, transportation and transportation -- preferred transportation lanes and not having availability of the equipment or the provider, the driver, the rail available to us and yet you still have a customer commitment in the food supply chain.

So the supply chain team needs to make a decision that day, that morning. And they have other available avenues. So if they have to go to spot truck or if they're relying on rail and all of a sudden, our intermodal is going to be challenged, then we're moving from rail to truck.

And so those are temporary decisions. We're going to incur the cost and that cost is going to hit the P&L. Now when we go back to customers, if it's evident to the customer that it's a dry van rate to the customer, then we can negotiate with that customer. But otherwise, that's going to be a cost that we incur, and it's in the service of a commitment to our customers, and we're maintaining those customer franchises and those relationships.

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

And in addition, and it's something that we talked about on the last call is when you have a more lengthy supply chain associated with, say, tapioca products coming in from Thailand, and you have a customer with a new product launch. We did make some decisions to airfreight product in, for example, as well.

But in all of those cases, as Jim is saying, to answer your question, we work with our customers and are passing through those price increases and about, Jim, you would say, half of the 20 was freight related and half to more than half is already being priced through in quarter 1. So if that helps answer your question very specifically, Ben.

Benjamin M. Theurer - *Barclays Bank PLC, Research Division - Head of the Mexico Equity Research & Director*

Yes. That helps very much. And then my second question is just around the -- you've laid out nicely the delays and what's been happening on the South Sioux City plan. So -- and the impact, obviously, that was double the amount initially expected and you still expect some impact in 2022.

What's been driving those delays? Is it the demand thing on the volume ramp-up? Or is it just operational things to actually get it established? So just to understand a little bit better what's been behind the drivers of the impact in 2021 and what you expect to be better in 2022, but still not good enough to make it to breakeven.

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

Yes. So let me break down our plant-based protein challenge and the 3 most relevant issues. The one and the largest is South Sioux City, and that's where we would be producing or are producing the pea protein isolate. And that's where we had a slower production ramp-up, again, as we optimize quality and yield to get in sync with maximizing batch sizes and the extended up time.

So we want to build food-grade inventory. The plant is commercially complete. We have food-grade certification, and we are in the process of building inventories of food-grade product to match what would be the required demand based on the average volume we anticipate per customer and to get that in sync takes some time.

So having the plant, being able to produce consistently food-grade quality to build sufficient inventory such that with all of the relationships that we have and discussions with customers, to get a good match where the commercial organization and the manufacturing and ops organization feel we're ready to go. So the good news is that our team has made excellent progress in South Sioux City over the last 2 months. We are steadily building high-quality food-grade inventory in anticipation of accelerated sales development through 2022. That again, was the most significant impact.

The second issue is related to just a slower start-up for our flour and concentrate facility in Vanscoy, Saskatchewan, and really, that was related to COVID-related labor shortages and delays in equipment deliveries. Some of that equipment was coming in from Europe. Just some delays there and a very tight labor market in that particular part of Canada.

That's, for the most part, all behind us. Our Specialty concentrates production line's commissioned in September, and we started incurring the cost of that in the fourth quarter. Today, that protein flour concentrate production is performing exceptionally well, and our sales are increasing.

And lastly, the third issue just relates to pea costs due to the drought in Western Canada, and we have secured our pea supply well into 2022. And that's all reflected in the operating income expectations for plant-based proteins in 2022. Hopefully, that gives you a kind of complete picture of the situation in that particular space.

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Benjamin M. Theurer - *Barclays Bank PLC, Research Division - Head of the Mexico Equity Research & Director*

Perfect, that was good. Thank you very much, Jim.

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

You're welcome.

Operator

Our next question comes from Adam Samuelson with Goldman Sachs.

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

Thank you. Good Morning, everyone.

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

Hi, Adam.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Good Morning.

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

So I guess my first question is kind of thinking about 2020, '21, obviously, a very inflationary environment. You talked about it in the prepared remarks and you highlighted you've completed and exceeded our initial targets on Cost Smart and productivity.

I guess, I look back and it's interesting you exceeded those targets, but EBIT in '21 ends up being lower than where it was in 2018, a couple of years ago. And so if the main Cost Smart program now is complete, how do we think about productivity moving forward? And particularly in the context that this becomes even a more urgent kind of problem in an inflationary environment?

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

Yes. So Cost Smart, as you said, served us extremely well. And it did deliver beyond our initial expectations. Remember, we raised the target for that twice from $125 million to $150 million then to $170 million and hit the 170 target. We are transitioning Cost Smart, which was one of our 4 strategic pillars to Cost Competitiveness. So cost and efficiencies is not in any way being deemphasized now that, that intensified program over 3 years is a sunsetting, it's transitioning into Cost Competitiveness. And one of the things in relationship to what could be an upside, for example, in 2022, relates to that initiative delivering very strongly.

So we have a number of items for operational efficiency and to offset inflation and we're embracing something called net structural savings, which our Global VP of Operations is driving very, very hard. And we feel very confident in those programs. And that represents, again, one of those upsides to the upper part of our range for 2022.

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So I want to make sure that no one misinterprets that the conclusion of the Cost Smart, say, intensified 3-year program in any way would reduce our focus on cost, it's just being rebranded to cost competitiveness, which is all about more of a cultural embracing of continuous improvement in the organization.

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

All right. That's helpful. And then maybe kind of touch on a little bit, it's a pretty wide guidance range for the full year. That's not that uncommon for you guys. But can you help us think about kind of how we -- to frame what drives you to the low end versus the high end of the range in terms of volumes, in terms of kind of pricing versus cost inflation mix? Just help us think about kind of the state of the world and the key kind of pivot points with high demand.

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

Sure. Jim is going to take that.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Adam, I think with regard to the upside, I think, first, if inflation is less than what we've assumed, you could see ocean freight rates coming back down. Oil is pretty elevated. That has a secondary impact into our chem cost, supply cost, diesel, et cetera. But inflation could be less than what we've assumed. Generally, we've tried to benchmark inflation here in kind of the late part of 2021, so November, December. Additionally, you could see a strong return to food service with Europe and Omicron as well as in maybe LatAm, Mexico and South America.

We really do think that as the -- as consumers come out and return to somewhat of a normal balance of behavior between eating out and eating at home, we're pretty well positioned with some of our specialty ingredients to benefit from that demand take up. I would say that within the U.S., food service traffic was a bit stretched in maybe, I would say, October, November. It sort of bounced back a bit in December. And so I just think that we still have some -- potentially some residual upside on volumes out of Europe and LatAm.

And then third, and Jim alluded to this, and it's within Cost Competitiveness. We have many efficiency efforts and continuous improvement underway. That can catch up and that can surpass the inflation. So those are all upsides.

I think our downside is really looking at corn costs globally. That could move higher, not -- to remind you that Ukraine is the third-largest exporter of corn in the marketplace. I think any disruptions there could further even just pressure futures on corn costs. And that doesn't really impact us as much in the U.S. or in Mexico, where we're largely hedged and buy domestically, but it does impact us in some of our other countries.

And then I think finally, on the downside, I think it is prudent to say, well, there could be some additional COVID variant or there could be specific Omicron breakouts throughout parts of Asia Pac, which could haul ports and congest ports, and that obviously causes some disruption. So really kind of thinking about those two are, probably, our largest downsides.

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

Yes. I think the low end of the guidance we discussed it. We debated it. And with the fact that, again, on the quarter 3 earnings call, no one knew of the Omicron variant. And the fact that we experienced that to the degree we did in quarter 4 and just with the unknowns around that, we're saying it's probably prudent to take into account there could be some other impact from the pandemic going forward. That hopefully helps you with how we frame the guidance.

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

Very helpful. I will pass it on. Thanks so much.

Operator

Our next question comes from Robert Moskow with Credit Suisse.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Hi, Rob.

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

Hi. I had a question about the supply chain disruption costs that you're incurring. You say that you're going to recapture some of it in the first quarter. But aren't these disruptions ongoing, like aren't you still relying on the spot markets and rerouting volume? I didn't see that as part of your guide for first quarter profit pressure. Are you saying that we're past it now and you're not -- and you're back to your normal routes or not?

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

Yes. I don't think we would say that we're past it. I would say that January, it's continued and it's getting better in the third week and fourth week of January. And as we head here -- as we're in February, in talking to our teams, the situation is absolutely getting better as we enter February. So -- but the first 3 weeks of January, it was still very intense.

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

Okay. So your guidance for profit down high single digit to low double digit, you mentioned the layout of corn costs. You mentioned the lap from Argentina, but you didn't mention higher supply chain costs. Is that -- but your cost will be higher, and you've incorporated that just for a month of that or you incorporated also for February?

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

We didn't obviously guide really, I think, towards North America in the first quarter. Generally, in North America, I think we're seeing relatively flat year-over-year, right? So while we have some additional costs, some costs that are carrying in, but we also have pricing, and we're also catching up on the pricing pass-through to the extent that we can with customers.

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

Okay. But you have your toughest comparison in first quarter North America profit and you're still coming in flat.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. And that's -- look, we -- obviously, we had some benefit last year from where we had hedged corn and the rise in the co-product values. Now this year, as we go in, we have higher volumes, we're going to have higher pricing into customers, which was reflecting the corn cost inflation throughout 2021. And we're also then managing through the expectation on inflation, whether it be freight or some of our input costs. But that's reflected, and we're trying to put that into our pricing and recapturing the full cost inflation that we witnessed last year.

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

And I think I got -- actually, second quarter is tougher than the first. But...

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

That's right.

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

And a follow-up for Jim Zallie. I think you mentioned that demand for plant-based proteins has been, I think you mentioned volatile in year 2 of the pandemic. Can you give me a little more specifics on what you mean by that? And also, maybe a little more color on the pipeline that you have and when it kicks in?

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

Yes. What I was referring to, Rob, is with many of the things that we read about alternative meat, plant-based meat, and the impact of the pandemic, the Omicron variant, et cetera, on food service consumption.

So overall, that was what I was referring to. But as it relates to how do we then feel about the growth prospects for plant-based proteins, our offerings are around different consumer product categories, not just alternative meat. Again, it's alternative dairy, snacks, bakery. And in the plant-based ingredient portfolio, we're focused on delivering attributes that would appeal to all of those categories like clean taste, functionality, affordability, nutrition.

And we just feel very positive about the go forward. When we see, for example, the challenges that Beyond and others have experienced to deliver through the pandemic with retail shifts, they continue, though, to invest in innovation, and they've also captivated many of the large food service suppliers like McDonald's, KFC, Panda Express, et cetera. And those channels are opening up consumers to new plant-based protein offerings.

And we just feel very good about the long-term growth prospects and with what we're -- the engagements we have with customers right now. But that was what I was referring to earlier was just those ups and downs primarily in alternative meat related to the impact of retail vis-a-vis food service.

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

And just to -- maybe to drill down again. Do you have a sense of what a normal margin structure in this pea protein business should be? Or what it is right now for your competitors? I mean, your competitors are doing it. So is it fair to say that you have a good sense of what they're earning and that gives you more confidence that once you get up to speed that you can get there? Like have you done good benchmarking work to really know what the margins are?

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

Well, certainly, when we justified the investment in pea protein isolate, we looked at the overall demand projections as well as the supply projections and the unique attributes that pea has vis-a-vis wheat and soy. And so when you think about alternative meats or plant-based meats, occupying a very, very small percentage, maybe 2% or less of the meat market at large today, and the ability to grow to 4% or 6% going forward, that just represents a tremendous amount of demand versus existing supply.

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And so we've modeled all of that out as it relates to the value proposition, working with our customers, and we feel very good about what that all means from a standpoint of the margins for this business. And we see a deficit going forward here over the next certainly 5 years with all of our models in relationship to demand outstripping supply and what that means for pricing and margins.

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

Thank you.

Operator

Our next question comes from Ben Bienvenu with Stephens.

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

Good Morning.

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

Good Morning.

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

I want to follow up more on the plant-based protein question from Rob there. With respect to, when you think about South Sioux City and Vanscoy ramping up to full capacity, what sort of runway does that give you to achieve your capture of the secular growth in the category that you've underwritten? And when do you start to think about potentially adding incremental capacity? And what's the organizational bandwidth to make additional plant or capacity investments?

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

Yes. It's one of the questions that our Board asks me all the time. So it's a very good question, a strategic question. Because we and our Board are looking past this short-term challenge, given what I was just talking about in relationship to the long-term drivers and growth prospects for plant-based proteins. And so this facility is sizable. This facility gives us a very nice foothold in the plant-based protein space and we think it serves us extremely well.

We're very focused, obviously, right now on the execution of that and getting the delivery and the returns on this investment. But we are already thinking about what our options could be as far as being able to expand that capacity.

But also -- and I talked about this previously, we're not just focused exclusively on pea protein. We think it's very wise and prudent to look at alternative sources of protein, from a standpoint of the total nutritional density as well as the functionality attributes that you're going to need to provide, not just for alternative meat, but for alternative dairy, et cetera.

So as far as what you can expect to hear from us going forward with additional perhaps investments in the plant-based protein space, it will be thought through very strategically based on a functional complement of plant-based proteins to deliver on all necessary attributes you need to have to deliver on taste, functionality, texture, et cetera.

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

Okay. Thank you, Jim. Jim Gray, reasoning the question around variance in the guidance on top end to bottom end. Can you talk a little bit about which buckets you feel like you have most versus least visibility into? And I think if we rewind to this time last year, you guys very shrewdly had hedged your gross corn costs through the first half of 2021. Would the same be true this year, and you're more open in the back half of 2022? I think you guys are hedged on natural gas, but could we revisit where you stand there? And then on freight, when do you -- how much is spot versus contracted? And when do you renegotiate those prices?

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Sure. I think, Ben, as we think about the kind of the certainty of our cost structure as we're looking into 2022. With regard to corn hedging and even coproducts, we're really looking now at our hedging practices and trying to be able to extend our hedges even further, not just into the year, but really get at the value at risk, and we'll have kind of more to talk about there. But clearly, it's something that I think is even a further opportunity to reduce profit volatility, both in our core business and in our specialty business. And we are sufficiently hedged within North America through even -- I would say, even into the third quarter and into the fourth quarter.

With regard to natural gas, we place most of our natural gas hedges in the year prior. So we are largely 80% plus, 90% plus covered on natural gas, where we need to buy that. I would say that you're always subject to a little bit to disruption. We're watching Europe very closely. We have operations in Hamburg, Germany. Germany is quite dependent upon energy sources from Russia. So that's at least on our radar.

And then I think with regard to freight, mostly when we think -- we've talked a lot about the U.S. freight market. We go out and we'll contract 95% to 98% of our preferred lanes and carriers. And we're in multiple iterations of doing this.

And so when we're talking about did the preferred carriers show up and do we have to use spot, we're talking about very, very small changes, 1, 2, 3, 4 points down versus the expected performance that our preferred carrier has been giving us at that particular facility. It's just that your rate when you go from your preferred lane to your spot is going to be 30%, 40%, 50% more. So to the extent that you have to do that or to the extent that you have to make up for a customer pick up, you're going to be incurring freight. But we're very thoughtful, very comprehensive on our freight coverage.

When we get disruptions with rail, we get disruptions with a dry van carrier or you get elevated ocean freight, those things are going to be in the moment. They're going to show up in the financials. We're working it as a team to get those rates back down, and we're also working with customers to share in that cost.

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

Okay. Thank you.

James Derek Gray - *Ingredion Incorporated - Executive VP & CFO*

Sure.

Operator

Ladies and gentlemen, this does conclude the Q&A portion of today's conference. I'd like to turn the call back to Jim Zallie, President and CEO for any closing remarks.

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

Thank you for joining us this morning. We look forward to a time when we can see you again in person. Please note, we are presenting virtually at the Consumer Analyst Group of New York on February 23 and hosting an Investor Day on June 2, which will be a combination of a virtual presentation and an in-person tour at our Bridgewater Innovation Center.

Until then, thank you for your continued interest in Ingredion.

Operator

Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.

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