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INGR - Q1 2020 Ingredion Inc Earnings Call

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OVERVIEW:

Co. reported 1Q20 net sales of $1.543b, reported operating income of $153m and reported EPS of $1.11.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Quarter 1 2020 Ingredion Incorporated Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

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

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

Good morning, and welcome to Ingredion's First Quarter 2020 Earnings Call. I'm Tiffany Willis, Vice President of Investor Relations and Corporate Communications Officer, and I'm happy to be with you today.

With me today at safe social distances are Jim Zallie, our President and CEO; and Jim Gray, 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, in the Investors section. The slides accompanying this presentation can also be found on the website and were posted a few hours ago for your convenience.

As a reminder, our comments within this presentation may contain forward-looking statements. These statements are subject to various risks and uncertainties. These statements include expectations and assumptions regarding the company's future operations and financial performance, including the impact of the COVID-19 pandemic. Actual results could differ materially from those predicted in the forward-looking statements, and Ingredion assumes no obligation to update them in the future as or if circumstances change.

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

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

And with that, I am pleased to turn the call over to Jim Zallie.

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

Thank you, Tiffany. I want to open by saying that I hope everyone of you that is joining us today, your families and your loved ones are staying safe and healthy. For anyone who has been directly affected by illness as a result of the virus, our heartfelt thoughts are with you. This is an extraordinary moment in time for all of us. The coronavirus has affected every business in the world. Together, we are navigating a global health crisis that is bigger and more widespread than anything we have witnessed in our lifetime.

I would like to take a moment to pay tribute and express our thanks to all the health care professionals, first responders and other essential services workers on the front lines for all they are doing. Also, I want to expressly thank our Ingredion employees for keeping our operations running smoothly and continuing to deliver ingredients and solutions to our customers.

The challenges presented by the pandemic are bringing out the best in many people, and it has been motivating to witness the leadership being displayed, both inside and outside of our company. Today, our objective on this call is to provide a picture and a perspective of what we have been seeing since the pandemic hit, the current dynamics in our business, and the actions we have been taking to not only manage through but to quickly adapt and make sure we are well positioned to emerge stronger.

Beginning in January, we started to see disruptions from COVID-19 in China, and we activated our Global Crisis Management Team on January 11. By early March, we had transitioned this into a Global Pandemic Response Team directing all activities through a project management office that immediately began coordinating, tracking and planning business impact activities across all regions and all functions.

Concurrently, we established and communicated 3 clear priorities that have guided us thus far. Our top priority has been to maintain our employees' health and safety. Ingredion has always been a company that has fully embraced its care first value. Our strong safety culture, which has allowed us to operate for many years at world-class levels when it comes to minimizing injuries in the workplace has enabled us, in this case, to readily adopt protocols and take measures to protect employees' health. We rapidly followed guidelines of public health authorities for physical distancing, increased personal hygiene and sanitization and provided the necessary personal protective equipment to employees. I am proud of the coordinated efforts of everyone in our organization to adjust and adapt to safe, new ways of working to enable us to maintain a secure supply of ingredients to our customers.

Our second priority has been to be a responsible corporate citizen, not only following local governmental guidelines to protect local health systems, but proudly supporting and giving back to the communities in which we operate. Ingredion teams around the world are supporting charitable organizations, and we are actively supporting the global food banking network with 2 corporate donations, which thus far will provide 1.2 million meals to people in need.

Our third priority has been to maintain business continuity, to serve our customers without interruption. We are focused on ensuring the safety and quality of our food and beverage ingredients as well as the availability of products into the supply chains of our customers. And I'm pleased to say that thus far, we've been able to do an excellent job in that regard, and we have received notes and comments of appreciation from a range of customers, big and small, acknowledging the support for our efforts on their behalf. We continue to monitor this rapidly evolving situation and are working closely with our customers, building on our strengths, sharing respective best practices and focusing on recovery planning.

Now let me transition to our first quarter. We are pleased with our results for the quarter. Amid macroeconomic disruptions, we delivered solid operational and financial results. This was driven by healthy demand for our products, continued growth of our specialty portfolio and further progress to streamline our organization.

For the quarter, our global net sales were flat compared to prior year. Absent $40 million of negative foreign exchange impacts, net sales were up 3% versus the prior year. Net sales, absent foreign exchange, were up in 3 of 4 regions. Adjusted operating income for the quarter was up 1% year-over-year and up 4% absent foreign exchange translation impacts. Adjusted operating income was either up or flat in all 4 regions.

Now let's discuss the highlights of each region's performance during the first quarter. In North America, sales were up slightly for the quarter versus prior year, with favorable price/mix offsetting volume decline. Operating income was $125 million, flat year-over-year. Improved price/mix and favorable freight costs were partially offset by higher net corn costs due to the timing of corn hedge mark-to-market impacts.

The South America region experienced 4% sales growth versus prior year despite significant foreign exchange headwinds. Absent foreign exchange, sales were up 15%, driven by strong pricing actions and volume growth. Operating income was $26 million, up 44% versus prior year due to favorable pricing and higher volumes. Our South America team has consistently been able to demonstrate an ability to drive necessary pricing actions successfully despite a variety of market challenges.

Moving to Asia Pacific. Sales were down 7% compared to prior year due to volume decline, foreign currency and unfavorable price/mix. With the early onset of COVID-19 in China and Korea, volumes in those countries were impacted by stay-at-home orders throughout the quarter. Operating income at $20 million was flat versus prior year impacted by weaker volumes, offset by favorable tapioca margins.

Moving to EMEA, our sales were flat for the quarter. Excluding foreign exchange, our sales were up 6% driven by favorable price/mix and volume growth. Operating income at $27 million was up 13%, driven by favorable price/mix, volume growth and lower cost of goods sold as a result of Cost Smart savings actions.

Now let me turn it over to Jim Gray, who will review the financial results in more detail. Jim?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Thank you, Jim. Net sales of $1.543 billion were flat for the quarter versus prior year. Gross profit margin was up 30 basis points. Reported and adjusted operating incomes were $153 million and $167 million, respectively. Reported operating income was lower than adjusted operating income due to asset closures and restructuring costs related to Cost Smart. Our reported and adjusted earnings per share were $1.11 and $1.59, respectively.

First quarter net sales of $1.543 billion were flat versus prior year. We experienced unfavorable foreign currency impacts of $40 million. Although volume was flat, favorable price/mix contributed $43 million to the net sales increase, offsetting currency weakness.

In North America, net sales were up slightly versus prior year. Price/mix was up 2%, offset by lower volumes. South America net sales were up 4%, with price/mix up 9% and volume up 6%, more than offsetting foreign currency weakness.

In APAC, net sales were down 7% due to the early impact of COVID-19 in the quarter, which impacted volume. Price/mix was lower due to pass-through of lower tapioca raw material costs. EMEA net sales were flat as favorable price/mix and volume growth were offset by foreign exchange.

For the quarter, reported operating income decreased $8 million, while adjusted operating income increased by $1 million. The decrease in reported operating income was driven by asset closures and restructuring costs related to Cost Smart. Region operating income growth was offset by corporate costs, which increased by $10 million due to higher legal and IT project costs and continued investments to drive innovation and streamline global processes.

Turning to our earnings bridge. On the left side of the page, you can see the reconciliation from reported to adjusted. On the right side, operationally, we saw an increase of $0.03 per share for the quarter, driven by favorable margin of $0.11 per share and offset by unfavorable foreign exchange, volume and other income of minus $0.05, minus $0.02 and minus $0.01 per share, respectively.

Moving to our nonoperational items. We saw an increase of $0.03 per share for the quarter, driven by favorable financing costs. Moving to cash flow. First quarter cash provided by operations was $65 million. Capital expenditures were $98 million, up $18 million from the prior year due to the timing of payments for our plant-based protein growth projects.

Before providing highlights to our 2020 outlook, I would like to characterize how stay-at-home restrictions and continued concerns for the virus' effect on public health are impacting consumer behavior and habits in the marketplace. To begin, we have seen and continue to expect that pantry stocking will occur for many center of store packaged foods. As examples, demand for soups and frozen entrees has increased. In other areas in the grocery store, for example, fresh categories have seen mixed demand. Yogurt sales have not seen the same spikes, perhaps because consumers have limited refrigeration space.

In away-from-home channels, such as quick-serve restaurants or pubs and bars, demand has dropped significantly. Fewer french fries and fountain drinks are being consumed in foodservice. Finally, in only one instance that we know of, temporary government mandates have halted production in our food and beverage segment, which is brewing in Mexico.

Due to the uncertainty created by the pandemic, our previous full year guidance of 2020 EPS, cash from operations and net sales outlook is no longer applicable. We have moderate visibility into quarter 2, but cannot fully predict how consumer behavior will evolve in response to infection rates in different locations for the remainder of the year.

In quarter 2, we anticipate that net sales will be down versus prior year in each reporting segment. In North America, net sales and operating income are anticipated to be down due to the decline in brewery sales within Mexico related to COVID-19 government mandates. We anticipate Ingredion volume into foodservice to be down, with volumes returning as we move into Q3.

In South America, the pandemic is in earlier stage. The sudden halt of consumer traffic into restaurants and bars as well as mom-and-pop stores will reduce sales of beer, carbonated soft drinks and impulse foods such as confectionery. This sudden decline in demand will negatively impact Ingredion volume sales into these segments.

EMEA net sales and operating income are expected to be down. Our Pakistan business has greater volume exposure to the textiles industry, which is not operating due to COVID-19 restrictions. Asia Pacific operating income is expected to be down primarily due to currency weakness.

As we look forward, we are focused on maintaining our strong cash position in this uncertain environment. We are monitoring working capital accounts closely. Our balance sheet remains strong. We will continue to be disciplined and are taking steps to ensure that we have the capital to operate our business and support our strategy for the long term. We anticipate stable cash flow in line with changes to operating income. Committed capital investments are anticipated to be between $285 million to $305 million assuming that equipment orders, access to our sites and contractor safety can be maintained. Our reported effective annual tax rate is expected to be between 28.5% and 32%, and our adjusted effective annual tax rate continues to be between 26% and 27%.

With regard to our Cost Smart savings program, we are on track to deliver the cumulative 2020 run rate savings target of $90 million to $100 million by year-end. And with much of our teams working remotely, we are saving on discretionary expenses and finding opportunities to improve our productivity.

So now let me turn it back to Jim Zallie.

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

Thanks, Jim. Before closing, I would like to spend a few minutes talking about how our strategy and our driving growth road map are serving us well during these turbulent times. Our strategy is built upon 4 pillars: number one, a purpose and performance-driven culture with an emphasis on people; two, commercial excellence, with a commitment to our customers; three, Cost Smart with a focus on cash; and four, driving specialties growth with an alignment to markets and trends.

Our entire organization is being guided by these 4 pillars, and we are committed to executing the key elements of our driving growth road map to create value for all stakeholders. As you know, the centerpiece of our road map is our 5 specialty growth platforms, which are well positioned to drive net sales growth.

As evidence of our company's agility and commitment to execute our strategy, despite the challenges, I'm pleased that even during the pandemic, we reached an agreement on the strategic acquisition of PureCircle. PureCircle is an industry-recognized leader and innovator, with a proven track record for producing great-tasting, naturally based Stevia ingredients. The pending acquisition of PureCircle allows us to strengthen our business model, aligning with one of the most important food and beverage trends shaping the industry sugar reduction.

By leveraging Ingredion's global footprint and customer list, we will be able to bring great tasting, high-quality, non-GMO Stevia ingredients to a more diverse and broader customer base. In addition to the commercial benefits, the acquisition presents opportunities for increased operating efficiency. We continue to progress the deal through applicable regulatory and shareholder approvals until closing, which is anticipated in the third quarter.

We look forward to working with the PureCircle team and updating you on the exciting prospects for this acquisition in future calls. We are also proud that at a time when making a positive difference for the world is more important than ever, we advanced our vision for sustainability. On Earth Day, we launched our 9th annual Sustainability Report putting forward, 2030 sustainability goals, aligned with the UN's sustainable development goals and established the bold commitment to sustainably source 100% of our 5 leading raw material crops, corn, tapioca, peas and Stevia by 2025.

With a clear strategy, a road map for growth and a strong, adaptable business model that has endured many tough as well as benign cycles, combined with a focused and committed team, I am confident in our future and our ability to create lasting value for our stakeholders.

Thanks for your attention. And now let's open the call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Heather Jones with Heather Jones Research.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

So wanted just a quick clarification. I didn't catch all the outlook language for the different regions. Did you say that EBIT for South America, you expect it to be down in Q2?

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

Yes. So let me take that first and just talk about how we view Q2. So when we look at the forecast for quarter 2, we're taking into account at what phase each region has been impacted and is being impacted by the rate of infection and how that is impacting consumer behavior and also government mandates for stay-at-home restrictions. And so what I would say is that in 3 of the 4 regions, excluding South America, we're taking a conservative view to quarter 2 that will be down in EBITDA in the low to mid -- EBIT -- I'm sorry, EBIT in the low to mid-teens. Asia Pacific might actually do better than that based on how April is coming in, where we've been pleasantly surprised.

In South America, operating income is likely to be down much more significantly based on the fact that, that region is being hit hardest now. They are equally in the southern hemisphere and entering flu season right now and the number of cases there continues to increase. We have seen the foodservice sector in South America, getting hit very hard starting in the third week, the last week in March throughout April, but we're seeing a recovery in May, and the recovery is actually even stronger than we had anticipated just a few days ago. So it's somewhat hard to predict, but we predict -- we anticipate that South America will be impacted worse than the other 3 regions in quarter 2.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

Okay. Okay. But it sounds like it's very much in rapid flux. Is that a fair characterization?

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

It very much is except for, I would say, Asia, where the bounce back has been stronger than we had anticipated, especially in China. And April results for us in Asia have been above our expectations. And that's why I would say that we're cautiously optimistic that we won't be down in EBIT in the low to mid-teens in Asia. We might actually outperform that. But in North America and in EMEA, due to the impact in EMEA, for example, of Pakistan and the shutdowns there and the impacts on the textile industry, that's how we're calling it right now.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

Okay. That's encouraging to hear. Corporate expense, you mentioned that the stay-at-home guidelines, et cetera, are trimming expenses. So I think previous guidance had been for that to be up 15% to 20% year-on-year. How are you guys seeing that now, because it came in higher than I was expecting for Q1?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Sure. So part of corporate expense, though, is also having to do with some of the longer-term compensation, which is held at corporate. We reset from prior year. And so we just encountered that. But what we're also seeing is that we had some legal expenses as we were going through the PureCircle transaction, which are impacting Q1. So that's really timing. But generally, we should see discretionary expenses like T&E, much, much lower. And we should also see some of the kind of third-party expenses much lower as we're just -- the entire company from an administrative and from a managerial side is working remotely.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

So you would think consolidated corporate expense is going to be up less than the 15% to 20% you originally anticipated?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

Okay. Thank you. And my final question is wondering, and I get the complexity of your different end markets and all this. I was wondering if you could give us sort of like in broad strokes, in a sense of how your sales roughly break down by foodservice versus retail, specifically in North America and South America, given the size of those regions, if you can give us a sense of that?

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

Yes. It varies by region, and it varies by country. And in North America, I would say it's in the 20% to 25% range is into foodservice. And in South America, it depends on how you define foodservice relative to the size of the brewing business that we have. But brewing is how we categorize mainly in South America, specifically in Brazil and Colombia, the exposure to foodservice. But I would say it's a little bit -- it's a higher proportion in South America...

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Just due to brewing.

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

Which is just due to brewing.

Operator

And our next question comes from Robert Moskow with Crédit Suisse.

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

I had a -- the plant-based investments that you're making, do you see any risk to your sales outlook because of that end markets exposure to foodservice? I would imagine that the restaurant sales of plant-based burgers will be negatively impacted. And then one clarification. Your brewery business in Mexico, in North America, about how big is that as a percentage of your North American sales? Thanks

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

Yes. I'm going to let Jim Gray get to that question. Let me take the plant-based protein question first, and then I'll turn it over to Jim to talk about Mexico and brewing. The plant-based protein investment in South Sioux City continues to move ahead scheduled for completion now in quarter 3. As it relates to the outlook for plant-based foods, we're still very bullish on it. The sales of the market leader in this particular case, Beyond Meat, I believe, has 50%, to your point, of their sales that go to foodservice, 50% at retail. Foodservice is obviously being impacted right now hard, but retail sales for their products in the first 3 months were up, I think, 300%. So -- and I believe they have their earnings today, so we'll see how they're breaking that out. But I don't know if that's going to more than compensate for the down decline in foodservice. But we anticipate the same sort of trends that quick-service restaurants, where a lot of those products are sold, will be picking up once the stay-at-home orders are relaxed. But also what we're seeing in relationship to foodservice is different subsegments of foodservice getting impacted differentially.

So quick-service restaurants that are already set up for drive-throughs are going to weather this better than others and already have implemented contactless pickups when you pick up your food from a drive-through, it's being presented to you on a tray, for example, and not being touched. So we anticipate foodservice and quick-service restaurants, where a lot of those products are being sold to come back more quickly and retail to actually continue strong but overall, this trend towards plant-based eatings, especially when you look at some of the concerns around the meat supply right now, I think, it's only going to bring heightened focus on plant-based diet. So we're very bullish on the long-term in relationship to this and comfortable with the fact that when our investment does commission, and we qualify product for food-grade sales, which takes a couple few months, that by that time, we'll be in a much more steady state where foodservice will have recovered to a large degree and food at retail will continue to benefit from the fact that people who eat plant-based diets have actually depended upon them for their at-home consumption. And so again, we're very optimistic in relationship to the plant-based trend and how that will continue through this pandemic. Jim, on Mexico?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. Rob, most of the brewing manufacturing sites in Mexico have been ordered closed by the government, so significantly limiting kind of production and resupply. So as a result, the demand for our adjuncts will likely be lower until that production resumes in -- kind of in later in the second quarter. We anticipate that kind of late May, early June. Sale of our brewing adjuncts in Mexico, so it's approximately 3% of our company net sales. I think you asked about North America, so it would be about 6% of North America. And just as one final thought. So beer remains available on store shelves and convenience and grocery channels. It's just that the inventories are being depleted. So there'll be a run to restock those shelves, once the government allows domestic brewing and domestic resupply.

Operator

And our next question comes from Ken Zaslow with Bank of Montreal.

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

So a couple of questions. One is, what do you think the lasting impact on your business will be when you come out of this? Do you think there'll be anything structurally that you'll need to change or that will either be a positive or a negative?

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

Well, I think one of the first lasting impacts is going to be the way we work internally, first of all, as an organization. We have been maintaining very close contact with our employees. We have implemented 2 pulse surveys since the pandemic started, where we're soliciting feedback and learning and understanding the ways of working, for example. And I'll just give you one example, obviously, most businesses, us included, 90% probably of our office workers are working remotely on a global basis throughout this pandemic as this has unfolded. And what we've learned is that a very large percentage of them could be very productive working remotely. We had already implemented flexible remote work policy where people could work remotely with supervisory approval 1 or 2 days a week prior to this. So we moved into this pretty seamlessly when we went to full-time remote, but an example would be customer service. We have metrics in relationship to how we measure customer closeout responses. And those have actually increased and the quality of those have actually increased, and the feedback we've gotten from our customer service people that have been equipped to work remotely is that the fact that they're uninterrupted, and they're just totally focused. They can actually be that much more productive and efficient. So that's something that's unique that's going to come out of this.

I think the way that we have -- we're going to be organized in the workplace and more mindful of the way things were prior to in open seating office areas, for example, we'll maybe go back to a little bit more of cubicles and some barriers to give people some privacy and some physical distancing that makes them feel comfortable. And certainly, we've implemented that in our factories. And also, I think you're going to see the use of technology continuing to allow us to help protect the health and safety of our employees as things go forward. And then just in relationship to business, in general, I think that there's going to be certain trends that are going to endure through this that will be consumer trends that we'll need to pivot towards. And some of these are already manifesting themselves right now, and we're going to be following those very, very closely. And they'll create opportunities for us as well. Jim?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

And Ken, I'd add that not all of your customers are equally prepared for this type of disruption. And so you find that you can share best practices with those customers that are extremely well prepared. But the bottom end of the performance chart, you're actually able to work more with and help along, right, and really support so that things like inventory is available and can be shipped at moment's notice. And so I think that the supply chain overall strengthens. And then Jim has talked about, and we've talked about a while in terms of the face of foodservice is probably going to change, but orders that are going to be delivered to home or on the go, where there are certain aspects of our functional ingredients that can help to innovate with regard to heat retention and stability, those are going to be even kind of more exciting opportunities for us as we go forward.

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

And just lastly, I do think you're going to see more of an emphasis on person's personal health. And so for example, everyone has heard the term comorbidity in relationship to COVID-19 and being at a higher risk with diabetes and high blood pressure. So health and wellness will, I think, take an even larger place in priorities of consumers. So for us, the acquisition of PureCircle and sugar reduction to cater to people that want to control their sugar intake, which is a very, very large percentage in North America, it was 85% of North Americans reduced their sugar intake over the last few years. So I think that bodes really well for us as we're positioned now with PureCircle.

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

My second question is, with the reduction of foodservice in the U.S., I'm assuming carbonated soft drinks have kind of come down. How is that either probably stressing the supply chain on the corn processing, obviously, led by the high fructose corn syrup. But how is that hurting the supply chain in corn processing? Is there going to be a backup? Can you get through the materials? Are you swinging capacity? How does that all play out? And how does that kind of lead to 2021 and beyond?

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

Yes. I think for us right now, it's really, I think, too early to tell. I think that, again, if the same kind of consumption patterns follow that we're seeing in Asia transition to Europe transition to North America and then South America, and this is a 6- to 8-week decline and then a slow steady recovery, I think that the industry will be able to transition through this. But we're monitoring. It's very early days right now. We're feeling that we're not as exposed to foodservice on the sweetener side as much as maybe we had in prior years, the way we've optimized our network. And so -- and the customer base that we sell to. So we feel that for us, it's just too early to predict exactly how this is going to play out.

Operator

Our next question comes from Adam Samuelson with Goldman Sachs.

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

So I was hoping, Jim and Jim, to get a little bit more color on it. I know you're not giving guidance per se, but kind of the low- to mid-teens decline in operating profit in the second quarter. And I guess I'm really thinking about North America. And just any framework you could provide on deconstructing that between volume, kind of mix, cost under absorption and net corn costs? I'm just trying to think about the interplay of those, understanding it's a very volatile environment. And then I got a follow-up.

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

Yes. Jim, do you want to take that?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. So Adam, I'd break the problem down first and just in terms of Mexico and the fact that with the shipment of adjuncts into brewing just stopping for a period of time. That's a significant kind of Q2 one-off impact to the business. And then what we're seeing is a mixture within either the U.S., Canada business or the Mexico business between a falloff in foodservice, whether that be fountain carbonated soft drinks or in terms of some of the ingredients that we would offer into kind of savory solutions in foodservice. But we also see the counterbalance really in terms of center of store, packaged foods take up. And so I kind of say that, yes, there's a bit of a softer in terms of syrup demand into beverages, CSDs, which is generally impacting us across both U.S., Canada as well as Mexico. And then also just the brewing is probably the bigger one that we would...

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

So Jim, is it fair to say this, that if you break out North America, to your point, the brewing industry, most brewing manufacturers in Mexico have been ordered to close by the government and are -- we're taking a conservative view that they will not come back on stream until the end of May to early June. So that's in that guidance that we provided. So that's the view we have. If they come up sooner, that could change that outlook. In U.S., Canada, the view is all the puts and takes, the positives on the net corn side -- on the recovery rates on corn as well as on the cost side with TD, et cetera, along with the reductions in volume that we're seeing, foodservice, et cetera, are less impactful, but it's more Mexico being down and U.S., Canada being less down, and we've provided you the perspective we have on when that recovery in Mexico brewery will take place. That's fair to say, right?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes.

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

That was helpful. And then just South America, just want to -- so one, just as you think about the declines in the economy and the issues, the slower entry into some of the slowdowns from a volume perspective. I mean maybe any similar thoughts in terms of how you're thinking about the shape of the demand curve? And also, just I noticed in Argentina, you've moved to hyperinflationary accounting, and it was accounted for in U.S. dollars this quarter, which I think is a change versus prior. Just making sure was there any below-the-line adjustments there as an offset now that the segment was actually in U.S. dollars?

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

Let me turn -- let me let Jim answer the question on Argentina, and then I'd just like to comment on the demand curve.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. So Argentina on the hyperinflationary, we moved last year. And so that's not been -- what we're doing is we're just -- we're taking it out and clarifying the adjusted -- when we're talking about adjusted op income, the impact for hyperinflation is down in financing costs.

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

Okay. And then just let me follow-up with it. Just on demand in South America. And let me talk specifically about brewing volumes in both Brazil and in Colombia. But from the end of March through April due to the stay-at-home orders, approximately 70% -- there's been a 70% reduction in brewing volumes in that period of time, that 5-, 6-week period of time and confectionery volumes as well being down very similar. That's something that we also saw in Asia during the early parts of this crisis. A lot of those are impulse purchases, made at small locations, certainly kiosks, think about airports, et cetera. So they have been down. What I will say is that we are seeing brewing recovering strongly, and we're cautiously optimistic. Again, it started to ramp back up here in May, very strongly, which indicates that there's a pent-up need to fill pipelines and the channels. So we're optimistic that things will continue throughout the second quarter with that recovery. I think confectionery is going to be a little bit of a slower recovery just due to the nature of how those products are purchased.

Operator

And our next question comes from Ben Bienvenu with Stephens.

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

I want to ask on the corn side. Obviously, we've seen corn prices come down a lot, basis has come down a lot. We've seen the co-products, corn oil, in particular, with all the ethanol production capacity coming offline, corn oil is a lot tighter. I'm curious you're starting now, I think, getting into the period where you might start to think about hedging out some of the rest of the year as we're into planning season. Can you talk about what ability or window you have to lock in some of these lower net corn costs? And how you think that might contribute to potentially alleviating some of the operating profit pressure in the back half of the year, if at all?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Sure. I'll take that. So Ben, one of the things that we highlighted in Q1's performance for North America was that the segment operating income was relatively flat. We actually did experience some significant corn hedge mark-to-market in Q1, that will come back to us the balance of the year, right? So as we're seeing lower corn futures, and we've laid in some of those futures relative to our production needs. So we'll benefit through that to the balance of the year. Plus also, as we highlighted, you're seeing basically generally higher co-product values. And to remind everybody, that really benefits us more in North America in the second half and more towards the fourth quarter, if we look at our lap versus prior year. When we look forward, and we get more news about plantings and acreage, and we look at the kind of lower gross corn cost that's either delivered to us as we go through summer and/or as we're looking at the futures for 2021, we have an ability to go forward and secure those futures such that we can kind of meet any type of revenue or pricing expectations for our customers. So we're kind of always looking at what we have in front of us, usually looking out probably 2 to 3 quarters in front of us and then also then thinking about how as we roll that calendar forward, how we're thinking about what the first half of '21 looks like.

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

Okay. On the operational continuity side, what, if any, have you seen with additional expenses that might linger in allowing you all to have business operational continuity in facilities? I recognized that these facilities don't have a ton of people in them. But what incremental expenses are there, if at all, that could linger through the duration of this year and potentially into next year? And are they material?

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

Yes. I would say that the cost of incremental PP&E as well as the efforts for increased sanitization, those are costs that will likely continue. But for the most part, they've been relatively modest. Our procurement team has done a phenomenal job of making sure that all of our sites around the world have the required and ample PPE. So that's been coordinated again through this project management office that I talked about. And that will be an incremental expense. But again, it's modest in the overall scheme of things.

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Maybe, Ben, I'd say the one unknown is to what degree each community around our facilities as well as around our offices, either have a return of flash outbreaks, and we need to do testing. So right now, the frequency of testing under that is still kind of an unknown cost to us.

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

And we have that as a separate work stream that we're looking at as part of our project management office to determine whether and if and how we would provide testing, and that's something that we're working on. It's just too early to tell exactly how we're going to approach that. But it is a separate work stream that we're looking at.

Operator

(Operator Instructions) Next question is a follow-up from Heather Jones with Heather Jones Research.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

I just had a quick question. You mentioned pipeline replenishment once brewers start brewing again in Mexico. But I was wondering if you could give us a sense of -- like you had mentioned QSR in North America has recovered fairly nicely. And could you give us a sense of like what's the normal lag between their recovery pattern and when you would start to see it in your order patterns?

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

Yes. So let me go back and clarify what I did say in relationship to foodservice and the question and specifically talk about North America. So what I would say is that in North America, foodservice impacts to us started to be felt more in the second half of April, and they are continuing into May. The impact overall that we anticipate from foodservice will be varied depending on the subsegment of foodservice. And what I was trying to highlight is that I believe that quick-service restaurants, where we do sell products either directly to or indirectly to, to other manufacturers that produce for quick-service restaurants, will be less impacted in comparison to casual dining, certainly fine dining. And so we see that recovering, if it follows the same pattern as what happened in China, in probably 4 to 6 weeks is what we anticipate.

Operator

And we have a follow-up from Robert Moskow with Crédit Suisse.

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

And just one clarity thing. Your interest expense in the quarter being down versus a year ago, but you're also including the hyperinflation impact in Argentina in that number. Can you quantify what that impact was? And -- so we could look at the true interest expense run rate?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

Yes. I want to say that the hyperinflation included in that was about a $2 million impact year-over-year, Rob.

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

Okay. So that means your normal interest expense was about $16 million?

James D. Gray - *Ingredion Incorporated - Executive VP & CFO*

And then we have -- I have also some gains, some -- also various hedging gains losses in that as well, right, just from normal. We have cost of goods sold and I'm shipping there, a little bit lower than $16 million on my net interest cost, yes, per quarter.

Operator

Thank you. And I'm showing no further questions in the queue at this time. I'd like to turn the call back to Jim Zallie for any closing remarks.

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

Okay. Thank you, everybody, for your time and attention today. We look forward to discussing our business further with you on May 13, when we will participate in the BMO Farm to Market Conference. In addition, we will also hold our Annual Meeting of Stockholders virtually on May 20 at 9 a.m. Central Time. Again, thank you for your time today, and I hope everyone stays safe and healthy as we navigate this pandemic together.

Operator

Ladies and gentlemen, thank you for your participation on today's conference. This does conclude your program, and you may now disconnect.