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INGR - Q4 2015 Ingredion Inc Earnings Call

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OVERVIEW:

Co. reported 2015 reported EPS of $5.51. 4Q15 net sales were $1.4b and reported EPS was $1.42. Expects 2016 net sales to be in line with 2015 and adjusted EPS to be $6.20-6.60.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Ingredion fourth-quarter 2015 earnings call. (Operator Instructions.) As a reminder, today's call is being recorded. And I will turn the conference over to Ms. Heather Kos. Please go ahead.

Heather Kos - *Ingredion Incorporated - VP, IR and Corporate Communications*

Good morning and welcome to Ingredion's fourth-quarter 2015 earnings call. Joining me on the call this morning are Ilene Gordon, our Chairman, President and CEO; and Jack Fortnum, our Executive Vice President and Chief Financial Officer.

Our results were issued this morning in a press release that can be found on our website, Ingredion.com. The slides accompanying this presentation can also be found on the website and were posted a few hours ago for your convenience.

As a reminder, our comments within this presentation may contain forward-looking statements. These statements are subject to various risks and uncertainties. Actual results could differ materially from those predicted in the forward-looking statements, and Ingredion is under no obligation to update them in the future as or if circumstances change.

Additional information concerning factors that could cause actual results to differ materially from those discussed in 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.

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

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

Thanks, Heather. And let me add my welcome to everyone joining us today. We appreciate your time and interest. I will give more details on the fourth quarter in a moment, but first I'd like to look back on 2015.

Ingredion ended the year with record operating income and earnings per share while generating strong operating cash flow of $686 million. Volumes grew 7% overall, driven by our acquisitions as well as organic volume growth in core and specialty ingredients. Our higher-value specialty ingredients sales mix grew 1 percentage point to account for 25% of our total sales.

We remain focused on continuous improvement efforts and optimizing our footprint, selling our Port Colborne plant in Canada and announcing plans to further reduce our cost structure in South America by consolidating several plants in Brazil. And pass-through pricing partially mitigated foreign-exchange headwinds. Overall, I am pleased our business model and strategic plan continued to deliver shareholder value.

As a result, North America and Asia-Pacific had record high operating income. EMEA was down, due to foreign-exchange headwinds and South America was down due to macroeconomic and foreign-exchange headwinds in the region. For our Company overall, our cash flow from operations and strong balance sheet enabled us to deploy cash to advance our strategic blueprint. Acquisitions of Penford and Kerr Concentrates have broadened our ingredient portfolio and have hit our expectations on earnings per share, accretion and exceeded our expectations on cost synergies.

During the year we increased our quarterly dividend by 7% and repurchased 435,000 shares. Overall, I am pleased our return on capital employed for the year was 11.5%, exceeding our stated long-term objective of 10%.

Now let's spend a moment on each region's performance in the quarter. Operating income in North America was $117 million for the quarter, up $31 million from last year. Overall volumes were up 17%. The impacts of our acquisitions, core growth as well as strong demand for our specialty products drove the increase.

Mexico reported double-digit specialty growth for the second year in a row as well as solid core growth. And we just announced an incremental $30 million investment in Mexico to support the growth demands of our core and specialty products in the regions. Additionally, continuous improvement programs continue to drive good operational efficiencies throughout the region.

In South America, operating income was $28 million, down $6 million from last year. Pricing actions, specialty volume growth, good cost discipline and continuous improvement projects were unfortunately offset by foreign-exchange, higher input costs and softer volume due to cool, wet weather in Argentina. Brazil continues to feel the effects of a slowing economy. Volumes were down, impacted by an accelerated decline in GDP, and domestic corn costs increased as corn exports rose beyond our expectation.

Given the macroeconomic environment, our local leadership team continued their ongoing focus on specialty ingredient growth, cost optimization and price mix management.

Although the Southern Cone economy is still challenging, we feel positive about the longer-term outlook. We expect to have short-term volatility in the first six months of this year as a significant evaluation to place late in the fourth quarter and prices haven't fully adjusted yet. As the economy adjusts, we expect a second half stronger than the first.

The Andean countries continue to perform well as specialty growth and cost discipline expand margin. We expect 2016 to be challenging for South America and we will maintain a high degree of cost and network optimization focus. In the longer term, we believe the underlying business fundamentals are positive for the future.

Moving along to Asia-Pacific, this region delivered $26 million of operating income, up $3 million from last year. During the quarter margin expansion offset currency headwinds.

Finally, the EMEA region reported operating income of $27 million, in line with last year. Higher volume and good cost management offset currency headwinds.

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

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Thank you, Ilene. Good morning, everyone.

Let me start by covering the highlights of the income statement. Net sales were up $37 million for the quarter. The majority of the increase is attributable to volume growth in our core and specialty ingredients and the addition of acquisition-related ingredients as well as favorable price mix in South and North America. This was partially offset by unfavorable foreign exchange.

Gross profit was higher by $41 million as a result of higher core and specialty volumes, the addition of acquisition-related volumes and a higher specialty mix and margin expansion in North America. Reported operating income was $55 million higher versus last year, while adjusted operating income was $24 million higher than last year. The increase in gross profit was partially offset by higher operating expenses, driven by the inclusion of Penford as well as lapping other income from 2014.

Reported operating income was lower than adjusted operating income by $3 million. Of this, $7 million is related to the settlement of the Western Sugar lawsuit, $4 million of restructuring costs associated with the Port Colborne sale and Penford acquisition, $2 million is for acquisition-related costs for Kerr, and $10 million is a gain on the sale of the Port Colborne plant transaction.

Our earnings per share, both reported and adjusted, were $1.42. For the quarter our adjusted earnings per share was $0.12 higher than last year's adjusted EPS.

Moving to the net sales bridge, our sales of $1.4 billion are higher than last year by $37 million. Volume growth contributed $131 million with price mix contributing $40 million. These positives were partially offset by the $135 million of foreign-exchange headwinds.

As we look more closely by region, you can see unfavorable foreign-exchange affected us across all four regions. Volume growth in North America, EMEA and South America were positive. And price mix was favorable by 14% in South America as we continued to price to recover currency devaluations. Adjusted operating income increased $24 million in the quarter. North America posted strong results due to core and specialty volume growth, acquisition-related volumes and lower operating costs.

South America operating income decreased by $6 million. Foreign-exchange headwinds, cooler wet weather in Argentina, higher cost for corn and other inputs were partially offset by favorable price mix due to pricing to recover currency devaluations, higher volumes and disciplined cost management.

APAC was up $3 million while EMEA was in line with last year. In APAC, margin expansion offset the effect of the strong US dollar while in EMEA volume and good cost management offset foreign-exchange headwinds.

Corporate costs were up due to continued investments in our systems, our human resources and other small items.

We will wrap up the quarter with earnings per share. On the left side of the page you can see the reconciliation from reported to adjusted. Fourth-quarter adjusted EPS was the same as fourth-quarter reported EPS. However, we did have some puts and takes, as I discussed earlier and as illustrated on the slide.

On the right side operationally we saw an improvement of $0.23 per share, primarily the result of margin improvement with some volume lift, partially offset by the foreign exchange and other expenses, largely due to lapping of a gain on the 2014 Kenyan land sale.

The nonoperational impact for the quarter was negative $0.11. Our tax rate and financing cost were higher, each of which had a negative $0.05 per share impact. The higher tax rate was driven by greater earnings in higher-tax jurisdictions as well as the income tax impact of the devaluation of the Mexican peso during the quarter. The devaluation increases the tax expense of our Mexican subsidiary, which use the US dollar as their functional currency.

Our financing costs were higher, largely due to the December devaluation of the Argentine peso. Hedge costs spiked in December and prevented hedges from offsetting the impact of the devaluation, negatively impacting the peso-denominated assets.

Additionally, noncontrolling interest was a negative $0.02 per share.

Share repurchases results in a $0.01 per share benefit.

I'm going to move fairly quickly through the year-to-date figures. Just as a reminder, these results include Penford operations as of March 11 and Kerr operations as of August 3.

Year-to-date net sales were down $48 million. The majority of the decline is attributable to unfavorable foreign exchange along with the impact of lower-priced corn, which is passed through in our selling prices. This decline was partially offset by acquisition-related and/or organic volume growth in corn and specialty ingredients as well as favorable price mix in South America.

Gross profit was higher by $127 million as a result of higher volumes, improved mix of specialty and core, lower energy in corn costs and lapping North America's adverse weather effects in the first quarter of 2014.

Reported and adjusted operating income was higher than 2014 by $79 million and $90 million, respectively. The increase in gross profit was primarily offset by higher operating expenses driven by the inclusion of Penford as well as lapping the other expenses driven by the inclusion of Penford as well as the lapping income from 2014, including an $11 million unfavorable swing in other income related to a tax indemnification payment from the National Starch acquisition. As we have mentioned on previous calls, the offsetting entry was recorded as a higher tax expense, and this had no impact on EPS.

Reported operating income was lower than adjusted operating income by $46 million, due to acquisition-related costs of $20 million, Brazil restructuring costs of $12 million, restructuring charges of $12 million related to the Penford acquisition, $7 million related to the settlement of the Western Sugar litigation, $4 million of restructuring charges related to the sale of the Port Colborne plant and $10 million of associated gain on the sale of our plant.

Reported and adjusted earnings per share were $5.51 and $5.88, respectively. For 2015 our adjusted earnings per share was $0.68 higher than last year's adjusted earnings per share.

The net sales bridge highlights volume growth contributing $387 million but was more than offset by $483 million of foreign-exchange headwinds. The price mix impact on net sales increase is largely due to pricing actions to recover currency devaluations, partially offset by lower pricing from passing along lower corn costs, relative to last year.

On a year-to-date basis foreign-exchange headwind affected us across all regions. Volume growth for the total Company was 7% and all regions were up except South America, which was flat. Price mix in North America and Asia-Pacific was lower due to passing through lower corn costs. And price mix was favorable by 10% in South America as we started to price to recover currency devaluation.

Adjusted operating income increased $90 million for the year. North America posted strong results as it had Penford volumes, corn and specialty volume growth, lower operating costs and, at last, the adverse weather from Q1 of 2014. North American price mix was down as a result of the pass-through of lower corn costs.

South America was down $7 million. Favorable price mix was offset by foreign exchange, higher corn and input cost and other expenses attributable to the inflationary environment. APAC was up $4 million while EMEA was down $2 million. In APAC, improved volume offset the effect of the unfavorable foreign exchange while in EMEA operating efficiencies and higher volumes primarily offset the foreign-exchange headwind.

As I mentioned earlier, we had again on a land sale in the fourth quarter of 2014. Absent the effect of the tax indemnification accounting, corporate expenses would have been flat year-over-year.

Moving to the earnings per share bridge, on the left side of the page you can see the reconciliation from 2015 EPS reported to adjusted of $0.37 that I spoke about earlier. On the right side, operationally we saw an improvement of $0.85 per share, primarily margin improvement with some volume lift partially offset by foreign-exchange and other expense. The year-to-date non-operational changes were a negative $0.17.

Our tax rate was higher, which had a negative $0.31 per share impact, primarily due to greater earnings in higher tax jurisdictions as well as the devaluation of the Mexican peso, which I explained earlier. This was partially offset by the impact of last year's accelerated share repurchase. The accelerated share repurchase from August of 2014 resulted in a $0.16 per share benefit.

Turning to our guidance, we expect net sales to be in line with last year. We also anticipate volumes to be slightly down from 2015, given our plant sale in Port Colborne, Canada. We expect continued growth in specialty volumes. Our range for anticipated adjusted earnings per share is $6.20 to $6.60. This guidance excludes acquisition-related and restructuring costs.

We anticipate that unfavorable foreign exchange will have a negative impact of $0.30 to $0.40 per share in our 2016 earnings per share guidance. We expect this to be partially offset by incremental pricing. As we have explained in our business model, these pricing actions typically require three to six months to take full effect.

We expect corporate expenses to be up year-over-year for continued investments in systems, human resources and other efficiencies in our business. For the year, our financing costs are expected to be slightly higher due to expected higher interest rates on our floating rate debt and our expectation to refinance our 2017 maturities during 2016. Our effective annual tax rate is expected to be approximately 30% to 32% versus an adjusted rate of 31.8% in 2015.

In North America, we expect net sales and volumes to be down from 2015, given our network optimization associated with the sale of our Port Colborne, Canada facility. It is important to keep in mind that a large portion of our sales and costs are based in US dollars, which helps us mitigate some of the foreign-exchange headwinds.

For the full year, we expect operating income to increase within improved product mix and margins. Penford is poised to hit at least $20 million in synergies, and the Kerr integration continues on track. We remain excited about the broadening of our Ingredion portfolio with solutions that consumers are increasingly demanding.

For the year, South American net sales are expected to be flat versus the prior year. We anticipate slow economic growth and foreign-exchange headwinds to continue in the region. We expect some short-term volatility in Argentina during the first half of the year but expect improvement in the back half and going forward. In Brazil we expect some volume weakness offset by good cost management. And we expect the Andean region to continue to perform well.

Throughout the region we continue to actively manage our costs to drive efficiencies and offset inflationary pressures. And we continue to look at optimization opportunities. Overall, we expect operating income in South America to be in line, relative to 2015.

Asia-Pacific and EMEA should continue to deliver modest operating income growth. We expect the APAC business to be negatively impacted by currency headwinds associated with the strengthening of the US dollar. But we expect to overcome these headwinds with product mix enhancements from continued growth in our specialty portfolio and good cost management.

We expect the EMEA region to have higher net sales compared to the prior year as volume growth offsets foreign-exchange headwinds. The underlying European business is anticipated to continue to grow, fueled by our specialty ingredients portfolio and investments in the region. However, we expect currency headwinds to partially offset the improvement.

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

Moving on to cash flow, our cash provided from operations for 2015 was $686 million, which was in our stated guidance range of $650 million to $700 million for the year. We continue to deploy our cash strategically in the form of two acquisitions, capital expenditures, dividend payments and share repurchases. We have a proven track record of both reinvesting and returning capital to shareholders and we expect to continue this in the future.

We expect cash from operations in 2016 of approximately $700 million. Importantly, we will continue to deploy our cash for capital expenditures as we concurrently explore M&A opportunities. Additionally, we expect to use cash in a shareholder-friendly way including share repurchases. We expect to spend around $300 million in capital investments in 2016 for growth as well as cost and process improvement around the world.

As Ilene mentioned, we raised our quarterly dividend by 7% in the third quarter and it is our intention to evaluate the annual dividend increases to target a dividend payout ratio in the 25% to 30% range. For the year, we repurchased 435,000 shares. We generally expect to buy back dilution going forward.

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

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

From a strategic perspective I'm pleased to report that our acquisitions and deployment of cash in shareholder-friendly ways demonstrate that our business model and blueprint for growth are working. Our underlying business is solid and performing well. And Ingredion has evolved into a leading global ingredient solutions provider with the portfolio and R&D capability to help customers develop products in line with growing consumer trends.

Additionally, we continue to take actions to optimize our cost structure for the future.

Regionally, North America is expected to continue its positive trajectory. Asia-Pacific and EMEA are projecting modest growth. And South America is expected to be in line with last year, given the macroeconomic headwinds. With our strong balance sheet, we expect to continue deploying our capital for growth, network optimization, acquisitions and other shareholder-friendly action.

And now we are glad to take your questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Akshay Jagdale, if you could state your name and company followed by your question.

Akshay Jagdale - *Jefferies LLC - Analyst*

This is Akshay Jagdale from Jefferies. Congratulations on a solid quarter.

So first, just on North America, you -- we've heard that the contract increasing has gone better than even last year and corn costs seem to be relatively benign. And then, you are guiding to Penford, delivering $20 million, at least, in synergies. In specialty, the commentary continues to be solid. Same thing on Mexico.

So why shouldn't we expect a year that's similar to this year, where you saw, throwing round numbers here, 30%-ish growth in operating income, if you exclude Penford, maybe around 25%? So why shouldn't we see continued very solid double-digit operating income growth in North America?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

I think we did comment that we would have growth in North America as well. I think there's a couple things that, if you look at this year's percentages, that don't just necessarily translate into next year. One was, don't forget we are lapping the 2014 polar vortex issue, where we had about a $0.20 impact to our earnings, which was a negative that year, which made the percentages higher so (technical difficulty) was low, as well as even in the fourth quarter last year we had some issues as the currencies fell late in the quarter, which impacted our feed pricing. And I think we commented that at the end of 2014 as well.

So the base was a little lower this year. But even excluding those items, we had a very strong year in North America.

I do think that there's a number of different variables. I think we were very satisfied with the way pricing and our contracting actually materialized for the year. But as you know, there's a variety of different impacts on that. And some of the things -- ethanol represents only 1% of our -- less than 1% of our revenues. That pricing is down and so you always have to look at a number of different factors from that perspective.

Ilene, Do you want to add something?

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

Yes. The other thing I would say is -- I agree with what Jack was saying. And on the other hand, we are excited about the opportunities in Mexico and we've continued to deliver double-digit specialty growth in Mexico. Their GDP is expected to be close to 3%, so again we [are] excited for the overall opportunities. But there is a balance there.

Akshay Jagdale - *Jefferies LLC - Analyst*

And just two more for me, so one on South America. Obviously, the devaluation causing a lot of noise here. So first on South America, can you give us some sense of what we should expect first half versus second half? And your interest expense is up a lot because of the devaluation. Can you be more specific on financing costs for next year?

And then the second question, on specialty can you just put into perspective -- you have made some long-term capital investments in that business. You mentioned 25% of sales this year. Can you give us some sense as to what you are seeing underlying growth-wise in that business for you and for the category? Thanks.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me start and then, if Ilene as anything to add, she can add it, particularly on the specialty growth side. Let me address South America first of all. I think that in our guidance we have obviously looked at a number of different issues. And we don't traditionally break out by quarter or anything our guidance. But we are seeing that, particularly in Argentina, we are looking at a relatively flat situation for the full year there. But what we are seeing is there is a little bit down in the first half of the year as prices adjust. We are actually -- and in Argentina as well we have had the export tax come off corn. And so we are waiting for the prices.

And it's fundamentally a core ingredient market, and so much of the business down there is HFCS, which relates to sugar. So we want to see those prices adjust up to world sugar prices, and then we will start to see the return of profitability, which we anticipate in the second half.

The one thing that was good about the devaluation is it did get our costs back in check, in terms of world costs, from that viewpoint.

In terms of Brazil, we are looking at Brazil starting out a little slow. And we are looking at Brazil as down overall for the full year, just because of the macro headwinds that they are facing, primarily with respect to the slow economy there.

But the Andean region is a positive note, you know, and we still consider volume growth there and margin growth. And so that's why we are ending up fundamentally flat year-over-year in South America.

I'm going to switch over to financing costs. And you had alluded to one of the charges in the quarter pertaining to the Argentine devaluation. And that's a one-off type of event that cost us a little bit of money on the hedging of some of the peso dollars there. The peso cost just went up dramatically, as everybody had anticipated devaluation in December. So that should be a nonrecurring item.

Obviously, it can happen at any point in time if people are expecting a large devaluation. We don't anticipate that to be a recurring type of item. And that would be $2 million to $3 million of that financing cost in the quarter.

And then for the full year, as you know, we have a significant amount of our debt which is variable-rate as we entered into the swaps and things. And so we were expecting financing cost to go up fairly significantly next year as -- it will partially depend on how the Fed increases the rates as well. And I think when we were looking at this, we factored in some Fed rate increases. And whether that transpires -- even yesterday was a question mark on how quickly they will be increasing the rates.

But in addition, we are also pulling up our 2017 maturities into 2016. Probably sometime in the middle of the year we are anticipating doing that, which will then lock in some longer-term interest rates which are higher than the variable rates we are experiencing today.

So all in all I think that our financing costs will be up. But I think that it's very manageable.

In terms of our specialty, I think I'm going to turn that over to Ilene. I think that's more related to our strategic piece.

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

Yes. The specialty growth -- we are very excited about our portfolio. And if you recall, little over a year we stated that our goal was to get our specialty portfolio to 30% of our total over the five-year period. And we are pleased that it has been increasing.

And, in fact, we always said that we expected the specialty portfolio to grow at the high single digit growth, probably two to three times the core. So again, it depends on the relative growth rate there.

But we continue to be a leader in the texture space and use our R&D to work with companies to develop these new solutions that are very much focused on the consumer trends. And the consumer trends continue to be very important and be very robust.

Now, we have also said that we have, as you mentioned, implemented some capital to support this specialty growth. And so that continued to be implemented last year. 2016 will continue and we will continue to look at those opportunities, as we mentioned, even in some of the Mexico investment. So that will provide us the capacity and features and capability to deliver that type of growth, to get the portfolio to 30% of the total.

Akshay Jagdale - *Jefferies LLC - Analyst*

Perfect. Thank you, I'll pass it on.

Operator

Ken Zaslow, if you can state your name and company followed by your question.

Ken Zaslow - *BMO Capital Markets - Analyst*

Ken Zaslow, Bank of Montreal. So I have a couple of questions. One is your cash flow from operations is increasing $14 million or so, but your net income is going to be higher than that. What's the disconnect? Is it just [XL] items or something like that? I'm just curious on what the differential is.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

There's two items, really, that we try to factor in. And we try to neutralize the impact of the margin accounts. It's always challenging because it's a year-end number where you are marking your foreign futures to actual. And that kind of -- even if you look at our current results, there's $30 million plus, $30 million negative on the one year. And it does flow through during the year. But we are never too sure where that is, and that's why we just target that $700 million as an average.

And then, of course, we continue to focus on our working capital as well. However, there is incremental pressure in terms of investing in our working capital as we move more into a specialty portfolio. Sometimes the inventories, etc., are a little bit larger than our core ingredients as we continue to make sure that we have the right ingredients at the right places at the right times because they are smaller lots.

Ken Zaslow - *BMO Capital Markets - Analyst*

So they should not correlate as tightly? Is that what you are trying to say?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes. I would say that the specialties just require a little bit more investment in inventories to service the customers appropriately.

Ken Zaslow - *BMO Capital Markets - Analyst*

Okay.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

As our portfolio increases to 25% plus moving forward, the inventory is impacting us by a little bit in terms of our cash flows.

Ken Zaslow - *BMO Capital Markets - Analyst*

And on your North American zone, just to make sure, how much is the divestiture? How much of a penalty is that this year?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Well, this year -- basically, it's a very little bit. You mean in the fourth quarter of this year? The transaction was really just completed in December.

Ken Zaslow - *BMO Capital Markets - Analyst*

For 2016, because you said North American volumes are going to be down due to the foreclosure, the Port Colborne closure. So I'm trying to figure out how much of a penalty because if I think about North American sales and volume, I would have thought sales would have been up rather strongly with the pricing environment. So I'm assuming that the closure is a 500 to 700 basis point decrease. Is that the right number? It just seems -- I'm surprised that your net sales are going to be down in North America.

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

Well, we don't give the specific numbers. And of course, while we said that we've sold the facility and we are trying to support our customers, so we moved some volume around, but we have not given the specific number of how much we are not supplying that particular market. Some of the other plants are able to absorb some of the volume.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

But I do think one of the things that you have to appreciate is that we did have an over-the-fence arrangement at that Port Colborne facility, which was a fairly low-margin type of product for us. It was fundamentally a liquid dextrose with high moisture levels in it. And so that has a significant impact in terms of actual volume weighting. And you will see some drag on the North American volumes in total because of that.

But really, if you think about it, it's more of a trade-up strategy from my perspective. And I think that's how you should be thinking about it. We are shedding some of the low-end volume. And so you will see a margin improvement affected by that volume dropoff, actually. And so think about it not as necessarily -- I know the numbers will work out that there's a small volume drag. But you will see there's an offsetting improvement in our margin from that as well as the fact that just by doing this network optimization, we have commented in the past that we do have significant savings of about $8 million in terms of return on this on an annualized basis in terms of our network optimization. So that will improve our margins as well.

So I think you will see a little bit of shortfall in the volumes. But I think the margins will more than offset any shortfall you will see in that volume.

Ken Zaslow - *BMO Capital Markets - Analyst*

What I was trying to get at is what base volume or base sales are growing at, in North America. I just was surprised but net, net it was down. I wasn't actually looking for -- I know you don't want to give too much detail. I was just looking for like what the base is looking to grow in North America.

But the other question I had was -- my last question is on South America. Again, your commentary is, look, we have net sales that are going to be flat. We have, obviously, FX headwinds and slow economic growth. So you are going to price over both of those? Is that how you get to neutral?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes, that as well as really focused on the costs down there. If we can't get the prices up, obviously have to drive costs down. I think the equation there is just as you expressed.

We do always have a little bit of lag on our price increases through the devaluation. And we were a little -- you might have picked up on fourth quarter there where, where corn costs moved up a little bit higher than we anticipated in Brazil because of the export of some of the corn outside the country. And probably my assumption is because the real had devalued, which [is a] nice source of US dollars.

But in general I think that you've got the formula correct. We are going to continue to chase devaluations if there is one. We do see that the US dollar as well -- we don't see quite the devaluations that we experienced this year. I think we were very successful in passing on the devaluations this year. I was actually very pleased with the way we performed from a pass-through of the devaluations.

I don't think we are going to see the same rate of devaluations this year that we've seen last year. And that's why we have curtailed our guidance down to the $0.30 to $0.40 range versus the $0.65 that we've seen this year.

And if there is further devaluations, it just means that we have to accelerate the pricing through the devaluations. And so that's how we are looking at that situation.

Ken Zaslow - *BMO Capital Markets - Analyst*

Great, I appreciate it. Thank you.

Operator

Farha Aslam, if you could state your name and company followed by your question.

Farha Aslam - *Stephens Inc. - Analyst*

Farha Aslam, Stephens Inc. The question around your specialty business. Ilene, You had highlighted that it's strong in the international markets and you noted texture. But could you share with us how that specialty business is growing despite the economic weakness we are seeing in some of those outside US markets.

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

Yes, of course. Even when I look around the world, and when you say outside the US I include Mexico in that, we think about Asia, even Europe. And what you seem to have in a place like Mexico, while there is what I call the higher end and we have solutions that are tailored towards texture and convenience, at the same time we have specialty solutions that are focused -- we call it save money. We were able to substitute starch for higher-priced oil and tailor it to the local consumer. So that would be one of the particular trends in Mexico.

If I go to some place like Asia, even targeting the Chinese market, we are able to come up with solutions, let's say, for the dairy market that are specialty-oriented and, again, are tailored towards the healthy texture side. The clean label would be another example in Europe, again where there is a set of consumers that are willing to pay more for those solutions because they get a product that could be an indulgence, it could be something that is very healthy. And they are consuming that as part of the focus on their awareness of the requirements to publish a clean label. As a -- ready meal is an example in Europe. People are -- solutions are used in gravy and in salad dressing to make the meal very palatable and very healthy.

So the different consumers -- I'd say that both segments, what I call the high-end segment as well as the save-money segment, is really alive and well in a lot of places outside the US.

Farha Aslam - *Stephens Inc. - Analyst*

That's helpful. And just my follow-up, Jack -- the guidance range is quite wide, understandable because of what's going on globally. But could you give us a read of what you factored in on the lower end and what you factored in on the higher end so we can gauge where you would fall in as we see things develop during the year?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes. First, I think the guidance range I think we have -- [thing is] reasonable. I actually think that the real one is some of the major impact is just how quickly we pass through pricing through the devaluation. It impacts both the higher and lower end of that range because if there's exchange differences that we don't really move it hits us on the lower side. If we can move the exchange through on the pricing, it will help us on the upper end of the equation.

The other one, on the -- I'll start with the lower end of the guidance as well. I think the one that we are still looking at is how slow will the volumes and business be in Brazil as well, with the slowdown in the economy there. I think that that could, if that economy does deteriorate rapidly it would take us to the lower end of our range.

And then Argentina is -- I hate to put all the onus on South America. But there is a little bit more volatility in those numbers because of the fact that we have seen what we believe is very positive changes in the Argentine environment from a macroeconomic perspective. However, they haven't filtered through the economy at this point in time and so they will take a while to move those through.

In the higher and of the range, though, I think we still -- I hate to put a lot of onus onto North America. But their volumes could continue to improve. And we can see some specialty growth coming out of North America and some good margin improvements there because of that on a mix basis.

And I would like to point out that -- we've mentioned it in the past as well. One of the things we invested in our capacity in Europe and freed up some specialty capacity in North America, which was supplying the European model before, and so we are still filling those channels up. And we commented that we were making significant investments in our specialties a few quarters back, the one in Asia as well as the one in North America will be starting up late this year, which will primarily hit 2017. But there's still some capacity that would hit us in the second half of this year. And if that gets accelerated, we could actually hit close to the top end of the range as well. So some pluses and minuses there.

In North America as well, the other piece that I would highlight is that ethanol pricing is a bit of a drag on us just because the fact that oil prices are down so dramatically. And that's the one negative that I would say.

It's not a big piece of our business. As I think I emphasized, that it's less than 1% of our total business. But dollar for dollar flows to the bottom line.

And the other component is really some of the share count. We are assuming 73 million shares, and that doesn't allow you much room. The guidance range is pretty narrow when you put it into dollars when you only have 73 million shares trading out there.

Farha Aslam - *Stephens Inc. - Analyst*

Right, that's helpful. Thank you.

Operator

Rob Moskow, please state your name and company followed by your question.

Rob Moskow - *Credit Suisse - Analyst*

From Credit Suisse. Jack, I remember talking about Argentina with you a couple years ago. And I know you've hit on it already a couple times. But just so I'm completely clear, as farmers are feeling more comfortable commercializing their corn, I think a lot went to the export markets. But are you starting to see better pricing on that, on those inputs, number one?

And then also, what has to happen first in order for your pricing to go up? Do you need to see sugar prices rise? I thought I heard that locally. Or do you just need to see your customers feel more comfortable raising price domestically?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Let me address the three categories. You summarized it fairly well, Rob. And I'll just elaborate on the three different pieces.

First of all, corn is actually moving very well through the system, both domestically and on an export basis now because I think people believe that the peso is fairly valued and so there's no reason to hold onto their corn or anything like that. I would highlight, though, that the export tax on corn has been removed. And so therefore it does put a little bit of incremental cost to us because in the domestic market it was a balance there in terms of if you export the corn you were penalized with the export tax. So that has a little bit of an impact on the import costs negatively.

But in general it's nice because of the fact that everybody is comfortable selling their corn at this point in time.

From a pricing perspective, it really is not so much in terms of passing the prices through. There's still pricing restrictions at the consumer level which they have continued till May of this year. We do think it will -- that's why we are saying the first half maybe a little choppier in terms of getting our prices up.

But the real issue there is just getting the domestic sugar price up. And I highlighted the sugar prices before because it's really the domestic prices. As people start to export sugar into the world market, we can compete with the world price of sugar. But sugar prices haven't increased to the same degree as we would expect because they are below world sugar prices today after the devaluation.

So how long will that take? It might take a few months to get them up to more world components.

The other part, in terms of input costs that you mentioned, is one of the things that happens when you have a devaluation like this is your wages and input cost like that get normalized in terms of, I would say, US dollars. Now, the thing that's kind of challenging for us to predict is what the inflation rate will be in Argentina, where we think that during the course of the year what you will see is inflation matching devaluations now. And so it's getting into I'll call it a US dollar equivalency type of marketplace, which we've operated in for years. We actually think that that's a very palatable type of marketplace because everything adjust more or less to a US dollar equilibrium.

And so I think we are very pleased. I think that that's where we are at, with Argentina.

So, for the full year we are not looking for a major recovery in Argentina. It's kind of flat to what we've seen this year. And I would like to highlight this year, in total for the year there were some pluses and minuses. But basically we hit the forecast bang on in Argentina this year as well. So where we expect the same type of the same type of -- I wouldn't say level of accuracy because there could be a lot of variables. But I think we got the market down fairly good in Argentina right now.

Rob Moskow - *Credit Suisse - Analyst*

Very good, thank you.

Operator

Brett Hundley, state your name and company followed by your question.

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

Brett Hundley, BB&T. Jack, I had two quick questions for you and then one for you, Ilene. Just so I'm sure I'm thinking about North America correctly, a lot is always made of contracting each year. But with where you have taken your business in recent years, the math I am backing into now is that, while North American contracting is likely a benefit or a tailwind for you in 2016, I'm actually getting a much bigger positive impact just from your specialty business in Mexico. And the reason I ask that is just, given the CapEx that you are putting into there, if that can be continuous in years ahead? I just want to use that to think about my forward model.

So does that make sense from a bought standpoint?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes and no. I just want to clarify a couple of things in terms of the investment in Mexico. What we are seeing in Mexico is solid growth both in the core and specialty. And we are seeing the double-digit growth in the specialty but we are also seeing good solid growth in the core as well. And the margins are acceptable down in Mexico to continue to invest in the core.

So that investment, I would say, supports both growth avenues. And so therefore it's really to grow with Mexico. I think we are seeing some positives in terms of the double digits in terms of their specialty growth. And obviously, the core is not going to grow at double digits down there; it's more with the GDP, which is still a very solid number on the core side.

And so I don't want you to overemphasize specialty in terms of the mix down in Mexico.

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

Okay, that's very clear. And then in Brazil, I'm sorry if I missed this. But with just the overall environment in South America, particularly in H1, is there any potential for you guys to pull forward some of your plant consolidation that you highlighted in 2015? I think most of it was going to be a benefit for 2017. Is there any potential to pull that forward a little bit?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

We continue to look in terms of how we can pull things forward and actually get our network optimization in place in Brazil. I think at this point in time one of the things we are doing is we are consolidating some of the capacity that we are shutting down in Brazil into other facilities, which requires relocating certain equipment. And that also requires certain customer approvals, once we start to run that equipment as well.

And so our timeline is pretty tight in terms of what we have seen so far, so we are going to hold to that timeline. And that's how we've got it structured in our guidance as well, at this point.

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

Okay, great. And then, Ilene, I had a question for you. And Jack is more strategically on specialty, and I don't know if Jim is on the line as well. But I was looking -- the genesis of the question, I was looking at a presentation by Tate recently. And they were talking about their specialty business and the focus that they want to take on North America. And of course, they were talking about certain levels of specialty that they want to reach. And they talked about investment and product innovation and plant expansion. You guys have done all that as well. You've been expanding through M&A. Kerr is an example.

But besides Tate, we see it more generally. We see this big focus on specialty both in North America and Europe. And it feels like it's getting crowded.

So I wanted to ask you about competitive advantages that Ingredion brings to the table. You obviously have this wide swath of ingredients from basic texturants all the way up to multifunctional branded ingredients. And so, maybe it's a case where there's just such sizable demand out there right now that everyone gets a piece of the action. And for the next five-plus years the marketplace is such that you will continue to grow at a very healthy rate.

If that's not the case, does it just come down to pricing in the marketplace? Or is this more about first mover advantage and protecting science with patents and things like that? Or is it know-how or just becoming large and building scale? I'm just curious if you can talk a little bit to the competitive advantages that Ingredion has in order to keep growing in the specialty space.

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

Yes, no, absolutely. We've really demonstrated a track record now with customers that we are able to work with them and develop new solutions that are very much on trend. And as you know, many of the customers are very much focused on the perimeter of the store. They have their fresh business unit. And we are the Company that they come to, to really help design the ingredients for those solutions.

And so I think one of our competitive advantages is that we've demonstrated this track record to work with these customers and get ready to help them bring to market several different solutions. And so we don't just work on one product area with the customer; we may be working with three or four. And they may come to our Bridgewater, New Jersey facility, work with us. And then we can help tailor that solution to different parts of the world.

So I think that it's a combination of our people -- and as you know, many of the larger companies are focused on the cost side and have eliminated some of their R&D people. And therefore, it makes our R&D people even more important to them, to be involved.

So I think we have the track record, the relationships and the know-how to really develop those solutions with -- and as a texture leader, we are the go-to guys as texture becomes what I call the new taste. And the customers really want to delight the consumers with these solutions.

Now, the other part of that is on the M&A side. And I think that we've demonstrated with our strong balance sheet -- and I spend a lot of my time on the pipeline of M&A, to continue to look for these opportunities where we can create shareholder value and be very much on trend for our customers and the consumers. And we actually have a track record there where we've demonstrated our ability to buy at the right price from a shareholder point of view and be very much on trend with our customers and the consumers on broadening the portfolio.

And we've done a great job of integrating these and valuing people and technology. So now, we have a track record of three different-sized acquisitions but significant when you put it altogether.

And then we go to the customers with these solutions and we are able to design the product portfolio for that particular solution that's needed.

So we expect to be able to continue to focus on M&A and find those solutions -- probably, again, I'd talk about the sweet spot of $300 million to $400 million in sales around the world, not necessarily just in North America but to really look for those opportunities, divisions of larger companies, family companies privately held, but really take advantage of other features to help us broaden the portfolio. So our competitive advantage, I think, is really in delivering results in both using our organic R&D as well as finding and integrating M&A.

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

Thanks for that, Ilene.

Operator

David Driscoll, if you would please state your name and company followed by your question.

Joe Sivo - *Citi Research - Analyst*

This is [Joe Sivo], on for David. On North American capacity, what is your estimate on how tight US wet corn milling capacity is? And are there any capacity expansion projects on the board, across that issue, that you are aware of? And if there aren't any, what would it take to see this type of announcement?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

That's kind of a three-part question. Let me first say I have not heard of any real capacity expansion projects on the board at this point in time. People are more interested in taking their finishing capacities and expanding those, and so you get a little bit of finishing-to-grind ratio improvement. And I don't want to -- as you know, we have a two-step process in the industry, where one is the growing portion, the second is the finishing channels. And you can fill out more finishing channels.

I don't expect a significant announcement on our grind expansion. I do think the industry is working at fairly high levels of utilization. Some capacity has come out of the marketplace over the last couple years. And I think it's put it in, from a grind perspective, into the high 80s type of range. On some of the sweeteners it may even be in the 90% ranges in terms of finishing channels. But I don't think that you are seeing a significant expansion; at least, we haven't heard anything in terms of rest releases on it or anything like that, from anyone. I'm not aware of any expansion from that perspective.

Joe Sivo - *Citi Research - Analyst*

Got it, thank you. And on the flat year-over-year comment on Argentina, is that for sales and profits? And if it's for profits, over the next few years do you think you could get back to the $75 million level?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes. I would say that it is for profits that we are talking about, like the EBIT line that's relatively flat. And over the next few years we are very encouraged by Argentina in terms of some of the policies that are being adopted, putting it back into a much more competitive position from a world perspective.

And so we expect it to come back. But it's obviously not a 2016 issue. It's more moving into 2017 and beyond. And so, once it gets rationalized, whether it's $75 million or $65 million, I can't give you the exact number into the future. But we expect that we would be earning our cost of capital down there, plus, down in Argentina in the future.

Joe Sivo - *Citi Research - Analyst*

Understood. Thank you very much.

Operator

Adam Samuelson, if you could state your name and company followed by your question.

Adam Samuelson - *Goldman Sachs - Analyst*

Adam Samuelson, Goldman Sachs. Maybe first, Jack, following up on the prior comments you said about no expansion in really industry growing capacity in North America but people expanding their finishing channels. Maybe if you could elaborate a little bit on that and give some examples or if you are seeing any areas of the core outside of HFCS really that you are starting to see a little bit more competitive intensity, some competitors who might have been more focused on the beverage market, maybe look to switch that grind and move it into different parts of the food channel?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

It's interesting, Adam. I think that the one area -- and we don't -- we compete in certain categories on it. But the biosolution still continues to be strong, even with oil prices where they are, where we are seeing more and more people moving some of the liquid dextrose into biosolutions, which is expanding the demand there. And that's really the one area that seems to be expanding.

Obviously, there's the expansion into more specialties across the board because of the different needs and things like that. But that's kind of a zero-sum game because you are just taking the current capacity. And so that's where I'm at with it. But maybe Ilene has a further comment.

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

The only thing I would add to that is the beer industry has announced expansions in Mexico, and they do use starch for producing their product. And I think Mexico has become an attractive place to produce. And then some of them export. So I would say that that's an important area that our industry would be prepared to supply.

Adam Samuelson - *Goldman Sachs - Analyst*

Okay, that's helpful. And then, maybe switching gears a little bit, on margins -- and this is more of a holistic 2015 over 2014. I know the trends have been strong all year, but your gross margins in 2015 were up by 240 basis points or so. I was hoping you could maybe could break that down a little bit into some of the different components, and whether that was maybe -- and obviously, the absence of some of the negatives in 2014 helped. But corn cost, productivity actions, network optimization, price mix, specialty -- any way to put a finer point on the drivers of the corporate margin expansion this year as we try to think about -- clearly, the Company is operating at a level that it has never operated before.

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

Yes. I think, if you think about the -- one of the things we've said in our earnings algorithm that we've said to people is we should have a 2% expansion in our margins over a longer period of time, assuming corn and exchange being equal. You've seen over the last couple years, whereas corn prices have come down, the denominator went down a little bit as well, because that's what caused our sales to be stable as well. And even with during the devaluations we priced through the devaluation. But it's -- to price back the margin component of that evaluation. And so that just gives you a little bit of an uplift in terms of the distortion on the numbers. The actual improvement comes from -- if you think about it, it's really a trade-off strategy from my vantage point.

1% may not sound like a lot in total but as I've been quoted in the past, 1% is a big number when you are looking at your entire business. We moved our specialties from 24% to 25%, and we have commented that they have double the margins of our core business.

And so effectively, that margin enhancement there as well as continuing to drive down our costs in terms of efficiencies really is what's driving our target of that 2% margin improvement. And I actually -- I think we are tracking very well along all the programs. And it is a combination of trading up our product portfolio and driving down our costs. And I like to emphasize the second part as well because that's within our control, and the trade-up strategy is working very nicely for us. And even components like our Port Colborne facility is illustrating how we are driving our trade-up strategy.

Adam Samuelson - *Goldman Sachs - Analyst*

Okay. And then maybe just finally, to be clear, on Penford I know you alluded to some ethanol weakness previously. In Penford -- ethanol, if I recall correctly, was about 25% ethanol of their output. And certainly 2014, when you bought it, a meaningful proportion of EBIT. Is Penford EBIT, including synergies, actually growing in 2016 or expected to grow, given ethanol industry fundamentals were there?

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

Yes, absolutely. In fact, the basis for -- one of the driving goals for buying Penford was the potato starch, which is gluten-free, non-GMO, a great way to broaden our portfolio. So we are pleased with how Penford is coming together both in the base business, even with the minor ethanol headwind from our portfolio point of view but, more so, the synergies that we alluded to that were on track. They are going well and we continue to enjoy having that product line as part of our expanded portfolio.

Adam Samuelson - *Goldman Sachs - Analyst*

Great, that's very helpful. Thank you.

Operator

We will go to the line of Sandy Klugman, if you could state your name and company followed by your question.

Sandy Klugman - *Vertical Research Partners - Analyst*

Sandy Klugman, Vertical Research Partners. Most of my questions have been asked, but perhaps a couple of follow-ups. One, the Company has very effectively offset some of the macro and FX headwinds that we are seeing through productivity initiatives.

A question is, how much further scope do you have to cut costs if the environment remains challenging?

Jack Fortnum - *Ingredion Incorporated - EVP and CFO*

That's always an interesting question. And you are probably asking somebody that's been in the Company for 30 years, so I'm always amazed at the way we continue to drive costs out of our systems. Right now we have a program which is our customer experience program which is really focused on delivering excellent services to our customers right from our core to our specialty ingredients. And that really looks at some of the distribution networks we have and really looking at how we can continue to drive cost out.

So there's always new areas to look at. I think it's unique in some of the perspectives that you can provide new technologies, you can share ideas across regions. And I still think we have a ways to go in that category.

Sandy Klugman - *Vertical Research Partners - Analyst*

Thank you, that's helpful. And then another follow-up -- things are obviously trending well with Penford and Kerr. Could you comment on what types of M&A opportunities you are seeing, given the current macro backdrop? And where do you see opportunities to either expand your product offerings or fill in geographical gaps in your portfolio?

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

Well, I think globally the opportunities are really spread out. And certainly with exchange rates, some have a better value proposition than others. We look geographically, and so there are some opportunities. We talk about Asia. I still look at Asia as some potential opportunities, both geographically and then broadening the portfolio. I think North America continues to provide opportunities, as evidenced in 2015 in terms of -- with closing on Penford and getting the Kerr acquisition done.

I think the focus really is on broadening the portfolio, though, because again, when I look at the features -- and so, I talk a lot about texture. So anything we can do to make sure that we continue to be the leader in texture will certainly be a high priority.

I've talked before about not just starch but non-starch hydrocolloids -- another way of looking at texture -- are important. And even on the nutrition side of the business, when you think about the consumer, very focused on health and wellness. We look at solutions to deliver both texture and other types of sweetness, as an example. Those are areas that would be very attractive to us and we think that we could create a lot of value.

Sandy Klugman - *Vertical Research Partners - Analyst*

That's very helpful. Thank you very much.

Operator

And we have no further questions in queue.

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

Okay, good. So just quickly, before we sign off I'll reiterate our confidence in our business model, strategy and long-term outlook. We remain keenly focused on value creation and we are committed to delivering shareholder value.

That brings our fourth-quarter 2015 earnings call to a close. Thanks again for your time today.

Operator

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