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INGR - Q3 2017 Ingredion Inc Earnings Call

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OVERVIEW:

Co. reported YTD reported operating income of $639m and reported EPS of $5.72. 3Q17 reported operating income was $233m and reported EPS was $2.26. Expects 2017 adjusted EPS to be $7.65-7.80.

CORPORATE PARTICIPANTS

Heather Kos

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

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

James P. Zallie *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Ingredion Third Quarter 2017 Earnings Call. (Operator Instructions) As a reminder, today's call is being recorded. I'll turn the conference now to Ms. Heather Kos. Please go ahead.

Heather Kos

Good morning, and welcome to Ingredion's Third Quarter 2017 Earnings Call. Joining me on the call this morning are Ilene Gordon, our Chairman, President and CEO, and Jim Gray, our Executive Vice President and Chief Financial Officer. Additionally, Jim Zallie, CEO-elect and currently Executive Vice President of Global Specialties and President of the Americas, will be participating in our Q&A session.

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 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 will also refer to certain non-GAAP financial measures, including adjusted earnings per share, adjusted operating income and adjusted effective tax rates which are reconciled to U.S. GAAP measures in Note II Non-GAAP Information included in our press release and today's presentation appendix.

Now I'm pleased to turn the call over to Ilene.

Ilene S. 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 am pleased to announce Ingredion ended the quarter with solid growth in earnings per share, operating income, adjusted operating income and adjusted earnings per share. Volumes grew by 2% driven by acquisition-related and specialty volume. The TIC Gums, Shandong Huanong and Sun Flour rice acquisition integrations are underway. We remain excited about the pipeline of projects and customer demand for new ingredients produced by these companies as well as the margin expansion potential from synergy opportunities.

Overall, I'm pleased that our business model and strategic blueprint continue to deliver shareholder value. And to that end, we announced a 20% increase in our dividend in September. Now let's spend a moment on each region's performance in the quarter.

Operating income in North America, was $179 million for the quarter, up $15 million from last year. Overall volumes were up 1% driven largely by our TIC Gums acquisition. In addition to supply chain interruptions caused by natural disasters on both us and our customers, Mexico core volumes were down for the quarter due to customer shifts in brewery.

Continuous improvement initiatives and lower input costs continue to drive good operational efficiencies throughout the region. The TIC Gums' integration continues as planned further enhancing our texture capabilities and enabling us to deliver custom solutions faster to small- and medium-sized customers. We are pleased with our profit growth as we continue to focus on our trade-up strategy underpinned by our intense customer focus.

In South America, operating income was $26 million, down $1 million versus last year. However, up $22 million from the second quarter. Our Brazil and Argentina network optimization and restructuring had made us more cost competitive, and we are pleased with the results so far. Volumes were up 3% for the quarter, but net sales were down given the pass-through of lower raw material costs in Brazil. We expect South America to maintain a tight focus on cost and continue to look at network optimization in addition to our ongoing focus on specialty growth.

For the short term, we expect continued operating efficiencies. In the longer term, we believe the underlying demographics are positive for future specialty and core ingredient growth, and believe we are well positioned to take advantage of an economic recovery as it materializes.

Moving along to Asia Pacific. The region delivered $29 million of operating income, in line with last year. Overall volume was up 8% versus last year, and specialty sales were particularly strong in China and Southeast Asia.

Our Shandong Huanong and Sun Flour rice business integrations are going well. Our Shandong cost synergies are on track for 2018, and the demand for our rice-based ingredients is strong. Just like we discussed in the second quarter, in Korea, price/mix was affected by our decision to diversify our core customer mix and repurpose capacity to higher margin sweetener blends. In the short term, moderate margin compression is expected as we shed some of our high fructose corn syrup business to make room for new specialty sweetener blends. As we continue to grow our specialty sweetener blends, we anticipate higher operational efficiency and price/mix.

Finally, the EMEA region reported operating income of $26 million, up $1 million from last year. Higher volumes aided partially by Ramadan occurring in the second quarter this year versus third quarter last year, were partially offset by higher cost in Europe.

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

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

Thank you, Ilene. Good morning, everyone. Let me start by covering the highlights of the income statement. Net sales were flat for the quarter. Higher volumes were offset by lower price/mix. Gross profit was higher by $19 million as a result of margin expansion in North America, and the inclusion of the TIC Gums business and specialty ingredient volume growth. Reported and adjusted operating incomes were $233 million and $241 million, respectively.

Reported operating income was lower than adjusted operating income by $8 million. The difference largely related to pretax restructuring charges of $5 million for our finance transformation project, and $2 million for other employee-related severance. As you recall, the finance transformation project is expected to help us better leverage our cost structure to support our strategic growth initiatives.

Additionally, we had pretax expense of $1 million for integration and acquisition costs. Our reported and adjusted earnings per share were $2.26 and $2.21, respectively. Reported earnings per share were higher than adjusted earnings per share given the finalization of the U.S./Canada tax settlement, which resulted in a tax-only deductible foreign exchange loss of $10 million.

Moving on to the net sales bridge. Our sales were flat versus last year. Volume and foreign exchange contributed $30 million and $3 million, respectively. This was offset by $37 million of unfavorable price/mix. Our price/mix change was largely driven by the pass-through of lower raw material costs in Brazil.

As we look more closely by region, you can see unfavorable foreign exchange affected South America slightly but was offset by favorable foreign exchange in EMEA. Volumes were up in all 4 regions. In North America, volume was up driven by our TIC Gums acquisition. In Asia Pacific, volume was up given our specialty capacity expansions. However, price/mix was down due to the pass-through of lower raw material costs as well as our decision to diversify our core Korea customer mix. In South America, price/mix was down driven by the pass-through of lower raw material costs.

For the quarter, reported operating income increased $12 million, while adjusted operating income increased $18 million, up 8%. North America posted strong results due to margin expansion driven by operational efficiencies and acquisition-related volumes.

South America operating income was down slightly primarily due to an Andean region pricing lag. As we've explained in the past calls given our business model, these pricing actions typically require 3 to 6 months to take full effect.

Asia Pacific was flat and EMEA was up $1 million. Corporate costs were down for the quarter given timing of expenses.

We'll wrap up the discussion of the quarter with earnings per share. On the left side of the page, you see the reconciliation from reported to adjusted. On the right side, operationally, we saw an improvement of $0.16 per share, primarily the result of volume of $0.08 per share due to acquisition and specialty-related ingredients, and margin of plus 6% per share with a lesser benefit from foreign exchange.

Moving to our nonoperational items. We recognize the benefit of $0.09 per share for the quarter. Our adjusted tax rate was lower, contributing $0.08 per-share benefit. The lower tax rate was largely driven by the appreciation of the Mexican peso during the quarter and resultant valuation of the U.S. dollar-denominated balances in Mexico, versus last year when the Mexico peso was depreciating. Our shares outstanding reflect a benefit of $0.03. These benefits were offset by higher financing costs and noncontrolling interests.

I'm going to move fairly quickly through the year-to-date figures. Net sales were up year-to-date. Higher volumes and foreign exchange more than offset lower price/mix. Gross profit was higher by $50 million as a result of margin expansion in North America and higher volumes from the inclusion of the TIC Gums business and organic growth in specialty ingredients. Reported and adjusted operating income were $639 million and $674 million, respectively. Reported operating income was lower than adjusted operating income by $35 million. This difference is largely related to pretax restructuring charges of $17 million in Argentina for employee severance, as we took action to improve efficiency and lower our operating costs; $5 million for our finance transformation initiative, and $1 million for other employee-related severance. Additionally, we had pretax expense of $12 million for the integration and acquisition costs, including the fair value markup of acquired TIC Gums inventory. Our reported and adjusted earnings per share were $5.72 and $5.98, respectively.

Moving on to the net sales bridge. Our year-to-date sales were up versus last year. FX contributed $36 million. However, volume was the biggest driver and contributed $125 million. This was partially offset by $70 million of price/mix. Our price/mix was largely driven by the pass-through of lower raw material costs.

As we look more closely by region, you can see unfavorable foreign exchange affected EMEA, predominantly driven by the British pound. Volumes were up in North America, Asia Pacific and EMEA. In North America, volume was up driven largely by our TIC Gums acquisition as well as specialty ingredients. In Asia Pacific, volume was up given our specialty capacity expansions. Price/mix was down 2%, largely driven by the pass-through of lower raw material costs in 3 of our 4 regions, and the diversification of our core customer mix in Korea.

For the year, reported operating income increased $20 million, while adjusted operating income increased $38 million. North America posted strong results due to margin expansion driven by operational efficiencies and growth in acquisition and specialty-related ingredients.

South America operating income decreased by $15 million. The decrease was largely a result of Argentina's difficult macroeconomic condition and the strike in Argentina and resulting temporary higher cost during the first half of this year. Asia Pacific and EMEA were up $1 million and $3 million, respectively. Corporate costs were lower given expense timing and good cost discipline.

Moving to earnings per share. Changes from operations saw an improvement of $0.36 per share, primarily the result of volume of $0.36 per share with a lesser benefit from foreign exchange of $0.08, and $0.02 of other income. This was partially offset by a margin impact of minus $0.10 per share. The lower margins were largely caused by South America with Argentina's difficult macroeconomic conditions and temporary higher cost during the first half of the year.

Moving to our nonoperational changes. We recognize the benefit of $0.16 per share. Our adjusted tax rate was lower contributing $0.20 per share benefit for the same reasons I explained for the quarter earlier. Our shares outstanding had a per-share benefit of $0.05. These benefits were offset by higher financing costs of minus $0.08 per share caused by higher debt balance and higher interest rates.

Moving on to cash flow. Our year-to-date cash provided by operations was $524 million. During the year, we deployed cash in the form of capital expenditures, dividends, share repurchases and acquisitions. Our year-to-date capital expenditures of $222 million were up $25 million from last year, primarily driven by growth and cost savings initiatives. I'd like to note that our working capital was worse given the timing associated with the U.S./Canada tax settlement. During the quarter, we paid the U.S. $63 million but do not anticipate receiving an offsetting payment of $45 million from Canada until 2018.

Turning to our guidance. We anticipate 2017 adjusted earnings per share in the range of $7.65 to $7.80. This guidance excludes acquisition-related, integration and restructuring costs as well as any potential impairment costs. We expect net sales and volumes to be up from 2016. We expect continued growth in specialty sales. We anticipate that the impact of foreign exchange will be a positive $0.05 overall. As we have explained in the past given our business model for most regions, foreign exchange is effectively a pass-through and reflected in customer pricing usually within 3 to 6 months.

We expect corporate expenses to be up year-over-year due to continued investments in our administrative processes to strengthen our capabilities and drive future efficiencies in our business. We did have some favorable timing during the quarter, which we anticipate to reverse during the fourth quarter. We expect financing costs for the year to be in the range of $72 million to $75 million due to higher interest rates on our floating-rate debt and our refinanced maturities.

Our adjusted effective annual tax rate is expected to be approximately 29% for the year versus an adjusted effective annual rate of 29.4% in 2016. Although year-to-date, our adjusted effective tax rate has been lower due to appreciation of the Mexican peso and resultant valuation of U.S. dollar-denominated balances in Mexico, we expect Q4's effective tax rate to be in the mid-30s.

We expect total diluted weighted average shares outstanding to be in the range of 73.3 million to 73.8 million for the year.

In North America, we expect net sales to be up. For the full year, we expect operating income to be above the 2016 level with improved product mix and margins. For Q4, it's important to remember that we will be lapping a strong Q4 of 2016. Additionally, our guidance includes the continued impact of natural disasters and the Mexico customer shift in brewery.

South American net sales are expected to be down versus the prior year given the pass-through of anticipated lower raw material cost in Brazil, and the temporary interruption of manufacturing activities in Argentina, partially offset by favorable volume in foreign exchange. We anticipate a continued slow recovery of the economic activity in Southern Cone.

In Argentina, we finalized an important organizational restructuring, enabling a more cost-competitive position going forward. However, in Brazil, we are seeing some positive economic growth. 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 down relative to 2016. However, we expect Q4 to be up sequentially from Q3.

Asia Pacific and EMEA should continue to deliver operating income growth. We expect Asia Pacific business to be negatively impacted by the continued diversification of our core customer mix in Korea, but we expect to overcome these headwinds with continued growth in specialty ingredients and good cost management.

We expect our EMEA region to have net sales growth compared to prior year. We anticipate modest growth in the European business fueled by our specialty ingredients portfolio. However, we expect currency headwinds and higher input cost to partially offset the anticipated improvement. Pakistan is expected to continue its volume growth and drive for continued efficiency gains. We continue to monitor the political environment and political risks to our business.

We expect cash from operations in 2017 to be in the range of $750 million to $775 million, which reflects the payment timing associated with the U.S./Canada tax settlement, I mentioned earlier. We expect to invest between $300 million and $320 million in capital expenditures around the world in 2017, to support growth as well as cost and process improvements. Importantly, we have a proven track record of both reinvesting and returning capital to shareholders through dividends and share repurchases, and we expect to continue this in the future as we concurrently explore M&A opportunities.

That brings my section of the presentation to a close. So let me turn it back to Ilene.

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

I'm pleased with our results this quarter. From a strategic perspective, our business model remains relevant, and our blueprint continues to drive growth and maintain our momentum. Regional and sector fluctuations are offset by our geographic scope and customer diversity, and we continue to optimize our cost structure for the future while enabling investment for growth in our specialty business.

As consumer demand for healthy products grows, we are well positioned to deliver innovative on-trend ingredient solutions to meet this demand.

We are very pleased with the integrations of our recent acquisitions, and we will continue to evaluate other acquisition opportunities that add value. I am also pleased with our ability to invest our capital to support growth and deliver shareholder value as evidenced by our 20% dividend increase.

And now, we're glad to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First, with the line of David Driscoll with Citi Investment Research.

David Christopher Driscoll - *Citigroup Inc, Research Division - MD and Senior Research Analyst*

And Ilene, I want to say congratulations on the announcement for your retirement. Good luck with the next chapter, and really appreciate all the assistance.

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

Thank you.

David Christopher Driscoll - *Citigroup Inc, Research Division - MD and Senior Research Analyst*

My question is on North America and the volume environment. Can you discuss organic volume growth in North America in a bit more detail, specialty versus bulk? And kind of how does it look on a forward basis? And just by way of background, I asked this question because I just get so many investor questions on the stability of North American margins, which are in my opinion, in large part, based upon volumes, and just kind of how you guys see the outlook.

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

Okay. No, thanks David for that question. And I'm going to turn it to Jim Zallie in a moment. But as you know, we have not specifically broken out specialty volume versus bulk by region but we are -- although we've alluded to the fact that the growth in specialty has continued to do well in the mature industries and so North America as a region, in general, is a more mature region, though of course, Mexico is considered a more emerging region. But Jim, why don't you take some of those details.

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

Yes. David, let me start by just answering the question related to quarter 3. So for the quarter 3, what I would say in our core business, our core sweetener business, volumes were fine in U.S./Canada. In Mexico, we saw some headwinds, primarily related to the brewing sector and also some moderate impact due to natural disasters. And for specialties, for the quarter, we basically were flat but in line with our expectations for the full year. And our focus going forward in specialties in North America, is really intense customer focus to understand all of the shifts that are taking place with consumer demand that are impacting our customers and focusing on providing the right solutions to those customers that are driving the growth in innovation. And we believe that our on-trend ingredients very much lend themselves to support those customers and their needs. So going forward, I think we're pretty optimistic about the future as it relates to specialties growth in North America.

David Christopher Driscoll - *Citigroup Inc, Research Division - MD and Senior Research Analyst*

So just let me be clear, like when you tie it all together for North America, does some small amount of positive volume growth feel like a reasonable outlook for this segment and then that would fundamentally support the existing margin structure. Is that a fair statement? Would you agree with that?

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

Hey, David, this is Jim Gray. Yes, I would say that we get weighted up average for Mexico over the long run. I think within U.S./Canada, we experience at least a bit of headwinds in some of the core sweeteners. But we think it's more than offset by some of the other sweetener segments and the starch segments and in particular, the specialty segments that we participate and compete in. And so yes, I think you're going to see modest sales growth but you're going to support that in terms of our overall margin mix and our margin improvement as we've kind of put forth in the algorithm.

David Christopher Driscoll - *Citigroup Inc, Research Division - MD and Senior Research Analyst*

And then just completely separately, some of the food companies have been indicating that they see some early signs of improvement in the emerging markets. Can you give us your viewpoint on that topic? And obviously, your Latin American business has been a struggle. So I mean, are there any indications that you're seeing some improvement within the emerging markets?

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

Well, this is Ilene. I'll start off and then -- on EMEA and Asia-Pac, and then turn to Jim Zallie, on the Americas. Certainly, in Asia-Pac, I think we mentioned, in places like China and Southeast Asia, we continue to see some improvement in -- and certainly with our focus on the specialty environment. And so we've been able to come up with solutions to really address the growth in those markets such as dairy, even the focus on clean label. EMEA, certainly the Europe side, where we have a very strong specialty franchise, has continued to perform. And then Pakistan is an area where we are growing specialty. So we do see in the emerging areas the opportunities. Even in Korea, consumers want to eat healthy. So we are well positioned with our solutions that we move from one area to the other and localize. But let me turn it to Jim, to talk about, especially South America there.

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

Yes. What I would just say for South America is that specifically in Brazil, that we're seeing a little bit of economic uptick from a standpoint of what that means going forward. And we've got a very intense focus there on specialties, and our specialties business continues to do well there despite some of the macroeconomic headwinds that have impacted that region. So I would say the economic uptick in Brazil is just starting, and we expect that hopefully to continue going forward into quarter 4 and into 2018.

Operator

Next, we'll go to Rob Moskow with Credit Suisse.

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

And Ilene, thank you for all your years of work on Ingredion. You really remade the company and set it up for success. So congratulations.

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

Thank you.

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

And for Jim, I just wanted to ask you about specialties being flat for the quarter. Nothing wrong with the quarter being flat. But my impression is that this is a growth business. And was there anything specific that caused it to be flat or -- and you said you're going to work to understand customer needs. I would assume that those needs just continue to push towards healthier product formulations and you need the starches to maintain the texture. Is anything specific happening in the quarter that we should know about?

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

Yes. I would just want to clarify. So for specialties overall, on a global basis, we're actually up. The comment that I made was in relationship to the specific question on North America, where volumes were flat. But for the year in North America, volumes are also up, so for specialties. So I would just say it's kind of a timing in shifts and rounds about that you typically see within a year within a quarter. And I don't think there's anything specifically that's overly concerning right now. Again, our focus is working to find the growth in innovation that actually is occurring in the U.S. market coming from what we call emerging customers. We've got a very strong distributor network that actually cater to small- and medium-sized and emerging customers. We're working on productivity projects as -- that require specialty ingredients with the large CPG companies, and we're just monitoring all of the consumer shifts that are taking place and are very in tune to that. And we think that lends itself really well to our specialty. So again, my comments were only for the quarter. Globally, specialty's up. North America, year-to-date, specialty's up.

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

I recognize that. So Jim, like what are the leading indicators in North America specifically? Is it the number of requests for new product work? Is it reformulation work? And has anything changed in that regard?

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

I think traditionally, we work to get new product briefs from customers and that can monitor our win rates, for example, with customers what our pipeline for new innovative projects are? So we've got a very healthy pipeline and monitor that on a regular basis, on a customer-by-customer basis. So we're feeling pretty good right now about the work that we're doing with customers from the standpoint of the richness of the pipeline.

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

The other thing I would add is the TIC Gums acquisition, which was very much focused on blending systems in small- and medium-sized customers is really giving us an opportunity to look at the portfolios of these customers and come up with solutions that can be offered to both base customers as well as the new customers. And so the whole purpose behind that acquisition was to really expand our types of customers and our capabilities. So that continues to make progress.

Operator

Our next question's from Brett Hundley with The Vertical Group.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

I originally wanted to ask a broad question on NAFTA, and I realized kind of quickly that I don't think any of us have a good idea of how that ends up. We all read about how things are trending but what I wanted to alter my question was, you guys have a very unique perspective because of your footprint across North America. And I wanted to see if you're hearing anything from customers in country whether it's Mexico or Canada, kind of under the broader dynamic that's occurring with the NAFTA renegotiation. And if you're hearing anything positive or negative as it relates to your in-country assets and kind of the go-forward business dynamic.

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

This is Jim Zallie. So what I would say is that, we feel that the quality of communication that's occurring between all 3 countries and what is at stake is very clearly understood and that the teams that are actually doing the negotiating, are working together extremely well and the impacts from a standpoint on food and agriculture are really understood and being communicated to representatives at the state level such that the governments involved will have all of the information at their disposal to make a very relevant decision at the end. So -- and then obviously, we're working through our industry organization, which is the Corn Refiners Association, to communicate in relationship to the impacts to our industry. So we feel communication is excellent and that all the facts are on the table, and we're developing, obviously, all of our plans for whatever the outcome may be to continue our business model.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

And I guess, where I was ultimately driving with here is a lot of people think about NAFTA dissolving as a worse case scenario for a lot of industries, particularly across agriculture. But what I'm increasingly wondering and I'm curious if you guys have had these conversations internally is, if NAFTA does dissolve, is that potentially even a net benefit for Ingredion? Ilene has long talked about the localness of these businesses. I'm just curious given your asset footprint if that's something that you -- even if benefit is too strong of a word, if you can navigate that better than many might think.

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

Yes. We really support free and open trade. And so that's really how we think about it. And that even after the sugar suspension agreements were renegotiated, we thought very balanced. We looked at that as -- we -- made us very hopeful that it'll all work out to be what it ought to be. So we continue to support that open trade and believe that, that's the course that we'll end up being at. And so we don't take a position and are not having these discussions, what if, we're obviously well planned, we have local ingredients. We still continue to, from a specialty point of view, take solutions from one area to another. And so as an example in Mexico, it's certainly very important that we have specialty solutions that help the consumer product companies save money, and we actually work on those briefs with those customers, but as it relates to NAFTA, we believe that the open trade will continue and be very important.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay. And then I just have a question on APAC and then I'll yield the floor. So I wanted to go back to an announcement that Thailand made on instituting tariffs for sweet and beverage imports. And I wanted to tie that back into product mix changes that you guys are seeing in your Korean business. And I'm just curious whether you're -- with what you're seeing in Korea, if you're seeing the potential for more action like that, more broadly across the APAC region, and what that means for maybe near term -- both near-term volumes and longer-term margins for that geographical segment for you guys?

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

I'll start off and then Jim Gray can add something. But I would say that I've been actually very excited about the trends in Korea towards healthy specialty type ingredients. And that has given us the energy to really come up with formulations, especially in the sweetener area, to serve that market with those solutions. And it's not driven by any type of tariff or tax talk anywhere. And so I look at that as the culture of Korea being -- really want to be driven towards healthy ingredients. So there's always discussions in different regions of how this might -- different taxes and trade. But for the most part, we are very focused on the consumer and the demand for these healthy ingredients and the millennials that are buying their products as they sit on their technology, their phones on their way home from work, whether it's in China or Thailand, and coming up with solutions that end up in the grocery stores. So we feel that, that region is really -- it's a young region, it's very ripe with wanting healthy, clean-label solutions. So Jim?

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

I -- maybe just to comment specifically on Thailand. As I interpreted, that import tariff was primarily designed just to tighten up the local market to support farmers of tapioca and rice. I view it as somewhat temporary. It might be in place for a year or so, but it didn't seem to indicate that it was kind of a permanent shift in the government's view on tariffs.

Brett Michael Hundley - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

And Ilene, let me echo my same thoughts that have been passed along here thus far. Congratulations on a job well done on Ingredion.

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

Thank you.

Operator

Next question's from Ken Zaslow with BMO Capital Markets.

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

Ilene, also good luck, and we wish you the best and you've done a remarkable job with Ingredion, and thank you very much.

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

Thank you.

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

Just going to the guidance for a second. You kind of indicated that it's going to be on the higher end of the guidance. Can you talk about the level of conservatism given that you exceeded expectation in the quarter and your nonoperating opportunities of FX, lower tax and lower interest rates is probably about $0.25 to numbers. Why only raise it -- why only kind of put it to the high-end? Is there something fundamentally a little bit more difficult than you thought because, again, it just seems like with the B+, the $0.25, you would be above the guidance. Can you talk to that?

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

Sure, sure.

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

I'm going to turn it to Jim Gray.

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

Yes, Ken, I don't know if I necessarily -- oh, you're saying the $0.25 in total, okay.

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

Yes, yes. FX is up $0.05, tax is up $0.10 and probably, interest expense another $0.08 or $0.09, in that range. I might be off by $0.01 or $0.02, but order of magnitude.

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

Yes, yes. So just maybe 1 or 2 things, but the FX does pass-through too on the tax rate that's in the adjusted effective tax rate. The way we're kind of looking at Mexico resolving from a tax perspective, we're seeing a little weakening in the peso here going into Q4. To remind you, at the end of the year, we value -- we revalue our U.S. dollar-denominated balances that sit on our Mexico books. And we have a tax liability or a tax benefit. So if Mexico peso devalues a bit, we're going to have a bit of a tax liability, so that's why we guided a little bit more towards the adjusted effective tax rate being in the mid-30s. So that's going to be one. I think operationally, what we're seeing is -- really, what we're a little bit cautious about is just some of the impacts that a natural disaster, specifically Harvey, have had on some of our key inputs. And as that -- particularly chemical industry has been pretty well matched on supply and demand, has taken a little while for them to catch up on available supply. We're thinking that's going to have some pressure on input cost. So we're just a little cautious there. I think in Asia-Pac, we're a little also cautious just a little bit on -- right now, what the -- the rain and -- have had on the impact in tapioca root. We're seeing some price increases on root costs. It's pretty normal. We've been through these changes in the past but it could have a pressure for a quarter or 2 on some costs that we see in Asia-Pac.

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

Okay. And then my next question is in terms of Mexico, can you give us an update on your volume movement there?

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

Volume movement in Mexico?

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

Yes. How is that trending, particularly given the consolidation on the beer industry and stuff like that? I didn't know if there's any update on that.

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

Yes, I'm going to let Jim Zallie handle that.

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

Yes. As I mentioned earlier that there were some headwinds in Mexico, primarily related to shifts in brewery. And specifically, what happened is 2 of our larger customers were optimizing their network, 1 in particular -- and shifted their mix of adjuncts. And so we did see some volume decline but longer term, our products are very competitive for that market. And we used that position, obviously, and the leverage we have from an operational efficiency standpoint to drive our specialties business in Mexico. So -- but that's what's happening with brewing in Mexico for the quarter, and it's something that probably will go into a little bit of quarter 4 but long term again, cost competitiveness on our ingredients for the brewing sector remain intact.

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

But it would not affect 2018, is that fair?

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

I don't think we anticipate anything acute in that area for 2018.

Operator

Next, we'll go to Farha Aslam with Stephens.

Farha Aslam - *Stephens Inc., Research Division - MD*

And Ilene, my congratulations as well. You've had a fantastic effect on Ingredion, over the years.

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

I'm very excited.

Farha Aslam - *Stephens Inc., Research Division - MD*

And when we look at South America, I mean that's the segment that's really -- you see the delta quarter-to-quarter. Could you share with us your outlook on how you expect South America to recover? And longer term, what's the earnings power of South America, going forward?

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

I'll start off, since I've had discontinuity and then I'm going to let Jim Zallie give his view. He was in fact just down there. I do see the -- I always like this green shoots -- Brazilian raised their GDP. It's starting to come back. That is exciting. And a lot of people wanting healthy solutions. We're going to grow specialty down there. We've really nicely optimized our footprint in Brazil. And by taking the right costing actions in Argentina, we really feel like we've made some progress in that area. And of course, Colombia GDP is in better than the other 2 and has some nice forecasts for next year and the year after to come back. So we think that South America is an exciting market and many of the solutions that come from North America can be used down there, of course, altered to the particular area. So I think the challenges have been more in the shorter term. So I know -- Jim, would you like to add something to that?

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

Yes. I think that we have been waiting for where the bottom is going to be for South America, and I think Brazil feels like it's reached that. I think one of the things that's important to highlight is the political stability, if you want to call it that, in both now Brazil and Argentina. Specifically in Argentina, it appears the mockery government has won in most recent parliamentary and senate elections. And so he seems to have more of a mandate. It seems like the President of Brazil is going to be able to finish his term. So what I am feeling is that there's political stability between those 2 countries and they're very large trading partners with one another. And the GDP forecasts for quarter 4 and for 2018, are certainly up in comparison to what they have been. So we are seeing the feelings of green shoots in Brazil right now. So that we remain optimistic on that. And the Andean region imposed the VAT, which kind of moderates its growth and the consumer confidence there has come off a little bit. But overall, again, it's a more specialties business for us and continues to grow nicely. But I would say that what's optimistic is the political stability and consumer confidence. Ilene talked about GDP increasing. Inflation is also coming down in both Argentina as well as Brazil, and also unemployment is coming down in Brazil. And so we think all of those factors collectively make for a brighter outlook for 2018 than 2017.

Farha Aslam - *Stephens Inc., Research Division - MD*

Helpful. And Jim, as you take over leadership of Ingredion, do you anticipate maintaining the company's target of double-digit EPS growth?

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

Well, what I would say to that is that, we have November 14 on your calendars for the Analyst Day, and that's the purpose of that, and we look forward to seeing you there and everyone else.

Operator

Our next question is from Akshay Jagdale with Jefferies.

Akshay S. Jagdale - *Jefferies LLC, Research Division - Equity Analyst*

Ilene, congratulations. You'll be dearly missed.

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

Thank you.

Akshay S. Jagdale - *Jefferies LLC, Research Division - Equity Analyst*

So I wanted to ask first about just this year, how it's panned out relative to your initial expectations and the implications that, that might have on '18. So since you gave your first preliminary look in 4Q, the EBIT, the EBIT pre-FX, if I may, or constant currency is weaker than what you're -- maybe thought, right? And so there's been some pretty significant issues, right? You got the South America issue, which is probably the biggest one, the brewery customers in Mexico and then the APAC's mix shift. So first, am I capturing the main headwinds relative to what you thought was going to happen? And secondly, some of those things are going to come back in '18, right? Specifically, in South America, you've got this cost savings, I think it's $8 million next year and these $10 million-or-so in transitory costs in the first half. So can you just help me -- I'm trying to get a sense of '18, like some of these issues seem like they were pretty big and transitory this year, but should benefit next year. So am I thinking about that correctly? Maybe you can give us a little more color there.

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

Well, it's Ilene, I'll start off and then I'll turn it to Jim Gray and we are working through next year. And as you know, we don't give guidance for 2018 yet. We will at the fourth quarter call. But it's interesting, actually, I was looking back at the original guidance last February of $7.40 to $7.80. And there was a lot of water ahead of us in the year. And today, to really bring the bottom up and we brought it up to $750 million at the end of Q1 and then now we're bringing it up to $755 million. So I would say that we're certainly still in the original range and more of the above in the first -- in the top half of the original guidance. So things have really -- many positive things have happened to help us be in the trajectory that we've committed to on our algorithm. I would say, certainly, you've been able to point to the things that we've been very transparent on, whether it's -- obviously, when we gave that guidance, we weren't ready to do the restructuring in Southern Cone, and so we've been through the whole Argentina issue. And we've denoted some things with the brewery, and then of course, some of the natural disasters we really weren't dialing in, but we've been able to have a number of things to be -- to offset that. And of course, we were excited about the sugar suspension agreement and how that's been navigated by our government and industry as we went through all that. So I think you've captivated a lot of the main events but I would not say that our results are weaker than we anticipated, I think they're right on. And so it really is all about setting ourselves up, growing our specialty, our specialty growth is on track with our algorithm and so I think that when we have our Analyst Day and you'll hear us continue to talk about our excitement of growing our specialty strategy and some of the bolt-ons that we got on -- we got that done in 2016. I mean, TIC Gums was the end of last year, the rice one was completed on March 11. So really, we are getting -- we're still working through all the benefits of the integration of these specialty acquisitions. So I know, Jim, how do you think about the -- all these sides...

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

Yes. Akshay, I think it's interesting that you pick up on those 3 events. First, in South America, particularly in Argentina. And we did have some one-time costs that were captured within our operating income. Those are transitory. But we really had to take the actions to do everything we could to set ourselves up for the best success we can going forward. And I think that's what we've done in Argentina. I think when you think about Mexico and the headwinds that we've experienced a little bit in brewery, customers have to resolve things in mergers and plant shifts and so it's not -- it wasn't unexpected and it's something that we're very capable of managing through in the long run. So still feel very optimistic about the cost base that we have in Mexico and our ability to compete and win, particularly whether it's adjunct inputs or other specialty ingredients or other starches within Mexico and kind of really love the Mexico market opportunity. When you think about Asia Pacific, I don't want to show -- necessarily focus on necessarily what we're doing in our Korea core mix shifts. That's -- those are lumps that we have to take. We're moving towards more specialty blends, but more importantly, we've made some great investments in Asia-Pac that really set us up in other organic platforms, notably rice as well as expanding in tapioca, that we feel are very, very on-trend. So I would say I'm really excited about the longer-term smart moves we've made in Asia-Pac. And then kind of excited to see how that's going to play out in '18 and beyond. And then finally, I just -- I don't want to underplay, but TIC Gums acquisition is going to -- is really going to be beneficial. It's a wonderful marriage of furthering our capabilities in both starch as well as gums, we're on some very, very unique platforms there and love the customer service spirit that we have in TIC Gums. And I think that's going to really play well for us, not just in North America, but elsewhere across the globe.

Akshay S. Jagdale - *Jefferies LLC, Research Division - Equity Analyst*

Perfect. Yes, I didn't mean to imply it's been worse year in any way, it's been a very solid year but below the line items, right, so you've had several benefits there, slightly lower tax rate, lower financing costs than initially I guess expected. So you've been able to navigate through a lot of those things and I was just trying to get a sense of some of the benefits of the things you navigated through that might be coming next year. But thank you for the color. Can I ask about the contracting season? Obviously, ADM made some comments, I think, recently. So can you give us some sense of how that's going for next year and how is the uncertainty about NAFTA impacting those, if at all?

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

Yes. No, it's Ilene. And I ask Jim Zallie to be ready to make any comments here since we don't really talk about contracting this early. But Jim, how would you see that?

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

Yes, I mean, yes, I would just repeat what you just said that we -- our policy is that we don't comment on 2018 contracting until it is complete. However, just in relationship to overall industry fundamentals and industry capacity utilization remaining high and overall sweetener dynamics, we're feeling very good about 2018 as well. And again, it's really too early to understand the full ramifications of NAFTA and what is actually going to happen with NAFTA.

Akshay S. Jagdale - *Jefferies LLC, Research Division - Equity Analyst*

Okay. And just one last one for you, Jim. And I don't want you to steal any thunder from your Analyst Day here. But one of the things we hear about from investors is sort of trying to better evaluate more frequently, I guess, the value of your specialty portfolio. And I know we've had discussions with Ilene about the challenges that are posed to sort of breaking that out financially in terms of separating the cost. So my question to you is just more broader. I mean, do you think -- I mean the stock's done really well under Ilene's leadership, no doubt about that. But do you think the market is fairly valuing the specialty portfolio you have today and the opportunity going forward? Just high-level, what do you think?

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

Well, I mean I would -- this is Jim Gray. I think the market definitely has both a view of what we've delivered in terms of net sales and profit growth as well as some consensus and implicit expectation of what we can do going forward with regard to net sales and profit growth. I think that -- and it's hard for me to kind of say where the market's at. I would say though that when we look at our plans, our long-term plans and our capital allocation, we see many opportunities to further our strategic blueprint and that includes real crisp focus on specialty products and platforms where we think we can compete very effectively in the future, and compete globally. We are trying to make sure that our costs are in line to go do that so that we can leverage that growth, and accelerate that growth as much as possible. But I remain really excited about what our growth potential is from a profit perspective driven by our specialty platforms.

Operator

And we'll go to Adam Samuelson with Goldman Sachs.

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

And let me just follow on and echo everyone's comments. And Ilene, congratulations on tenure and retirement. And good luck in your -- the next part of your life. Again, there's been a lot of ground covered today. I guess I wanted to hone in a little bit on Mexico and Latin America. If you look at some of the comments made by some of the big food and beverage companies, especially the bottlers, noted a real softening in Mexico on the volume side for CSDs beyond just some of the brewing disruptions that you've already alluded to. So -- in parts of Columbia as well. I just wanted to get your sense if you're seeing the similar comments in your engagements with those customers and how the negotiations on pricing with them have evolved for 2018. And then I have a follow-up in North America.

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

Yes. It's Ilene, I'll start off and then Jim Zallie will make some comments. But we work very closely with our customers to help come up with these specialty solutions. And we do see these trends of the consumers wanting healthy ingredients around the world continuing to accelerate. They're obviously in different stages in different parts of the world, a more mature market in the U.S., Canada versus more of the growth in a place like China or even very early days in Brazil. But we do see the consumers wanting the healthy ingredients. So we're very excited about our portfolio and our ability through our Idea Labs to develop those solutions and then to localize them. But of course, when you look at some of the mature regions, the larger companies are finding challenges and have to renovate their portfolio. And some are more able to do that than others, certainly with healthy ingredients. And so that's why when Jim Gray mentioned before, again, the TIC acquisition, which brings us a newer set of customers, smaller ones to go after, that could be bought by the big ones or that we can tailor our solutions. But I still think that the acceleration of the demand for the healthy ingredients is really in every region, at different rates, and so that, that really is our whole strategic focus. And so I know, Jim, you have spent a lot of time with customers so what would you want to add there?

James P. Zallie - *Ingredion Incorporated - Executive VP of Global Specialties & President of Americas*

Yes. Just specifically, maybe to talk about some of the recent announcements as it relates to Mexico and then Colombia, I do think what we've heard from various customer announcements is that the impact of the earthquake in Mexico did have some impact on supply chain dislocations and disruptions and that impacted some of the customers that you're referring to, their business. We're not really seeing that much of an impact but we do see a small impact in quarter 3 and a little bit probably in quarter 4. But again, this will be a kind of temporary natural disaster-related impact but it won't change the fundamentals and the bullishness that we have for Mexico. In addition, Mexico GDP has kind of moderated down to the lower ends of the 2% range. For Colombia, I did allude to this fact that Colombia had been growing nicely, I would say in the 3%, 4% GDP range. This year, it's forecasted at about 1.7%. And they did impose early in the year a VAT from 16% to 19%. And consumer confidence has taken a little bit of a hit in that regard so I think consumer spending there. But the fundamentals of the country in Colombia are still very sound, very solid, and our market position which Jim talked about, our market positions in Mexico, our market positions certainly in a country like Colombia, are excellent and the cost competitiveness in which we operate lends itself extremely well to participate at a very high level when consumer activity starts to strengthen. So we don't see anything that you're referring to that are maybe natural disaster related being anything that would be protracted in regards to impacting our business.

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

Okay. And then I guess the follow-up on North America, was that -- and you alluded earlier, the specialty volumes in U.S. and Canada were flat in the quarter. Some deceleration from the first half, maybe it's a little bit quarterly noise. And just trying to understand the confidence level and the idea that it's just noise. And your -- any kind of quantification or color on your brief activity, your new product pipeline, customer win that would point to a re-acceleration in that as you move into next year, excluding kind of TIC Gums coming into the -- based on -- for organic, I guess in the first quarter.

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

Hey, Adam. This is Jim Gray. Let me comment once and then Jim Zallie can provide color as well. One of the reasons that we don't talk about specialties from quarter-to-quarter, right, is understanding that our CPG firms that we serve have different innovation cycles, right? So right now, if you're in a big CPG company, you're actually getting ready for your innovation. You've probably already approved it and the pipeline. You're beginning to make cycle because you want to have product landing whenever they're going to reset shelves, right, at Walmart or wherever else. And sometimes in your category, they may reset shelves in January, they may reset shelves in April, right? So our offtake of our demand for our new ingredients that support innovation and our customers, whether it's in clean label, non-GMO, gluten-free, et cetera, et cetera, there's various timing differences on when that offtake can go, right? So from quarter-to-quarter, it doesn't really matter. What we need to focus on are those indicators that say that we still have a robust specialty business. We look at our innovation pipeline. We look at the number of conversations that we're having, the breadth of those conversations, the quality of the customers, the size and the potential growth for those customers. That's really how we've kind of shaped our business when we're looking at, broadly across North America. So I would just say, as Jim echoed, we're still very positive on all of the technology we bring, particularly our new platforms that we're bringing in rice, in potato and evolving in tapioca and honestly, behind all the work that's done in Bridgewater and behind our commercial teams, we remain very excited about the opportunities within U.S., Canada, as you pointed out, I would say broadly in North America. And then we're rapidly working on an integration of TIC Gums into that. So with that said, I'll be purposely commercial and just say, come to November 14, because we're going to highlight some of that as well and are very kind of proud of that progress.

Operator

Our final question will be from Arthur Reeves with Société Générale.

Arthur John Reeves - *Societe Generale Cross Asset Research - Equity Analyst*

Congratulations, Ilene. Two questions from me, please. In South America, we've got operating income in the quarter of $26 million. Is that the sort of new run rate now that you've done all the restructuring, or was that affected by any one-offs in the quarter? And then my second question is about North America, just covering the previous question. You've talked before about smaller customers growing faster than larger customers. Is that still the case, please?

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

Arthur, let me take the South America kind of run rate question. So just to remind you and everyone, so South America's business tends to be a little bit more seasonal. So as we see spring, summer and then their fall, right, which is kind of that November, December, January, February, that's when we see the peak in our business there. So quarter-to-quarter, usually first half is 40%, 45% of the profit. The second half is going to be 60%, maybe a little bit more of the profit. So anticipate that Q4 will be sequentially larger than Q3. And then to answer your kind of question technically, actually, no, because we are building in some expected savings from the labor actions and the restructuring that we took in Argentina. The run rate on that savings we'll start to see that more in Q4 of '17, and then that will carry over into 2018. So we would probably expect -- if all things being constant, we would expect a bit higher run rate on a Q3 for '18 versus Q3 for '17.

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

And what I would say on the small- or medium-sized customers, yes, they are growing faster than the larger ones. So you know that the large companies are buying some of the smaller ones. And so we look at our role is really to come up with solutions that delight the consumer who may be served by any one of the size customers now and in the future. And so it's all about healthy ingredients and so our specialty starches, some of our specialty sweeteners, blends really address those different areas and those different types of consumers that we reach in different parts of the world to tailor to their tastes.

So I think we're at the end here and I know we've been through the questions. So what I would just like to send a couple of closing comments here and say that before we sign off, I'd like to reiterate our confidence in our business model, strategy and long-term outlook. We remain keenly focused on value creation and delivering value to shareholders. Thank you for all your comments and questions, and we'd like to remind you about November 14, if we haven't already, as our upcoming Analyst Day in Bridgewater, New Jersey. You're all invited. We hope to see you there. So that brings our third quarter 2017 earnings call to a close. Thanks, again, for your time today.

Operator

Ladies and gentlemen, that does conclude your conference. You may now disconnect.
