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INGR.N - Q2 2020 Ingredion Inc Earnings Call

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OVERVIEW:

INGR reported 1H20 net sales of $2.892b and reported EPS of $2.08. 2Q20 net sales were $1.349b and reported EPS was $0.98.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

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

I would now like to hand the conference to your speaker today, Tiffany Willis, Vice President, Investor Relations and Corporate Communications Officer. Please go ahead, ma'am.

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

Thank you, Victor, and good morning, everyone, and welcome to Ingredion's Second Quarter 2020 Earnings Call. I'm Tiffany Willis, Vice President of Investor Relations and Corporate Communications Officer.

On today's call are Jim Zallie, our President and CEO; and Jim Gray, our Executive Vice President and Chief Financial Officer.

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

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

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

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

And with that, I'm now pleased to turn the call over to Jim Zallie.

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

Thank you, Tiffany, and good morning, everyone. Back in early May, when we last updated you, our world and our industry were all still coming to grips with the impact of the global pandemic. While the uncertainty has persisted, Ingredion has remained an essential business in the food supply chain, continuing to provide a secure supply of ingredients to customers and meet their changing needs. I am proud that over the last 6 months, our employees have risen to the challenges, demonstrating preparedness, persistence and resilience, which has enabled us to continue to progress our strategy through these unprecedented times.

The 3 priorities that we established from the beginning have continued to guide our actions. Our first priority for employees' safety, health and wellness, has allowed us to operate our facilities and continue to seamlessly meet the needs of our customers while quickly, creatively and productively adapting to new ways of working. Second, our role during these times as a responsible corporate citizen has brought us even closer to the communities in which we operate, reinforcing the already strong local bonds and connections we have always had. Third, we have delivered on our commitment to maintain business continuity, and I'm pleased that our employees have embraced the necessary changes and disruptions from the pandemic as opportunities to reimagine and reinvent our approach to customers and deliver value in new and different ways, all while ensuring supply chain, reliability and uninterrupted service. I could not be more proud and appreciative of the dedication, caring and spirit of our global employees, and I want to thank them for embodying the essence of our purpose at Ingredion to Make Life Better.

Now turning our attention to the second quarter. We operated in an extremely challenging global environment. As COVID-19 cases increased, government responses and consumer behavior shifts significantly reduced food consumption away from home which, in turn, impacted our results. For the quarter, our global net sales were down 13% compared to the year ago period. Absent foreign exchange impacts of $59 million net sales were down 9% versus prior year. Net sales were impacted across all 4 regions by volume decline and foreign exchange impacts.

Adjusted operating income for the quarter was down 29% year-over-year and down 25%, absent foreign exchange translation impacts. The economic pressure from the current environment resulted in adjusted operating income being down year-over-year in all 4 regions. However, South America operating income was up 6% absent foreign exchange impacts.

Before moving to region performance, I want to emphasize that we continue to execute against our strategic priorities in the quarter. We have expanded our shared services in Mexico, progressed the structuring of global business services, consolidated our potato starch network in North America and closed on our acquisition of PureCircle. In addition, we continue to make solid progress on the start-up of our South Sioux City pea protein isolate facility as it has begun commissioning and certification.

We continue to execute against our Cost Smart savings program and are increasing our savings run rate target to $170 million by 2021. This $20 million increase is a direct result of our teams identifying even more effective and efficient ways to operate our business without compromising quality or service to customers.

Moving to our second quarter regional results, let me begin with North America. Sales were down 13% for the quarter versus prior year. The volume decline was impacted by significantly lower consumption of food away-from-home in both the U.S. and Canada. Sales weakness from out-of-home channels were then further impacted by government-mandated brewery shutdowns in Mexico, which occurred early in the quarter and remained throughout. I'll speak to both of these issues in greater detail in a moment.

Operating income was $101 million, down 27% versus the prior year. Sales declines from the lower consumption of food away-from-home and the brewing shutdown pressured our bottom line.

Looking closer at North America's net sales, we experienced a decline in U.S. and Canada sweetener sales versus prior year, which was primarily driven by declines in high fructose sales mainly into food service beverages. While we saw a rebound as we exited the quarter, our total North America net sales reflects the sweetener decline in U.S. and Canada. It also reflects a decline in sales of brewing ingredients throughout the second quarter in Mexico. Brewing's steep decline pressured net sales for Mexico in the quarter. And while June and July sales to brewing in Mexico have picked up substantially, recovery of our overall volumes to prior levels -- prior year levels have not yet developed.

South America exited the quarter with sales down 19% versus prior year. However, absent foreign exchange, sales were down only 1% as favorable price/mix offset the majority of the volume decline. Operating income was $13 million, down 19% versus prior year due to foreign exchange impact and volume weakness. Excluding foreign exchange impacts, adjusted operating income was up 6% as strong price/mix more than offset volume decline.

To provide more insight into our South America performance, I want to highlight our net sales trend throughout the second quarter. Our sweetener sales were consistently pressured compared to prior year and our brewing ingredient sales were volatile, with a very weak April followed by a strong bounce back in May and June. Carrying through to July, we are seeing healthy brewing ingredient sales. Sweetener sales still lag well below prior year as impulse buying of confectionery through informal channels is constrained by workers not commuting into businesses and children not attending school.

Moving to Asia Pacific, sales were down 8% compared to the prior year, due to volume decline and foreign currency. Operating income was $22 million, down 4% versus prior year as weaker volumes from stay-at-home orders were offset by improved tapioca margins and effective management of operating expenses.

Shifting to EMEA, our sales were down 8% for the quarter. Excluding foreign exchange, our sales were down 2%, driven by reduced volume from weakness in Pakistan primarily in the export-driven textile sector. This impact was mitigated by favorable price/mix and strong specialty sales in Europe. Operating income at $21 million was down 9% for the quarter. Absent foreign currency, operating income was flat compared to the prior year.

Now let me turn it over to Jim Gray, who will round out the financial review.

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

Thanks, Jim. Net sales of $1,349 million were down 13% for the quarter versus prior year. Gross profit margin was 20.1%, down 110 basis points. Reported and adjusted operating incomes were $113 million and $127 million, respectively. Reported operating income was lower than adjusted operating income due to asset closures and restructuring costs related to cost smart. Our reported and adjusted earnings per share were $0.98 and $1.12, respectively.

Second quarter net sales of $1,349 million were down 13% versus prior year. We experienced negative foreign exchange impacts of $59 million. Sales volume decline of $183 million, primarily driven by COVID-19 impacts around the world, was partially offset by $41 million of favorable price/mix.

In North America, net sales were down 13% versus prior year due to sales volume decline of negative 15%. South America net sales were down 19%, primarily driven by a negative impact of 18% from foreign exchange. Sales volume decline of 11% was nearly offset by 10 percentage points of favorable price/mix.

In Asia Pacific, net sales were down 8% as pressure was felt from foreign currency weakness and sales volume decline. Unfavorable price/mix reflects lower tapioca raw material costs in ASEANI and related pricing to customers.

EMEA net sales were down 8%, primarily driven by foreign currency weakness in Pakistan. Sales volume declines in Pakistan outweighed the rest of the region, however, the region did deliver strong price mix.

For the quarter, reported operating income decreased by $55 million, while adjusted operating income decreased by $51 million. The decrease in reported operating income versus adjusted operating income is primarily due to asset closures in our North America potato network and restructuring costs related to Cost Smart.

Operating income declined in each region, as Jim referenced earlier. The increase in corporate costs for the quarter was driven by higher legal costs, continued investments to drive innovation, and centralization of global business services into corporate.

In addition, our company incurred incremental COVID-19 expense for personal protective equipment, sanitization and health screening as well as an interim appreciation pay program at our U.S. manufacturing facilities, which has ended. This direct expense amounted to $7 million during the quarter, with the majority incurred in North America.

Turning to our earnings bridge. On the left side of the page, you can see the reconciliation from reported to adjusted. On the right side, operationally, we saw a decrease of $0.55 per share for the quarter, primarily driven by a volume decline of $0.35 and a margin decrease of $0.09. Unfavorable foreign exchange was an $0.08 impact to the quarter.

Moving to our non-operational items. We saw an increase of $0.01 per share for the quarter, driven by a favorable tax rate. Financing costs are higher due to realized losses on FX hedges as well as impacts of hyperinflation accounting. Underlying net interest expense was lower versus prior year.

Year-to-date, net sales of $2,892 million were down 6% for the first half versus the year ago period. Gross profit margin was 20.5%, down 40 basis points. Reported and adjusted operating incomes were $266 million and $294 million, respectively. Reported operating income was lower than adjusted operating income due to asset closures and restructuring costs related to Cost Smart.

Our reported and adjusted earnings per share were $2.08 and $2.72, respectively.

Year-to-date, net sales of $2,892 million were down $194 million from the same period a year ago. Foreign exchange impacts represented a $100 million headwind. Sales volumes declined of $178 million was partially offset by $84 million of favorable price/mix. The growth product platforms that comprise specialties represent 32% of net sales year-to-date. Excluding foreign exchange impacts, net sales of specialty ingredients within the product portfolio were slightly positive year-over-year, and we will provide another update regarding specialty ingredients at year-end.

Through the first half of 2020, we advanced many initiatives under our Cost Smart savings program to optimize our network and reshape our organization. During the quarter, we completed the consolidation of our potato manufacturing network in the U.S. Furthermore, we continue to advance the expansion of global business services into the functions of finance and HR. We are also pursuing opportunities in this new dynamic work environment to reengineer how we work with one another and with our customers.

We're confident in our ability to deliver on our 2020 run rate savings target of $90 million to $100 million, which is part of our now increased savings target of $170 million by 2021. I'd also highlight that our total company expenses year-to-date are down 1% despite the additional COVID-19 costs I referenced earlier.

Turning to our year-to-date earnings bridge. Operationally, we saw a decrease of $0.53 per share, driven by a volume decline of $0.38, which was slightly offset by margin improvement of $0.02 per share. Unfavorable foreign exchange and other income items represented a negative $0.13 and a negative $0.04 decline per share, respectively.

Moving to our nonoperational items. We saw an increase of $0.06 per share year-to-date, driven by a favorable tax rate, lower financing costs and other nonoperating income items.

Moving to cash flow. Cash provided by operations was $294 million in the first half. Capital expenditures were $175 million, up $19 million from the prior year period due to the timing of payments for our growth projects.

During the second quarter, we issued two senior notes aggregating $1 billion in principal and subsequently paid down our revolving credit facility and substantially lowered our future financing costs. At quarter end, we had cash and cash equivalents of $1,047 million. Following the quarter's end, we have used cash towards the acquisition of PureCircle and the redemption of our November 2020 senior notes.

Moving from cash flow to our balance sheet. We are well positioned with greater financial flexibility due to our strong balance sheet. With solid investment-grade ratings and a debt leverage ratio of 1.8x net debt to adjusted EBITDA for the trailing 12 months, we have sufficient debt capacity and solid creditworthiness to manage through future business cycles.

Turning to the third quarter. Due to the uncertainty of COVID-19, we cannot reasonably estimate full year results at this time. During the third quarter, we expect continued adverse impacts from COVID-19 on net sales across our operating segments, with recovery and sales generally correlated with easing of restrictions and increased consumer mobility. For the third quarter, we expect adjusted operating income for the company to be down in the mid-teens versus prior year, with the greatest range of potential outcomes in South America.

We expect sequential improvement in North America as the U.S. and Mexico demonstrate greater consumer mobility in comparison to the severe shutdowns experienced in quarter 2. In Q3, we anticipate South America's operating income change to be similar to quarter 2 due to the impact of the prevalence of COVID-19 cases and extended country lockdowns, combined with the fact that South America will be at the height of their winter season.

Barring a significant second wave of heightened COVID cases, we believe Asia Pacific performance can be down low single digits or better in the third quarter. We anticipate that EMEA demonstrates sequential improvement assuming that Pakistan does not experience continued or severe stay-at-home restrictions.

Regarding PureCircle, given the distressed conditions under which it is recently operating, we will be laser-focused on its turnaround for the next 12 months and anticipate mid-single digit operating losses in the near-term as the team works to drive the integration. For Ingredion, overall, we anticipate cash flow in line with changes to operating income. For the year, committed capital investments are anticipated to be between $290 million to $310 million. Our reported effective annual tax rate is anticipated to be between 29% and 33%, and our adjusted effective annual tax rate is expected to be between 26% to 27%.

With that, let me turn the call back to Jim.

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

Thanks, Jim. As we navigate this challenging environment, we remain steadfast and focused on advancing our driving growth road map and positioning our company for long-term success. We've made substantial progress across our specialty growth platforms, and I'm very pleased with the increasing breadth and depth of capabilities we are building for each of them.

Our sugar reduction platform has evolved immensely with the addition of PureCircle. The acquisition of the leading global player in the stevia space will benefit us significantly over time. PureCircle allows us to further build out our sugar reduction capabilities with an expanded global presence.

PureCircle had revenues ending its fiscal year of June 30, 2020, of $101 million. We expect to achieve both cost synergies of greater than 10% and additional revenue synergies starting in the second half of this year. Longer term, we expect to achieve high single-digit revenue growth. After a very challenging last 12 months for the PureCircle organization, now having stability and a bright future to look forward to as part of the Ingredion family, opens up a new energizing chapter for the team. We held an excellent virtual day one integration kickoff and are very impressed with the PureCircle talent and expertise.

Turning to plant-based proteins. Our South Sioux City manufacturing facility to produce pea protein isolate is scheduled to commission in the second half of this year. I recently had a chance to visit the facility and was very impressed with the overall site progress and caliber of the team that we have assembled at this new location. The project remains on schedule with primary construction complete, and the facility is entering the phases of commissioning and certification. And I'm looking forward to hosting members of our Board at the facility next month.

Our other investment in pulse-based flours and concentrates with Verdient in Vanscoy, Saskatchewan continues to advance. And during the quarter, we further complemented our plant-based protein portfolio by forming an exclusive relationship with NorQuin, a leader in high-value quinoa based ingredients.

Turning to country growth opportunities. I wanted to highlight that we will be making a significant investment to capitalize on the continued growth in the largest specialty starch market in the world in China. We have been operating in China for over 30 years and manufacturing there for nearly 20 years. And have developed a very strong reputation for delivering specialty starch solutions.

Given our strong local presence and customer preference to source locally, we have committed $85 million over the next 2 years to more than double our local supply capacity, and at the same time, optimize our global supply chain.

Before I close, I would like to reinforce that we remain guided by our 4 strategic pillars and have been making solid progress executing against each of them despite the circumstances presented by the pandemic. Specialties growth underpinned by a reputation and heritage for innovation is central to our strategy, and we are focused on making specialties an increasing percentage of our overall portfolio, broadening beyond starch and beyond corn-based ingredients.

Commercial excellence, being easy to do business with and reinventing the way we connect and co-create with customers, has progressed well despite the pandemic. As an example, the number of digital customer engagement has increased more than 300% in the quarter and customer training sessions have more than doubled. Cost Smart continues to develop momentum, not as an initiative, but as a mindset throughout the organization to drive business process simplification and efficiency with a pandemic being a further catalyst to find new ways to achieve both.

Lastly, our commitment to embody our purpose, live our values and invest in and develop our talent has served us extremely well during the pandemic, and I am confident it will continue to do so. We reinforced our value of everyone belongs, emphasizing our stance against racial injustice and the importance of an inclusive culture. And we launched a new employee value proposition this past quarter.

We also further strengthened our executive talent, and I'm pleased to share that we recently announced that Jeremy Xu will soon join Ingredion as Senior Vice President and Chief Innovation Officer. Jeremy will succeed Tony DeLio in this capacity, while Tony transitions to lead the integration of PureCircle. Jeremy brings more than 20 years of scientific industry experience, serving most recently for 4 years as President of Human Nutrition & Health at Royal DSM and for 16 years prior to that at DuPont. We look forward to Jeremy joining the Ingredion family.

I look forward to providing additional updates on the progress against our strategic pillars in future calls.

Now let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from line of Ben Bienvenu from Stephens.

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

I want to ask first about the North America business. So I appreciate the monthly cadence around sales. If we could just use that kind of June period, exit rate as a rough proxy for volume. On a weighted average basis, it looks like 3Q volume could be down kind of mid- to low-single digits. If that math is roughly correct, it looks like the margin compression implied by your overall guidance that you talked through is substantially less than 2Q. Is that just a function of better fixed cost absorption with volumes being down less than you saw in 2Q? Is it net corn cost? Could you just elaborate on what looks to be a recovery in margins? And then any elaboration on the severity of the margin compression in 2Q in North America would be helpful because that was surprising to us.

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

Yes. Let me take a shot at that and then turn it over to Jim to maybe give even some more rounded out color on this. So for North America, with operating income being down $38 million versus prior year, 2/3 of that decrease was driven by the U.S., Canada where the government restrictions and limited consumer mobility and away-from-home consumption of food and beverages led to lower sales volumes and unfavorable fixed cost absorption. To partially offset the impact of that lower fixed cost absorption, we did optimize our plant network during the quarter, short-term shutdowns, reduced discretionary spending and reduced maintenance where possible. We also incurred in the quarter $5 million directly related to COVID workplace-related measures. About $2.5 million of that was appreciation pay which was given for approximately 2 months, which rolled off at the end of May. The remaining of the decrease was driven by Mexico, where the government mandate declaring brewing as nonessential really significantly impacted our sales volumes and fixed cost absorption.

Going forward in quarter 3 in North America, based on the exit rates we've seen and based on things getting a little bit more steady and normal, we see much improved fixed cost absorption. And Jim, I'm going to turn it over to you to talk about the net corn equation.

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

Sure. Ben, the -- as we saw through the Q2, we would have had placed hedges on corn purchases that we had in the fall of last year, as we see moving into Q3, we'll see an improved gross corn cost. And then also, I would say that for co-product values, gluten meal and oil kind of remained elevated. And then we saw that those values start to decline, anyway, kind of towards the end of June. So going into Q3, we'll see an improved net corn costs relative to prior year and also sequentially.

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

And Ben, I would just add a little bit more color in regards to, say, the negative surprise for North America in comparison to the outlook we provided in early May. We were coming off of 2 robust months for food start sales and food consumed at home at the time. There was a significant decrease in demand that then manifested itself suddenly in May, and we believe that had -- that was related to our customers rebalancing their inventories and possibly less elevated pantry loading. And then the Mexican brewing shutdowns at the time in early May, we thought we're going to be lifted by the end of May, and they continue pretty much through the entire quarter, which was very surprising for us.

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

Very, very helpful. Corporate expenses were also a bit of a surprise. I think last -- we got an update from you. You were thinking that line item would be up kind of high single digits for the balance of the year. Is that still the case for the balance of the back half of the year? And if 2Q was a surprise to the high side, could you talk about maybe why? And is there potential for that to occur in the back half relative to whatever your new expectation may be?

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

No. I mean, corporate costs were not -- they weren't higher as a surprise. We -- prior to the acquisition announcement of PureCircle, we incurred legal fees and fees related to the transaction and those hit the quarter. Then once we announced the transaction and anything, while we were waiting for the vote and regulatory, then those expenses will be put towards the acquisition and integration costs. So you had some of that impacting Q2 prior to the April announcement of the acquisition.

And other than that, what we see is just -- it's just last year, we would have had probably an appropriate adjustment in bonus accrual. And this year, we're continuing and we'll look at kind of what our outlook is as we think about when is the appropriate timing for that.

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

Okay. So would you -- in light of that, would you expect corporate expenses to still be up high single digits as you had previously called out?

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

For Q3, yes, that would be in line with where we're thinking.

Operator

Our next question will come from the line of Robert Moskow from Crédit Suisse.

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

Couple of things. Can you help us quantify what the exit rate in sales was in North America? You said it got better in June and better in July. Maybe is it still down low single digit in July, just maybe a little more clarity there? And then secondly, actually I have a few more questions. But the second question is PureCircle, you called it a turnaround. Can you go a little deeper into what are the problems with business? Are there also challenges in just the overall stevia business? My sense is it has become rather commoditized. So do you -- you have a good line of sight as to what you need to fix at that company in order to -- return it to grow?

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

Okay. So let me take the North America question and then ask Jim to maybe add some color or commentary on that, and then I'll take the PureCircle, and then you equally have his commentary on that. So for North America exit rate, obviously, sales bounced back very strongly in June, and that's carrying through into July. Away-from-home is going to depressed, in our opinion. And when we look at what our exposure in North America is to food service, we have estimated that food starches are a little bit more exposed than sweeteners. And overall, it's about [25]. So the exit rate in the U.S., Canada market was probably down -- still down low single digits. And in Mexico, to mid-single digits, I would say, as it declined. And that's expected given the COVID case situation in Mexico. So hopefully, that helps. Jim, any other commentary in regards to the exit rate and the go forward?

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

Yes. The only thing I'd add is that Rob and to all listening, what we continue to look at is how much inventories of our customers' products need to be rebuilt on shelves as well as customers anticipating whether or not they need to also then build inventories as we look at potential changes in behavior going into Q3. But we have seen, I think, a strong rebound in June as we were exiting the quarter. And that's right. So that's the type of volume rates that we're seeing, volumes -- sales volumes.

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

Before we go to PureCircle, does that all add up to a low single-digit number for North America in July? You gave us the components, but we don't know the percentages would be...

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

Yes. Well, again, what I'm going to say is in July, what we see is -- I think we still see some recovery in industries like brewing and -- within Mexico. And then as we see different segments within food service, like QSR start back up, you're seeing some pull for different -- either beverage syrups or other types of ingredients that support products that go into QSRs in particular.

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

July beverage sales for us in Mexico is actually stronger than prior year. But again, food consumed away-from-home and reduce mobility is impacting overall volumes in Mexico.

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

Yes. Yes.

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

Well, I'm just going to assume it's still down low single-digit group for North America. Okay. So PureCircle?

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

Okay. On PureCircle, obviously, we're very pleased with the acquisition from a standpoint of the quality of the asset-based on its leadership position in the field of stevia, its innovation capabilities, and it's technology that we've acquired. So we're very, very pleased with that. It's no secret that PureCircle had a very difficult 12 months prior to us acquiring the business. And what we've seen is a lot of opportunity in relationship to delivering cost synergies to leverage the sales and go-to-market network of Ingredion to expand its global presence and reach. And especially the reputation with customers because the business had been hampered for about 12 months with a lot of uncertainty and that uncertainty spilled over to its customers. And with us coming in, given our reputation and equally some of the ingredients that complement its portfolio for sugar reduction has already helped immensely from a standpoint of the customer connectivity and the opportunities that, that presents.

In addition, on the cost synergy side, there's obviously opportunities from a standpoint of SG&A savings. But in addition, there's opportunities to improve its cost of goods sold, specifically with higher yielding -- executing on higher-yielding agronomics. We have a lot of experience, given our understanding of agricultural commodities. And so we believe that those 2 elements are going to enable us to earn that business around in a little bit more -- in 12 months plus.

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

Got it. Okay. My last question. That's a pretty big capital investment in China. You said you're doing it because your customers prefer local sourcing. But you've been operating there for many years, and you've been pursuing an export model into China for raw materials. Will this new model being lower cost? Or will it be higher cost because I think corn is inherently higher cost in the country?

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

Yes. No, I just want to kind of correct you, Rob. The majority of our sales in China have come from locally sourced product other than, say, tapioca for industrial starch that would make its way into China coming from Thailand. But most of the product was being manufactured at our 2 manufacturing facilities in China. It was just logical, given the growth in the country as well as the reputation we have with customers and the customers saying, we would feel most comfortable going forward with you having a larger local presence and capacity to continue to supply our needs. So for us, it was logical to expand one of those facilities, which is vertically integrated into the local corn supply chain to produce specialty food starches for the growing market. It's also noteworthy to point out that over the last 18 months, tariffs of modified food starch into China related to the dispute between China and the U.S. have increased. So this obviously would avoid those tariffs. So from a delivered cost in country, this will actually be more economical for us and allow us to be most competitive and meet the local customer requirements to source more product locally.

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

Yes. That's what I was referring to. Last year, I remember those tariffs hurt your business. And I was wondering if it locally sourcing is helping you obviate that issue or not. But I can take that offline.

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

Yes. There's -- and then there's obviously benefits from a sustainability standpoint and shipping of the product across the water, et cetera. So just overall, the investment made good sense for us.

Operator

Our next question will come from the line of Heather Jones from Heather Jones Research.

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

I just have a couple. I was wondering, in Mexico, and this may be impossible, but I just thought I'd ask. Is it -- could you give us a sense of how much of the weakness you're seeing there is COVID related limitations on movement, the breweries, et cetera? And do you get a sense of some of it's just the economy is weaker? And if you could just parse out those too? I'm trying to -- that would color how the -- how that region will recover. I'm just wondering if you have a sense of what's driving each -- which of those is driving it?

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

Yes. I would say that in the quarter, the -- obviously, the government-mandated brewing shutdowns hit us very acutely because those breweries were just shutdown and could not operate. Now that's been lifted, and we're seeing the volume, as I just indicated to Rob, coming back very strongly with July up even versus prior year. So that's a good sign. I do think that high number of COVID cases in Mexico is hampering mobility and is hampering, obviously, travel and that hampers discretionary spending on things like confectionery and food consumed away-from-home. So you're seeing that perhaps a little bit harsher impact than even in U.S., Canada for the quarter, but we're seeing it recover. And overall, I think, the Mexican food market has always proven for us as a very strong local supplier to be a very robust market for the kind of products that we supply. So we're hopeful that, that's going to continue to progress in quarter 2.

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

Okay. Thank you. And then a quick detailed question. The Q3 guidance for a mid-teens declining and consolidated EBIT. I just wanted to make sure that includes the PureCircle losses?

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

Yes, it does.

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

Okay. And then finally, just thinking about what you guys thinking about what's going on with the net corn side, what you're doing with PureCircle, how these different regions are recovering? And then what you're doing in your footprint? Could you give us a sense -- and I know it's really early, but just based on what you know now, could you give us a sense of what you're thinking as far as '21? I mean, do you think you will be able to have fully recovered from this COVID impact just with adapting? Or just if you could just share with us any initial thoughts you're having about '21?

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

I think that as it relates to '21, what we're watching very closely is what the forecasts are for food consumed away-from-home as well as how governments around the world collectively manage the health crisis, the pandemic and whether we have a second wave or not, and that's where all the uncertainty comes in. So those are the key -- the key determinant is, obviously, the prevalence of COVID cases in the countries in which we operate, as well as the impact that's going to have on mobility and food service and food consumed away-from-home. We believe we're going to continue to see elevated levels of consumption of food consumed at home. So our sales to customers that supply for food at retail and at home were feeling very good about. We think that industries like brewing will actually do well and have proven to do well when there's a bounce back, and we think that, that will continue, so we're pretty confident about that.

The big question mark is about how long food consumed away-from-home will remain depressed. And there are some forecasts that, that will continue at a subdued rate, but a slightly increased rate, year-on-year in 2021, but not getting back perhaps to 2019 levels until 2022. We're watching those forecasts like everyone else, and it's just very hard to predict, and everybody is hopeful, of course, about a vaccine and what that's going to mean. So it's just very hard to predict, Heather, really is.

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

And Heather, I mean, that's the -- as you think about the top line and what we're thinking for 2021, I also would say that in terms of our cost of materials, we're watching the different flow of demands of agro products. Recently, you've seen China, making some unprecedented corn purchases, some unprecedented soybean purchases. And so clearly, that has an effect, an impact on the potential values for co-products in the United States for 2021. So looking at cost of materials. And obviously, thinking about the corn crop and the size of the corn crop this year and the carryout. And then also, I think the third area is just continuing to advancing our growth initiatives. So where we -- you mentioned PureCircle and your preface to your question, but really just continuing in this remote way to being able to advance our growth initiatives wherever they may be in the world. And so I think that we've learned in the last 4, 5 months, how to work with teams remotely and locally. And luckily, we have a great local footprint in many countries with employees in those countries. And so that enables us to continue to get in and work things like integrations as well as projects where we're restructuring or reshaping organization.

Operator

Our next question will come from the line of Ken Zaslow from Bank of Montreal.

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

I'm going to -- let me just expand on Heather's question in a second. Let's say food service does kind of come down at a certain level, say, 5%, 10% because you don't have a full recovery of the food service sector. How did your model adjust? And how does your utilization rates adjust? Can you be flexing? Does it change the longer-term story or the longer-term growth rate here? How do we think about it in the event that food service capacity likely will not be at the same level it was pre-COVID?

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

Yes. Jim, you want to take that one?

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

Ken, I just look at it in that when you're making ingredients that broadly go into food and beverage. We're just looking at, okay, now where is the eating occasion and how are our customers adjusting, right? So while long-term food service in 2021 or 2022 might not return fully to the 2019 levels. Generally, the populations are growing, and you're going to have consumption, therefore, in home. And so we look to our customers where they're going to look at innovation and meal preparation in home and believe that there's still a desire by consumers for healthier ingredients. And we believe that we can supply those ingredients, whether it's pulse-based proteins or our food starches or our very functional specialty ingredients into those types of solutions.

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

And there are actions also, Ken, that we are taking and can take in relationship to the cost side of the equation in our network. So we highlight it, for example, the consolidation of our potato starch network in North America this past quarter with the closure of one of our facilities. And that was a facility that had exposure, which supplied coatings into better and breaded type products, which find their way into food service applications. So those are the kind of things that we also can flex to a degree, especially when the volumes are down, maybe on food service, which is a minor proportion of our overall business, maybe mid-single digits or so. There's a couple of things that we can do.

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

And Ken, just to highlight, I think, this was maybe, I don't know, ag CAGNY presentation almost 2 years ago. When you think about what was the challenge in food service, it was as you get more curbside pickup, as you get more delivery, the temperature and the taste of the ingredients needs to replicate what it is when it's in restaurant served to your table. Our ingredients help with that, right? And so much of the talk within the restaurants and whatnot is, do you get temperatures maintaining? Does it work well in the packaging? And I think that's a -- we've highlighted this...

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

So that provides an opportunity for innovation going forward to deliver the highest quality product when it gets to the consumer from a standpoint of the convenience factor and contactless pickup and delivery.

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

Do you think there will be a milestone or something that you will have to trigger another network optimization? Or do you think that flexing the different parts and being able to adapt in this environment is enough? Just trying to think about how you think about your entire network over the next 1 to 2 years or even longer term?

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

Yes. Not right now. I think that we have taken actions in recent years, as you know, to trim our network. And we think that, that's helped us better prepare for a situation like this. And we think that we can continue to optimize our manufacturing, flex, continue to work with the right customers that are going to develop innovative new products and capitalize on the opportunities presented by the pandemic. So not in the near term, do we have any plans like that.

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

Okay. And then my last question is, can you just comment on Brazil? And what you're seeing down there? And is there a stabilization of how your business is just kind of giving us a parameter for there? And then I'll leave it there, and I appreciate it.

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

Yes. Sure. So let me just talk about overall South America for a moment. So South America year-over-year, our net sales were down 19% in the quarter, but that was driven primarily by foreign exchange weakness in Brazil and in Colombia. The net sales volume was down 11% due to government restrictions, which really hampered the away-from-home consumption of food and beverages. And that was offset by very strong pricing with price/mix up 10%. And if it wasn't for the foreign exchange, year-over-year operating income was actually up in South America by 6% for the quarter.

For the third quarter, we expect sequential improvement in operating income. However, that operating income change is still going to be down year-on-year. And a lot really the story of South America is related to the prevalence of the virus. As you know, Brazil has more than 2.7 million cases, Peru has 400,000 cases -- north of 400,000 and Colombia north of 300,000 cases. Colombia just extended its lockdown through the end of August. So that is hampering just mobility and food consumed away-from-home. On a piece of brighter news, this morning, I think we all saw that the Argentine government has reached an agreement with its creditors, so that kind of bodes well for a little bit more of a -- removes a piece of uncertainty from the Argentine economy going forward. But really, the story for South America is we're seeing recovery, but the pandemic as well as it being the winter season down there had made it a little bit challenging and more difficult to predict, let's say, going forward.

Operator

Our next question will come from the line of Adam Samuelson from Goldman Sachs.

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

I guess, first, I wanted to just ask and get your view on your customers' inventories. And I guess you made some comments about the inventories on shelf for the at-home products, but more just in terms of -- in their manufacturing footprint. I'm struck when I look at the monthly sales trends in North America. It seems like your sales bottomed later than a lot of the sell-through and kind of the channel disruptions that would have happened, sweetener sales. And sell-through was worse in April, your sweetener sale didn't bottom until May. And just any sense or kind of caution around the June recovery being inventory restocking on the part of your customers in terms of their input purchases or just any framing there?

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

Yes. I would say it's just very hard to predict in conversations that I have had with customers. The supply chain in the food industry is extensive. And everyone is taking decisions, trying to read the tea leaves of the consumer and changing their ordering in different ways, and that's rippling through the entire supply chain. So I think we're going to see it be bumpy going forward. Jim, I don't know if you have any color that you'd like to add?

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

Yes. Just, Adam, I mean the uncertainty around customers in terms of just how much ingredients might have been needed for foods that were going towards in-home uses, that uncertainty was in March, right? And so you really saw kind of more of that demand, I think, in March in inventory and definitely building there. So I don't think it's to the premise of your question. I think the optimizing of customer inventories was more a result of actions taken in March or April that then impacted us in May.

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

Okay. All right. That's helpful. And then just a clarification question on PureCircle, Jim Gray. I think you had said mid single digit negative, and I wanted to just make sure that's -- that percent margins or EBIT dollars? I just wanted to make sure that we're characterizing that. And is that a quarterly number? Or is that an annual expectation for the next 12 months?

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

That was an op margin number for the next 12 months.

Operator

I'm not showing any further questions at this time. I'd like to turn the call back over to Jim Zallie for any further remarks.

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

Okay. Thank you for your time today, and I hope everyone continues to stay safe and healthy as we progress together through this next phase of the pandemic. Jim and I look forward to updating you during our next call. Thanks very much.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.
