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Darling Ingredients, Inc. (DAR)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Darling Ingredients Incorporated Conference Call to discuss the company's first quarter 2024 financial results. After the speakers' prepared remarks, there will be a question-and-answer period and instructions to ask a question will be given at that time. Today's call is being recorded.

I would like to turn the call over to Ms. Suann Guthrie. Please go ahead.

Suann Guthrie

Senior Vice President-Investor Relations, Sustainability & Global Communications, Darling Ingredients, Inc.

Thank you. Thank you for joining the Darling Ingredients first quarter 2024 earnings call. Here with me today are Mr. Randall C. Stuewe, Chairman and Chief Executive Officer; Mr. Brad Phillips, Chief Financial Officer; Mr. Bob Day, Chief Strategy Officer and Mr. Matt Jansen, Chief Operating Officer of North America. Our first quarter 2024 earnings news release and slide presentation are available on the investor page under Events & Presentations tab on our corporate website and will be joined by a transcript of this call once it is available.

During this call, we will be making forward-looking statements, which are predictions, projections and other statements about future events. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could materially differ because of factors discussed in the yesterday's press release and the comments made during this conference call and in the Risk Factors section of our Form 10-K, 10-Q and other reported filings with the Securities and Exchange Commission. We do not undertake any duty to update any forward-looking statements.

Now, I will hand the call over to Randy.

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

Thanks, Suann, and good morning, everyone. Thanks for joining us for our first quarter 2024 earnings call. As I mentioned to you during our last earnings call in February, the global ingredients markets are facing challenges due to replenish global oilseed and grain stocks, slower global consumer demand for premium ingredients, and most importantly, delayed or canceled renewable diesel start-ups. For the quarter, our combined adjusted EBITDA was $280.1 million, but it included a $25 million out-of-period inventory adjustment within the food segment. As you can see on the slides, this is the third quarter in a row we have dealt with a deflationary pricing, but we now feel strongly we are seeing the winds begin to change in a positive direction.

Now, turning to the Feed Ingredients segment. Global raw material volumes remain strong and we are seeing fat prices slowly improve. Palm and soy oil continues to hold a strong premium over waste fats and imported fats are now a premium to North America. This shows me that we are still waiting for renewable diesel capacity and pretreatment to ramp up. Global fat prices illustrate that these announced renewable diesel producers are not yet taking advantage of the economics and lower carbon intensity of waste fats and feedstocks. Also during the quarter, we completed the Miropasz acquisition on January 30, adding three poultry rendering plants to our portfolio. The plants are performing quite well and I expect them to be accretive this year. And after 481 days offline, our Ward, South Carolina rendering plant is operational, providing us much needed capacity in the eastern United States.

Now, turning to our food segment. Our Rousselot sales volumes remain robust. Segment revenue was lower quarter over last year, Q1 over last year due to a decline in selling price in collagen, gelatin and our edible fats business. Adjusting for the $25 million out-of-period adjustment related to the Gelnex inventory, gross margins in the food segment actually widened to around 30%. This is a testament to our laser focus on spread management in a declining price environment.

Now, we announced earlier this month that we have identified a portfolio of collagen peptide profiles that are believed to provide targeted health and wellness benefits. During scientific trials, these active collagen peptide profiles have demonstrated that collagen can be beneficial in reducing the post-meal blood sugar spike in a very natural way. This is a game-changing discovery that opens the door for many new product launches worldwide. Our first active peptide will be available this fall in 2024.

Turning to our fuel segment. Feedstock prices tended to trend lower and improved DGD earnings compared to Q4 2023. However, weak RINs and LCFS prices and a lower of cost or market adjustment impacted DGD earnings. The margin outlook remains favorable due to lower fat prices and our competitor advantage plus an optimistic view we have on the LCFS. Our sustainable aviation unit construction is running ahead of schedule and on budget and is planned to start up in the fourth quarter of 2024. We continue to work with a number of interested parties on SAF purchases and remain confident in our outlook for SAF.

Now I'd like to hand the call over to Brad to go through the financials and I'll come back and give you my views on 2024.

Brad Phillips

Executive Vice President & Chief Financial Officer, Darling Ingredients, Inc.

Okay. Thanks, Randy. Net income for the first quarter 2024 totaled $81.2 million or $0.50 per diluted share compared to net income of $185.8 million or $1.14 per diluted share for the first quarter of 2023. Net sales of $1.42 billion for the first quarter of 2024 as compared to $1.79 billion for the first quarter of 2023. Operating income decreased $118.7 million to $137.2 million for the first quarter of 2024 compared to $255.8 million for the first quarter of 2023, primarily due to $120.6 million decrease in the gross margin, which as Randy previously referenced, included a $25 million out-of-period adjustment of overstated Gelnex inventories.

Also, our share of the equity and Diamond Green Diesel's earnings were $15.9 million lower than the first quarter of 2023. Depreciation and amortization was $11.5 million higher, primarily due to the addition of Gelnex. We did recognize $25.2 million of income from the change in fair value of contingent consideration related to lowering an earnout liability. Non-operating expenses increased $14.9 million, primarily due to interest expense increasing $12.6 million attributable primarily to additional debt related to acquiring Gelnex April 1, 2023.

The company recorded income tax expense of $3.9 million for the three months ended March 30, 2024 yielding an effective tax rate of 4.6%, which differs from the federal statutory rate of 21% due primarily to biofuel tax incentives and the relative mix of earnings among jurisdictions with different tax rates. The effective tax rate, excluding the impact of the biofuel tax incentives is 25.4% for the three months ended March 30, 2024. The company also paid $33 million of income taxes in the first quarter.

For 2024, we expect the effective tax rate to remain about the same at 5% and cash taxes of approximately $70 million for the remainder of the year. Company's total debt outstanding as of March 30, 2024 was $4.465 billion compared to $4.427 billion at yearend 2023, primarily due to the acquisition of Miropasz on January 31. Our bank covenant projected leverage ratio at Q1 2024 was 3.71 times and we had $811.1 million available to borrow under our revolving credit facility. Working capital noticeably improved in the first quarter 2024. Capital expenditures totaled $93.8 million in the first quarter as compared to $111.3 million in first quarter 2023. No cash dividends were received from Diamond Green Diesel in the first quarter and there were no share repurchases in the first quarter.

With that, I'll turn it back over to you, Randy.

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

Thanks, Brad. For several years, we've enjoyed tailwinds from a demand-driven global economy and strong global commodity and specialty ingredient prices. We are now adapting to the new reality of abundant global supplies. In my 21 years plus at this company, I've seen this cycle many times and I am confident in the team's ability to make any necessary adjustments in our procurement processes and lowering our operating costs to regain margin leverage. In April, we saw nice progress in our core ingredients business and DGD has finally worked through its higher priced feedstocks. With SAF starting up in Q4, several contracts are underway and we remain optimistic on LCFS and DGD margin outlook remains favorable. Our goal to reduce debt and working our way toward investment grade has not wavered. Through aggressive CapEx management and a focus on improving working capital along with improved performance at DGD, I still believe we can attain by the end of – the yearend of 2024.

Additionally, as we discussed in February, we're doing a comprehensive review of our global portfolio and continue to put a strong emphasis on cost and spread management. For the full year, given what we see today around the globe with solid raw material volumes, improving premium protein and collagen demand, along with slowly improving fat prices and DGD performance, we feel optimistic that momentum will be built during the year and we will be able to deliver $1.3 billion to $1.4 billion combined adjusted EBITDA, all while setting the table for a much improved 2025.

So with that, let's go ahead and open it up to Q&A.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] . The first question comes from Dushyant Ailani from Jefferies. Please go ahead.

Dushyant Ailani
Analyst, Jefferies LLC

Q

Hi. Thank you for taking my questions. I just had the question on the guide that you have for the $1.3 billion to $1.4 billion. Does that include any reversal of the LCM adjustments or could there be additional upside to that?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

No – this is Randy. The $1.3 billion to $1.4 billion is really what we see today with a small improvement in fat prices, but really back half loaded here. It doesn't include any SAF early start-up. It's just a snapshot, as we've always done, of what we see right now. As I said in February, our hope is to beat last year, but we're going to need some help from fat prices. And ultimately, if you do and I'm probably going to answer a few questions here and have Brad help me.

But, you can go straight to the feed segment and do the kind of the year-over-year, quarter-over-quarter type of analysis. And you see 100% of that is related to fat prices being down from Q4 to Q1 by 20% and year-over-year by 35% to 40%. And so, ultimately, fat prices will drive whether that number is $1.3 billion, $1.4 billion, $1.5 billion, $1.6 billion, $1.7 billion, $1.8 billion as we come back here. We also remain and as we'll talk through the Q&A, optimistic that we'll get some LCFS bump towards the end of the year. And clearly, DGD, as worked through the higher price feedstock with the longer supply chain, it continues to outperform anybody on the street out there in the business today. So, the $1.3 billion, $1.4 billion as Suann taught me, be conservative and hopefully we'll give you some upside here.

Dushyant Ailani
Analyst, Jefferies LLC

Q

Awesome. Thank you, Randy. And then just a quick question on I guess on your leverage ratio, 3.7, any kind of updates on targets what your goal is for the year end?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah. And I've Brad, help here. Remember, the leverage ratio as a point in time of total debt divided by the core ingredients plus dividends. And so clearly, as we've been building out SAF and we had the Q3 and Q4 lower earnings of last year in DGD, dividends didn't arrive here. So, that's just a function of that. As Brad and I and Matt would tell you, cash is building rapidly in DGD and we remain optimistic on dividends, which will then pull that ratio down. It's a rolling 12-month calculation. By no means is anything change other than the delay of the dividend out of DGD. Brad, anything...

Brad Phillips
Executive Vice President & Chief Financial Officer, Darling Ingredients, Inc.

A

That's right. Just the timing and when these dividends get started, which we anticipate, as Randy just mentioned, cash is building at – has been building at DGD now and the SAF projects winding down.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

This is Matt and I would just add that on the dividend out of DGD is a – it's not a subjective policy here. It's formulaic, it's calculated every month. And so, there is not a discretionary push and pull in that.

Operator: The next question comes from Tom Palmer from Citi. Please go ahead.

Thomas Palmer
Analyst, Citigroup Global Markets, Inc.

Q

Good morning and thanks for the question. In the past, you've given a bit of a breakdown in terms of EBITDA between the base business and DGD. I know at least from your response to the prior question that maybe there is a bit more variability on the feed side, but was hoping maybe you could give us kind of a rough split of how you're thinking about the year.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

So, Tom, you're referencing really the guidance and splitting that out, is that's kind of where you're going?

Thomas Palmer
Analyst, Citigroup Global Markets, Inc.

Q

Yes, that's right. Kind of base business versus DGD for 2024?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah, Tom. If we had to throw that out there today, 900 million out of the base business is what we see today and basically a billion out of DGD. And that's 0.75 times a little over 1.3 billion gallons. Remember, just a point in time.

Thomas Palmer
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thanks for that detail. And then just wanted to follow up on kind of some of the moving pieces within feed. I mean, you noted the expectation for fat and potentially protein prices to strengthen a bit here. I guess could you walk through what the major catalysts are. I mean, obviously, there is disconnect right now between some of the products you sell and what we're seeing with, say, soybean or palm oil, what kind of bridges that gap and how quickly might that take hold?

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

So, this is Matt. I'll take the first cut at that. And so, first of all, for the last little over a year, we've been hindered by the ward plant that we've been rebuilding. And we're actually very proud of the fact that we've got that plant now up and running. We did a total rebuild of that plant in 481 days and frankly could have even done a little bit quicker if we could have gotten the equipment there even earlier. So now, what that does going forward, that allows us to leverage our footprint in the space, especially in the eastern half of the US where we've been over the last year, like I mentioned incurring some cost. And it's frankly been inefficient for the – just because of that plant being down. So, that's back up and running now. And that's something that will give us now the ability to leverage our footprint in the space.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah, that's a good point. And globally, I'd step back, Tom, and give you give you three analysis. One, there's an absolute fact here that anybody that says they're pre-treating waste fats in North America for RD isn't doing a very good job of it, or we wouldn't be a discount to where we were 10 years ago to vegetable oil, whether it's palm or soy or canola, that's number one. That impact we're seeing globally. I mean, you had European fats move in here for the first time in my career even with plus €106, €110. Brazil was moving up here and now Brazil's over US. But at the end of the day, the fat pricing drives this thing. And when you look at what's going on in the segment, you got three pieces. You've got animal fats, you got premium proteins. We saw a massive destocking of the premium pet foods.

People were trading down. That seems to have come back a little bit now. We've got great orders in that business again, so that feels much better. China was – it kind of disappeared for a little while Chinese New Year, but once again, buying the premium chicken products for the aquaculture business. And then the other piece that obviously exists in the feed segment because of shared assets is the UCO business. And that business has come down sharply and that's a very profitable business for us. And so at the end of the day, the outlook for the feed segment has improved protein demand and then a rebound in fat prices at some point in time here as we go forward. Bob, anything I'm forgetting here.

Robert Day
Executive Vice President and Chief Strategy Officer, Darling Ingredients, Inc.

A

I think you highlighted it really well and it's the spread between vegetable oil and animal fats. And as time goes on, we should see that spread tighten versus where we are. Otherwise, yeah [indiscernible] (00:19:04). Hope that helps, Tom.

Operator: The next question comes from Ben Bienvenu from Stephens. Please go ahead.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Hey, thanks so much. You mentioned the pull forward of the SAF production commissioning, making good progress there. Can you talk a little bit about the development of getting that volume contracted and the potential contribution that you think that could bring to 2025 or even 2024 Randy, as you mentioned, maybe there is some stock contribution.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

So, this is Matt. I'll again take the first cut at this. As we mentioned the plant now, we will commission in Q4 of this year, which is a solid quarter ahead of the original plan. That plan is also on budget at $315 million at the entity level, so we're tracking there. And so that's something that we're very optimistic about. I would say from a contracting standpoint, we continue to see a lot of interest in our product. We are taking what I think is the best approach towards this. And I'm confident that we'll be able to, let's say, contract the volume that we'll be producing how that plant is going to be [indiscernible] (00:20:27) at 250 million gallons on an annual basis. We don't have anything in our 2024 numbers related to the project in terms of EBITDA. But I am confident, given the state of the discussions where we are right now that we'll be able to A, meet the volume, and certainly B, meet the return expectations from that project.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah, I think that's fair enough and I don't think there's been a lot of chatter out there, Ben. It's building. 17,000 barrels a day is not going to be hard to disappear. We have plenty of interest there. It's down to the final negotiations on spread and pricing here in both the voluntary and the mandated markets. And clearly that's going to drive it here. But we have no fear of any challenges there other than hurry up and get it online.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Okay. That's great. Thank you both. As we think about kind of nearing the end of that CapEx project, you've built out DGD, you've kind of moved through the M&A activity you've had over the last couple of years. As you think about cash spend priorities from here. And I recognize you want to get leverage down and then distributions will be in the wake of that. How should we think about your appetite for continued opportunistic M&A and or incremental growth CapEx projects?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah. I mean, it's one that I'll comment on. Number one, we are on an aggressive CapEx reduction program this year. Told Brad, we're going to scale it back. We were $93.7 million in Q1. I think that's a pretty close run rate. Q1 is always a little lower because of winter weather and construction, but that also had the final bills of building out, rebuilding ward as Matt mentioned. And so, target there is $400 for the year, plus or minus a little bit there. Ultimately, we've got some pretty substantial inventories while we had a pretty big working capital reduction in Q1.

There is still more work to do there, so cash generation is key. And then the dividends out of DGD, we want to get the debt down below $4 billion and then it puts us in a different position of going forward. We will not walk away from a well-priced bolt-on, but we're going to be very, very cautious this year because our priorities are operating cost management, working capital improvement and really just getting DGD lined out and living through the lower-priced inventory. I mean, we're trying as you step back [ph] macro (00:23:25). What are we trying to do? We're trying to work towards a share base of owners of this company that both understand that there is going to be some volatility in commodities. We've got a very well managed business model globally. And then ultimately this thing once we're in position in 2025 here, we'll have chances for all kinds of share repurchases to ultimately considering a dividend and that's where we're headed.

And then ultimately, as we go into 2025, we've got some debt maturing or going current as I say. And we've got to figure out the long-term capital structure. But right now for us, it's really just as we said, it's just a real focus on margin management, spread management around the world, which I got to give credit to the team. They've done a nice job and that's what's evident if you look between Q4 and Q1 with a massive price decline again of 20%, but yet other than the inventory adjustment, you were 3 something in Q4 and 3 middle and in there 3 low in Q1 with the 20% fat price decline. And so that's attributable to people making the changes in the spread management ratios around the world.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

I would just say that we get asked regularly about what about SAF2 on top of the – subsequent to the SAF1. And we've got the engineering for that and that's something that as the year progresses, I would say given the fact that we get up and running with Q4 and we are able to contract at the margins and the returns that we are expecting. Then an SAF2 is something that we've got in the holster for some time in potentially 2025.

Operator: The next question comes from Adam Samuelson from Goldman Sachs. Please go ahead.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Yes, thank you. Good morning, everyone.

Suann Guthrie
Senior Vice President-Investor Relations, Sustainability & Global Communications, Darling Ingredients, Inc.

A

Good morning.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

So, I guess I wanted to come back to the outlook on DGD margins. And Randy talked $0.75 a gallon plus or minus. You were basically there in the first quarter, excluding the LCM adjustments. And I guess I'm trying to just think about the margin capture at DGD with waste fats still at a healthy discount to veg oils relative to obviously the reduction in margin that implies in the feed segment. And just how do you think about – is that DGD capture kind of satisfactory given kind of the pressure it has on the feed business? Or is the disconnect that the LCFS just needs to work up over 60 to get those values up and that has the double benefit of improving the margin realization of DGD and driving kind of broader demand for the waste fats for the feed business?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah. And I'll tag this with Matt here. Number one, Adam, I'm just going to step forward to say, I've learned my lesson here a little bit. We're coming out conservative. Clearly, the LCFS is not reacted to what I think is very positive future look here, I think the RINs [ph] S&D (00:26:53) is going to tighten up here because there is RD capacity in real or we wouldn't be a discount and soybean wouldn't be a discount to palm oil. So, ultimately, this is just a projection in time that we believe as we approach 2025 that that margin structure can improve quite a bit, but that's what we see right now. Matt, Bob?

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

I would just say that the other complexity to this is that there is a timing discrepancy here in terms of in our feed business, the fat prices are reflected much more responsibly in the results wherein the price movements in a DGD, simply because of the supply chain management that's required to sustain a 1.2 billion to 1.3 billion gallon business. It's got a longer tail to it. And we've seen that over the last few months as prices have fallen, the feedstock prices at DGD haven't fallen as quickly in the numbers. And so, there is a little bit of a timing discrepancy there. But in terms of in the bigger, broader picture, I would say it's doing exactly what we thought it would.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah. I think from Adam, from not to get too deep in the sausage grinding. But if we would have rewound the movie a year and a half ago, DGD3, when it came online between the system would use two thirds of North America's waste fat supply, so we made a strategic decision to qualify feedstock suppliers from around the world, including our own plants in Europe and South America. And that's the length to the supply chain. That's the good news, we qualified other people and found other sources. The bad news was that in a deflationary environment, that supply chain was much longer and that had to play out in Q4 and Q1. And then you top on that is that there was all this expectations between the some of the Gulf Coast guys we're going to pre-treat. The West Coast guys we're going to pre-treat. And we've never found a consumer yet for Darling's waste fats in North America. So, we woke up in Q1 here or Q4 and Q1 really with DGD as the only capable technology of pre-treating our fat. Bob, anything you want to add?

Robert Day
Executive Vice President and Chief Strategy Officer, Darling Ingredients, Inc.

A

Yeah. I'll just provide some color from a broader [ph] S&D (00:29:16) perspective on renewable diesel. I think, there is a really different picture between 2024 and 2025. In 2024, we always knew that the RIN [ph] S&D (00:29:27) was going to be a bit heavy. We'll produce $8 billion or $8.5 billion D4 plus D5 RINs this year versus an RVO of $5.55 million and maybe a shortfall on D6 of $1 billion, so it's about $2 billion RIN oversupply. But when we get to the 2025, the RVO increased to $5.95 million. And if we move to the producers' tax credit really imported biofuel and domestically produced biodiesel, it loses a lot of support and that represents almost $4 billion of the $8 billion to $8.5 billion RINs. So, it's a significant change.

And if you kind of look at where biodiesel is today at a, call it a $0.20 per gallon margin without the blenders tax credit, it goes to minus $0.80. And so in order for biodiesel to be at breakeven, the RIN has got to do the work. And so, we're bullish RINs as we get into 2025. And then if you just look at the at CARB's estimates through the regulatory impact assessment, they estimate we're going to be seeing, $1.30 a gallon type LCFS credit values, at least that's what they're aspiring to. And so if you layer that all on top, it really bodes well for a renewable diesel margin as we play out. And as we get to the end of 2024, we believe the market's going to see that and we'll start to react to that type of an [ph] S&D (00:30:56) reality.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And if I could just maybe follow on that last point, and it kind of goes back to the original question, how do we think about maybe flat price veg oils in that scenario where that pretty significant amount of veg oil demand and waste fat veg oil in particular is going to be challenged [ph] to find (00:31:20) homes in the biodiesel market that yes, maybe the waste fat discounts to veg oil narrow or go away but that could put downward pressure on the veg oil market broadly, do you – are you concerned about that in any way?

Brad Phillips
Executive Vice President & Chief Financial Officer, Darling Ingredients, Inc.

A

Well. I think, look, the RVO is what it is. And if we have a stronger LCFS in California, it's going to be more supportive of demand overall. But I mean you're right, it favors renewable diesel over biodiesel. Biodiesel is generally produced from vegetable oil or renewable diesel, outside of Diamond Green diesel, lot of it's vegetable oil as well. But as we go forward, we should see more animal fats. I mean, I think what it points to is increased demand for UCO and animal fats and less demand for vegetable oil. And so, those spreads should come together, but the overall demand for fats and oils really shouldn't change. It's really about the spreads between the different products.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

The only thing that I'd add is, it would come down to ultimate crush capacity in crush. And whether or not crush, given the new crush plants out there, do they start to scale back? That always takes longer than you think it does. But that's the kind of the wild card that's out there.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

And that's a really good point. But it's a really good point because crush margins, soy crush margins are not very good right now and they're not projected to look really good here over the next couple of years. And so, one way to control supply as an industry of vegetable oil is to lower crush and at $25 a ton, crush margins, you're not far away from slowing that down.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

It would surprise me to see imports drop off as well as I think that freestanding biodiesel refiners will be disadvantaged.

Operator: The next question comes from Manav Gupta from UBS. Please go ahead.

Manav Gupta
Analyst, UBS Securities LLC

Q

Guys, you said you're constructive on the [indiscernible] (00:33:21) prices. Recent CARB workshop for the first time introduced the concept of a 7% step down or 9% step down for 2025 versus the proposed 5% step down. Do you think CARB is finally recognizing that the prices are too low and there is a strong possibility that now when the revised numbers come out, you could see a 7% step down or a 9% step down, which actually hits the credit bank pretty hard?

Robert Day
Executive Vice President and Chief Strategy Officer, Darling Ingredients, Inc.

A

Look, I think we're projected to be at 13.75%. So a 5% or seven or 9% step down. All of them are a significant increase to where we are today. What we know is that through this, the regulatory impact assessment, they've got goals as far as where they would like to see LCFS credits trading. And really, we believe they're going to put a step down in place that they believe is going to allow that market to move to the prices they think it should be at. We had the workshop recently. There is a lot of constructive dialogue going on in all scenarios. It's a step down from where we are today, where that might not have been the way the discussion was going a while ago. So, it's hard to speculate as to where they're going to land. But, we think it's going be based on good data and analysis and when they make that decision.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah. And keep in mind, Manav, it's always been a 2025 kickoff if you will. Maybe everybody got a little optimistic, aggressive in thinking that [ph] card (00:35:05) would move faster here. It's still a very regimented and gated process there. And I think you'll – I think they're going to publish here shortly. I think it'll go to a board meeting in July. And then after that, we'll see on the execution time.

Manav Gupta
Analyst, UBS Securities LLC

Q

Perfect. My quick follow up here is on the DGD margin for the quarter. I mean, it was a big improvement from $0.41 to $0.76. But as you highlighted, there was – there's still a feedstock lag effect working against you like so, if we adjust for that, the price decline in the feedstocks. Would it be fair to say that if the feedstock prices had not moved at all, this $0.76 could easily been like $1 for the quarter? I'm just trying to quantify the impact of the feedstock price lag for the quarter?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

I don't see the exact calculation. But I would say that, generally speaking or directionally that [indiscernible] (00:36:03)

Operator: The next question comes from Paul Cheng from Scotiabank. Please go ahead.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Q

Hey, guys. Good morning.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Good morning.

Suann Guthrie
Senior Vice President-Investor Relations, Sustainability & Global Communications, Darling Ingredients, Inc.

A

Hey.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Q

Randy, I don't know if you can comment. Did you see the first quarter sales seems really high comparing to their production level? So, I assume that we are drawing down inventories. So at this point, how much is the inventory that we remain.

In other words, that for the rest of the year, should we assume the sales, it will be pretty closely aligned with the production volume or that is still going to be in excess of the production volumes.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

This is Matt. I'll answer that. I would say, first of all that DGD does not really have a program to store a bunch of finished product. So, really the operational intention and expectation is ship what is produced. And so what happens is from time to time, as you bridge months and bridge quarters, sometimes don't get invoiced in one month and they may get invoiced in the next. And therefore, you can see a shift. But I would say that's likely what you're talking about right here.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah, I think for the year, Paul, I mean, we're still out there that 13 to 1,350 in a total production and shipped – produced and shipped hopefully can match up. It's just the timing of vessels and barges and railcars of different things here. And obviously as we start to transition in Q4 to take in 250 million gallons of already offline, most of that I think, Matt, it's almost the SPK and SAF will move out what by rail then or barge. Yeah, so it could be a little bit of timing, but production is what's important to us here and the timing of sales is what happens.

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Q

And second question just on the feed volume [indiscernible] (00:38:07) I mean, with the small acquisition, you get three more plans and also that what is coming back. So Randy, can you give us some idea then how sequentially the volume is going to look like?

Suann Guthrie
Senior Vice President-Investor Relations, Sustainability & Global Communications, Darling Ingredients, Inc.

A

Can you repeat that, Paul?

Paul Y. Cheng
Analyst, Scotia Capital (USA), Inc.

Q

If we're looking at the feed ingredient that sentiment. From the first to the second quarter. How's the volumes we should expect, given that you just complete a small acquisition that add three plans and then you also have what being rebuild and working. I know that not at one to one. But are we going to see some incremental benefit from a volume spend point for the feed ingredient when we move from the first to the second quarter?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah. I mean, Paul, so when I look and Matt can comment more on North America, but globally we've made procurement changes in our spreads in Europe. We're still actively doing it in South America. Raw material volumes are rather large or just, the cattle slaughter shipping again from the US down to South America, so the piles of raw material are quite large. North America, clearly Matt already commented about that is such a blessing to have that online. Just from a – we were running at a 100% capacity and then running through Saturday. So, that should take a lot of pressure off the system.

And then we've seen some pricing improvement in the fat side. It's been very modest in North America. It's been a little better in Europe today. It's back really reflecting palm oil values as our alternative there. So, Q2 within the core ingredients business looks to be stronger at least this moment. We don't have April numbers yet because the month's not closed, but it looks stronger and the operating team feels better about it than Q1. Matt, anything you want to add.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

I think you've covered it.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Okay.

Operator: The next question comes from Andrew Strelzik from BMO. Please go ahead.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Hey, good morning. Thanks for taking the questions. My first one is a two parter on the guidance. I think a month or so ago, you maybe were at a conference and I recognize there wasn't formal guidance or anything like that. But you kind of insinuated that [indiscernible] (00:40:54) kind of suggested a $1.55 billion, $1 6 billion type of EBITDA number. And so I guess I was just hoping that maybe you could bridge from your comments at that time to now the formal guidance of $1.3 billion to $1.4 billion. And then secondarily, you kind of alluded a little bit to this in the last question, but you talked about a back half kind of loaded year. Is that just a reflection of the first quarter or is 2Q also a little bit limited? And then kind of we see the full acceleration in the back part of the year?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah. Number one, Andrew, my crystal ball had foggy in it when I gave that prediction before, but it was hinged on a couple of things. One, it was hinged on some optimism that the LCFS market would come back upon realizing what was going to happen to do that with the change of CARB. And number two, just believing that waste fats couldn't stay down below world veg oil prices very long.

And first off, I was wrong on both of those. It's a timing thing. We're saying Q2 is going to be stronger than Q1 from the core ingredients side. And then obviously we got a turnaround in DGD coming on here for DGD3. And I think that plant ran 15 or 18 months before we turn it around, which is an absolute, amazing deal. And that's to do the tie-ins also for SAF1. So, it's really when I talk about back half of the year, we're going to [indiscernible] (00:42:30) momentum. You get the LCFS announcement out there and people then realize that it's real.

People realize that these R&D plants aren't running at the rate or going to run the rate that should help. As you move into – as you get closer to next year, you realize that the RVO is going to have less imports, 800, 900 million gallons. That has to have a positive effect on both RINs and domestic feedstock values and ultimately, what else am I forgetting, guys? I mean, what else can drive this.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

I would just – historically speaking, I would say Q3 is naturally a challenge for us to keep in mind as we plan for this, principally due just to the summer heat and all. But we're ready for it. So.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Okay, great. That was helpful. And then my other question is just on the adjustments you're making to the procurement process and the operating costs, which you've been talking about for the last several months, so that's entirely new. But I'm just curious, are you finding new opportunities within those buckets. And you referenced some of the evidence that that some of that is already playing out. But, I guess how would you frame the extent to which you realize those benefits versus kind of incrementally what might be to come in future quarters? Thank you.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah, it's a very fair question. I mean, number one, typically a lot of the procurement formulas in North America were CPI based. They had to be relooked at that [ph] wasn't (00:44:16) enough in a lot of cases. We've given a lot of labor increases post COVID. And so as these contracts matured and changed, we've had to step out and 7% interest rate on these assets is a different calculation in diesel fuel $450 a gallon. So, it's just been a comprehensive look all around and the team has been very open to it. As I said, we've had tailwinds since fourth quarter 2019 and then the winds changed and deflation hit. And you have to go look at this stuff and we've done it.

I mean, the Brazilian acquisition has really been a good acquisition. It's meeting business case, but it's one where we're having to be when you transition from a private owner to a public company. I've always said and the guys have heard you say, private owners run for tax avoidance, public company runs for earnings. And that requires us to make changes in the raw material procurement from the slaughterhouses down there more often than it's been historically done. So, I think there is nothing really tangibly too new of what we're doing here other than we've given the team. Number one, you've seen us take CapEx down solidly a $100 million for the year. Number two, we've kind of just told that we've had to work with the teams to just say, hey, until we see fat prices come up, you've got to be really cognizant of cost management. And so, that's kind of where we're at. You guys, anything you want to add to that.

Robert Day
Executive Vice President and Chief Strategy Officer, Darling Ingredients, Inc.

A

I just say, look, I appreciate the question. It's a pretty prevalent theme around here. Our suppliers, they've got several options. They can go to another rendering plant. And meanwhile we're kind of at capacity across the continent. They can go to landfill. And landfill is less acceptable and more expensive every day or they can build a new rendering plant and that's a whole lot more expensive than it was a few years ago. And so all of that is taken into consideration when we're repricing agreements. We don't realize an immediate impact in a one-month period from restructuring these agreements. And a lot of these they come up with their three-year agreements. But over time, we're in a really healthy position given the book value of our assets relative to replacement value.

Operator: The next question comes from Derrick Whitfield from Stifel. Please go ahead.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Thanks. Good morning, all. Randy, focusing in on guidance and kind of pulling you back closer to your previous crystal ball projection. I can certainly appreciate the conservative EBITDA guidance as your stock doesn't reflect meaningful value for DGD and you've now taken out the bear case with the guidance. Having said that, if we assume fat prices remain depressed and annualized Q1, you could easily be above the top end of your guidance based on DGD spot margins north of a dollar per gallon with the contribution from south. And kind of thinking about the interplay between your businesses, assuming static RIN and LCFS prices or flat prices are a net positive for Darling as the impact for downstream is far greater than the impact for upstream. Is that fair?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

If I missed that last part

Suann Guthrie
Senior Vice President-Investor Relations, Sustainability & Global Communications, Darling Ingredients, Inc.

A

Lower spot prices are a net benefit to Darling in terms of the earnings power of DGD.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah, I think that's right. And given the relative size of DGD today and its capacity, it's a very good hedge for the base business at Darling.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.
A

Yeah. And it buys, three times more fat than what we produce ultimately or that's logistically feasible globally to it. So yeah, the leverage is there. But I also remind people wherein myself as Darling had that I keep 100% of any fat price increase on this side of the table. What we're really looking forward at DGD is some LCFS help and then it really has a chance to be a double win for us.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.
Q

Completely agree. I think everything comes what else if those prices go higher? Regarding the progress that you guys have made with your collagen peptide research and products, how should we think about the build out of that business line and business lines and what the run rate potential could be?

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.
A

Yeah, I mean, look, let me just back up a second. I think, what really excites us about that is not just the progress we've made in developing peptide profiles, but the infrastructure that we have globally to deliver on a portfolio of value-added products. So with the acquisition of Gelnex, we essentially have access to low-cost collagen production around the world and we have the capacity needed to develop this portfolio. So without a significant amount of additional investment, we're in a position to do this as the announcements recently that we're coming out with a product that will secrete GLP1 into the body and have health benefits that way. We have several other products that are in the pipeline right now. It's hard to predict exactly when we can complete that process and when we're going to be launching. But I think, we're very confident that we're going to have several over the next couple of years that we're going to be able to bring to market.

Operator: The next question comes from Ryan Todd from Piper Sandler. Please go ahead.

Ryan M. Todd
Analyst, Piper Sandler & Co.
Q

Okay. Thanks. Maybe just a couple follow ups on some earlier questions. I mean, as we think about fat pricing and how you think about the trajectory over the over the course of the year. I mean, the supply side in particular is hard for us to wrap our heads around because of the wide range of sources on a global basis. But is the biggest single thing that we should be looking at in terms of that price recovery over the course of the year? Is that really the ability of the North American renewable diesel industry to ramp up consumption of waste fat to the pre-treatment units between now and year end? Is that kind of the single biggest driver on the demand side, or are there other big things on the demand or supply side that we should be thinking about in terms of fat market recovery?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.
A

Well, and I'll start and then Matt and Bob can key in. I'm going to drive on my side of the table here from the global side. I mean, clearly, we've had an abundance now or just ample crops around the world. Yeah, we've got a little dryness here, a little dryness there. But at the end of the day, global stocks are very, very strong around the world of oilseeds. There is a major shift and who's crushing or processing those oil seeds underway right now, I don't know that we've seen play out yet. So, that's number one.

Number two is, we're seeing oil in the $80 a barrel range now. And typically, history would say at those times you start to see a lot of palm oil disappear into the system in the Asian countries. And so, you saw I think yesterday or a couple of days ago, I think Malaysia or Indonesia has raised their biodiesel mandate now to 35% and then South America from 6% to 20%. So, you're starting to see people make the movements that are going to start to move. It doesn't take a lot of movement to change the [ph] S&D (00:52:24) globally of fats and oils.

And then the third piece as you throw on the North American side, I mean as we were building our numbers here, if I took every one of the sell-side guys, capacity utilizations out there and what's running, the US is going to have to import £4 billion of fat in order to feed these machines. And clearly, they're not. So, I mean, as we look at this thing going forward, the global S&D's got a little bit of work to do. Ultimately with the number of oilseeds being processed in North America, that's both soy and canola, you have to ask yourself, what's China going to do for fat? Are they going to buy finished product? Are they going to buy seed? Are they going to buy more palm oil? I don't know. I think that's what I mean. Bob, you want to add anything.

Robert Day
Executive Vice President and Chief Strategy Officer, Darling Ingredients, Inc.

A

I mean, Randy I think you touched on what's most important and that's really global demand and then the fuel sector. As you pointed out, palm can kind of go into conventional, find its way into conventional fuel. But what I would – what we pay attention to here is what is biofuel policy? How is that shaping up as we get into 2025, 2026 and beyond? What we saw was high prices caused a lot of new supply to come to market of waste oils. So, there is a bigger opportunity for more regulation and more policy that's going to support biofuel production. That's really where demand needs to come from to absorb this additional supply we've seen on the market.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

Great. Thank you. And then maybe just one on the – on your comments on SAF earlier. I mean, is – it seems from discussions with many people that I think the expectation on the commercial side is that you're probably looking to renewable diesel plus $1 to $2 a gallon in terms of what kind of the SAF economics looks like. Is that a fair range or is it too early to say at this point? And I know there are some cost and yield impacts. I mean, if that's the case, what sort of margin accretion are you talking about in terms of like SAF production versus RD production?

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

This is Matt. I would say that from a SAF margin standpoint where we have discussions that we're having right now and they are going to be well within our expectations of our investment thesis and both from a volume as well as a margin standpoint. So, the plant has yet to turn on and we're taking the right steps in order to get this in a place where we think it needs to be. And so I would just say, stated.

Operator: The next question comes from Ben Kallo from Baird. Please go ahead.

Benjamin Joseph Kallo
Analyst, Robert W. Baird & Co., Inc.

Q

Hey, guys. Good morning. Thank you. Just on the guidance and SAF tie-in. Could you just talk to us about how you guys factored in the tie-in and how much it impacts the guide, so we do a bridge for next year, we can think about that.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

So, there is no SAF in the 2024 guidance. And the tie-in DGD3 is going to do a catalyst change in Q2 and be ready for the tie-in, so we won't have to be shutting down our RD facility as the SAF plant is up. So, we're staggering that to have the DGD3 line ready to go for a full run as we tie in the SAF line. And as mentioned, we'll be operational in Q4 on the SAF side.

Benjamin Joseph Kallo
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. On the food segment, the one timer, should we look at it as a one timer, the expiration or whatever? Or is that going to carry into Q2 or how should we think about Q2? I know definitely that you expect a recovery today in Q2, but how do we think about Q2 food volume calls it?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah, I mean, I think KPMG always gets mad at me when I call it a one timer, so I can't use that word, Ben Kallo. But at the end of the day, you got to add back that 25. And that's really the solid run rate of what we would say for the food segment this year. And then next year, as Bob was alluding and hopefully we start to build a portfolio of sales on the new peptides here.

Operator: The next question comes from Heather Jones from Heather Jones Research. Please go ahead.

Heather Lynn Jones
Analyst, Heather Jones Research, LLC

Q

Good morning, everyone.

Suann Guthrie
Senior Vice President-Investor Relations, Sustainability & Global Communications, Darling Ingredients, Inc.

A

Hey.

Heather Lynn Jones
Analyst, Heather Jones Research, LLC

Q

Hi. Just first, I just want to talk about, so Randy, you alluded to this earlier that the [indiscernible] (00:57:49) Chinese UCO and Brazilian [indiscernible] (00:57:51) has closed and for Chinese UCO by a pretty-wide margin. So, just thinking about you've mentioned how these RD plants haven't been ramping as they said they would, etcetera. But given that, that is closed in DGD, now US fats are cheaper. Just if DGD keeps running at its normal speed, wouldn't that result in a substantial improvement in domestic fats in the US?

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

I think. Matt and Bob and I are look at each other. I mean, strategically, we made a decision that we didn't as collectively as the owner and part owner, JB owner of DGD, that we felt was important to own the world arbitrage.

And we're making investments in Port Arthur to be able to unload directly there. So ultimately, we can own that because that's important to margin management in the long term. We've always said the number one thing for DGD was it's real estate that it owns and operates on the Gulf Coast, and that's both for inbound and outbound.

And so the answer is, from time to time, one geography in the world would be a premium to the other. You're watching that trend right now as the US and Canada are cheaper than imports. And so that should be supportive as we go forward. Ultimately, as you're building a portfolio of suppliers and inputs into the DGD system, you got different markets around the world, meaning finished product markets that require different or you can qualify different fats for different carbon intensity. So, you're always going to be playing that arbitrage. And that's what gave DGD the superior profitability of anybody out there today in the world. So, it'll move from time to time, but I don't see it going all domestic then portion of it back import because that's just logistically impossible at the scale we're at. I know Matt, you're deeper.

Matthew J. Jansen
Executive Vice President and Chief Operating Officer, North America, Darling Ingredients, Inc.

A

I would just say just to be clear, the driving decision force in DGD is margin and it sense to buy the cheapest available feedstock, all things considered, including the CI score. So to your question in terms of lower domestic price, that's exactly where a DGD is focusing its origination efforts right now.

Heather Lynn Jones
Analyst, Heather Jones Research, LLC

Q

Okay. Thank you. And then my follow up is on ward. So, Randy, I think you mentioned on the Q4 call something about dumping like 30 some million pounds in a landfill. It's been down for almost year and a half. I mean, can you give us – I mean dumping in a landfill was pretty expensive. And, obviously not getting through finished product pricing. So, just wondering if you could give us a sense of what's the magnitude of drag that's been on your business just so we can get a sense of how that by itself could help the remainder of the year.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

I'll try to answer that, Heather. So, at the end of the day, when that plant went down, I mean we had a series of supply contracts and a series of customers that were relying on the ward plant to operate in order to process their volume. And so, when that plant went down, then there was all of a sudden this volume that had to find a place to be processed. And so, we did a massive game of shifting around in terms of trying to put as much of that volume that into our other plants. But as a result, there was still some product that resulted in the – As Bob was talking about, the next best alternative, which was a landfill. And so, in terms of quantifying that, I don't have that specific number for you. But what I can say is that plant is up and running now and our Eastern Shore plants are essentially at this point running on all through of cylinders, and so as of April 1.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Randy Stuewe for closing remarks.

Randall C. Stuewe
Chairman & Chief Executive Officer, Darling Ingredients, Inc.

Hello, everyone. Appreciate, all the questions. As always, if you have additional questions, reach out to Suann. Stay safe. Have a great day. And I'll turn it back over to the operator to conclude our call. Thank you.

Operator: The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.