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CORPORATE PARTICIPANTS

Brad Phillips *Darling Ingredients Inc. - Executive VP & CFO*

John Bullock *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

Melissa A. Gaither *Darling Ingredients Inc. - VP of IR & Global Communications*

Randall C. Stuewe *Darling Ingredients Inc. - Chairman & CEO*

CONFERENCE CALL PARTICIPANTS

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

Craig Edward Irwin *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Heather Lynn Jones *The Vertical Trading Group, LLC, Research Division - Research Analyst*

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

Thomas Hinsdale Palmer *JP Morgan Chase & Co, Research Division - Analyst*

William Lewis Baldwin *Baldwin Anthony Securities, Inc., Research Division*

PRESENTATION

Operator

Good morning, everyone, and welcome to the Darling Ingredients Inc. conference call to discuss the company's second quarter 2018 financial results. On the call today are Mr. Randall Stuewe, Chairman and Chief Executive Officer; Mr. Brad Phillips, Executive Vice President and Chief Financial Officer; and Ms. Melissa Gaither, Vice President of Investor Relations and Global Communications. (Operator Instructions) Today's call is being recorded. I would now like to turn the call over to Melissa Gaither, Vice President, Investor Relations and Global Communications for Darling Ingredients. Ms. Gaither, please go ahead.

Melissa A. Gaither - *Darling Ingredients Inc. - VP of IR & Global Communications*

Thank you, Brandon, and good morning, everyone. Thank you for joining us to discuss Darling Ingredients' earning results for the second quarter ended June 30, 2018. To augment management's formal presentation, please refer to the presentation section of our IR website for the earnings slide presentation. Randy Stuewe, our Chairman and CEO, will begin today's call with an overview of our second quarter operations and financial performances, focusing on year-over-year comparison and will discuss some of the trends impacting our business. Brad Phillips, Executive Vice President and Chief Financial Officer, will then provide additional details about our financial results. Finally, Randy will conclude the prepared portion of the call with some general remarks about the business and the year ahead. And after which, we will be happy to answer your questions. Please see the full disclosure of our non-U. S. GAAP measures in both our earnings release and earnings slide presentation.

Now for the safe harbor statement. This conference call will contain forward-looking statements regarding Darling Ingredients' business opportunities and anticipated results of operations. Please bear in mind that forward-looking information is subject to many risks and uncertainties, and actual results may vary -- differ materially from what is projected. Many of these risks and uncertainties are described in Darling's annual report on Form 10-K for the year ending December 30, 2017, our recent press release announced yesterday and our filings with the SEC. Forward-looking statements in this conference call are based on our current expectations and beliefs, and we do not undertake any duty to update any of the forward-looking statements made on this conference call or otherwise.

I will now turn the call over to Randy.

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

Hey, thanks, Melissa. Good morning, everybody, and thanks for joining us. Operationally, we delivered a solid second quarter, with results improving over the 2017 period and sequentially. Our core business was supported by strong global slaughter activity and excellent execution. DGD delivered solid earnings prior to entering its anticipated shutdown. Our expansion projects and recent acquisitions contributed as well. As reported, we incurred 3 notable nonrecurring costs during the quarter that reduced net income by approximately $54 million, creating a loss of about $30.4 million or about $0.18 a share. Normalized to exclude these 3 events, our adjusted net income was $17.7 million or $0.11 per diluted share. These costs were a result of several strategic actions we took during the quarter to strengthen our portfolio and to drive sustainable growth across our global platform.

Let me comment about each one of them. These included restructuring and impairment charges associated with the closure of our Argentina gelatin facility, up USD 15 million. Persistent headwinds from Argentina's struggling economy, along with an unfavorable long-term outlook, drove our desire to realign our Rousselot network. A significant portion of these sales from our Hurlingham facility will be filled from our system, and we anticipate a long-term positive impact to our ongoing earnings.

Secondly, we recorded a loss on the sale of our industrial residuals business that was known as Terra Renewal Services. To refresh memories, we acquired this business in mid-2013. The assets acquired included a land application business, which is what we sold; and approximately 7 used cooking oil collection locations, which were not included in the sale. During the appraisal process, the majority of the value was attributed to the land app business and only a small portion was applied to what is now a very successful and profitable used cooking oil collection business. Thus, we took a write-down of $15.5 million. And finally, as we discussed on our first quarter call, we incurred debt extinguishment costs associated with the refinancing of our Eurobonds, which significantly lowered our long-term borrowing cost and extended the bonds maturity. Brad will cover a little more of the detail of those restructuring costs during his financial review.

Now let's move to the segment-specific updates. The Feed segment. Our Feed Ingredients Segment executed well and delivered strong operating margins through disciplined execution across all of our geographies. We saw improved raw material volumes, which were up 5.6% year-over-year and spreads were managed well. Our protein conversion operations in North America, China and Europe all reported solid results. While fat prices were significantly weaker during most of the quarter, we did see fat prices in North America strengthen near the end of the period, supported by the expected 1 billion pounds of new demand per year that our Diamond Green Diesel operation will require once it's back online. Fat prices in Europe remained soft due to the strong slaughter and weak demand from their biodiesel sector, as it struggles to control the displacement cost by the dumping of Argentina biodiesel. Ultimately, we expect the EU to rectify this situation later this year, and we expect to see stronger fat prices globally as our feedstocks grow in popularity to fulfill the low carbon fuel demand around the world.

On the global protein side, demand for higher-grade species specific proteins to supply specialty pet food and aquaculture customers, drove improved finished product pricing year-over-year and on a sequential basis. Ruminent meat and bone meal continues to struggle globally as it fights for market share, but ultimately, solid soy meal demand around the world should offset the supply push driven by the large slaughter and summer feeding season.

During the quarter, we also announced the acquisition of Kruger Commodities with locations in Michigan, Iowa and Nebraska. We are extremely pleased with this acquisition, and these facilities are already contributing to the Feed segment's performance. These assets are a strategic fit for our business and will help us capitalize on expanding our footprint in the Midwest in both specialty protein conversion and used cooking oil collection. Additionally, we have several growth projects in the segment that will begin to contribute later this year or early next. First, our Grapeland, Texas protein conversion facility is now in the back-end of construction and it's anticipated to commission in early December. Our Wahoo, Nebraska pull-through operation has broken ground and should be operational mid-2019 while our Hixson, Ontario poultry conversion facility recently completed a major expansion and is now operational. Our JV with Intrexon, called EnviroFlight, is advancing on schedule towards its goal to open as the largest black soldier fly facility in North America. The facility is built in a modular manner to allow for expansion based on market demand. Phase 1 will open around Q4 this year and will have the ability to produce 900 metric tons of product per year and is designed to scale on up to 3,200 metric tons shortly thereafter.

Now the Food segment. The Food segment results were consistent when adjusted to account for the closure of our Hurlingham, Argentina gelatin factory. As I mentioned, the majority of the Argentinian sales were repositioned to our other 11 factories worldwide. Rousselot, our global gelatin and collagen business, saw strong global demand and improved results in China, South America and the North American markets. Our specialty collagen product, called Peptan, is proving to be a meaningful part of our portfolio, and we are reviewing opportunities for future expansion projects to meet the rising need for this high-demand product. Additionally, improved raw material availability should lower raw material pricing and help us deliver improved margins in the coming quarters.

In Europe, lower palm oil market pressured sales, prices and spreads in our Sonac edible fats business. Raw material pricing adjustments are in process and margin should return to historical levels in the coming quarter.

Looking at the segment's growth projects this quarter. Our 2 new peptan plants in Amparo, Brazil and Angouleme, France will be online during Q1 of 2019. Based on the strength of that market, we expect these to be meaningful and strong contributors in the future.

Now turning to the Fuel segment. In the Fuel Ingredient segment, our portfolio business has executed well, leveraged operational efficiencies and favorable pricing to report consistent earnings, both sequentially and year-over-year when adjusted for the 2017 blenders tax credit that was received and recorded in the first quarter 2018. Rendac, our European bio disposal rendering business, capitalized on ample raw material volumes and produced consistent results. Ecoson, our European bio energy business, leveraged beneficial market conditions to generate solid contribution to the segment. Our new Belgium digester continues to ramp up to full capacity and bolstered our results. Based on the performance of this business and demand outlook for the Denderleeuw digester, we are already exploring an expansion of this facility. North American biodiesel benefited from the higher low sulfur diesel pricing, and Canada biodiesel held near breakeven without the blenders tax credit. Once again, there is a great deal of support in Washington, D.C. and from our trade groups to extend the blenders tax credit for 2018 and 2019. While we adjusted our operating model to -- our operating strategy to reflect the improved profitability, we remain very optimistic that the tax credit will ultimately be reinstated in 2018.

Now moving to Diamond Green Diesel, our 50-50 venture with Valero to produce premium and low carbon fuel additives. This facility entered expansion and turnaround phase in early June. The facility reported [entity] EBITDA of around $1.05 a gallon on sales of about 34.8 million gallons. EBITDA per gallon for this quarter was lower than our $1.25 target due to supply chain penalty cost and higher operating costs associated with the earlier shutdown, as well as hedge losses on our heating oil positions. We have achieved mechanical completion of the facility now and we are in the early stages of commissioning. We expect to be online in mid-August with a quick ramp up in production to the run rate of 275 million gallons per year.

Lastly, spot margins for our fuel additive remain attractive in $1.30 to $1.50 per gallon, with yellow CFF markets in California reaching a new high of around $1 -- or $190 per metric ton based on the Jacobson index. Premium LCFS markets are expanding well beyond California into several other U.S. states, Canada and European markets now, including Norway, Scandinavia and central Europe. Given the tone of the market and the delay in start up, we remain optimistic for the full year of 2018. We believe the $1.25 per gallon EBITDA margin on sales to still be very achievable. As we wrap up in the final accounting on the expansion, we anticipate an additional partner dividend of somewhere around $75 million up to $100 million for the balance of the year. With this, I'll turn it over to Brad and come back for some highlights after Brad's financial review. Brad?

Brad Phillips - *Darling Ingredients Inc. - Executive VP & CFO*

Thanks, Randy. For the second quarter 2018, we reported consolidated net sales of $846.6 million, a decrease of 5.4% compared to the 2017 period, primarily due to the reclassification of bill freight for the new revenue standard, and the de-consolidation of our European Best Hides subsidiary, of which we sold out of our majority interest position of 60% ownership to 40%, which was recorded in the first quarter. We posted a net loss in Q2 of $30.4 million or a net loss of $0.18 per diluted share compared to net income of $9.1 million or $0.05 per diluted share for the 2017 second quarter. The net loss reflects debt refinancing expense of $23.5 million related to the Eurobond refinancing, a loss of $15.5 million from the sale of Terra Renewal Services subsidiary and $15 million of restructuring and impairment charges incurred as a result of the Hurlingham, Argentina gelatin plant closure. Excluding these items, adjusted net income for the second quarter 2018 was $17.7 million or $0.11 per share. Gross margin for the second quarter was 22.9% compared to 21.9% for the same period last year. Gross margin improvement benefited from the re-class of the billed freight, which was somewhat offset by lower fat prices. SG&A during the quarter decreased by 7.1% to $78.6 million compared to the year-ago quarter. SG&A was lower partially due to favorable FX hedging. For the remainder of 2018, we project SG&A expenses to be in the $84 million to $86 million range per quarter.

Depreciation and amortization expense increased $5.5 million in the second quarter of 2018 to $78.5 million as compared to the same period in 2017. The increase is primarily due to higher capital expenditures for organic growth projects. Interest expense was $23 million during the 3 months ended June 30, 2018, compared to $22.4 million during the 3 months ended July 1, 2017, an increase of $0.6 million. The $0.6 million increase is primarily due to the change in foreign currency translation rates on the company's euro-denominated senior notes as compared to the prior year.

Other income and expense had a $5 million favorable variance with $1.2 million income compared to $3.8 million expense for the second quarter of 2017, primarily as a result of gains recorded from insurance proceeds on casualty losses, a decrease in non-service cost components of pension expense and a decrease in hedge ineffectiveness expense on cash flow hedges.

Now I'll address our tax expense for the quarter. The company recorded income tax expense of $1.7 million for the 3 months ended June 30, 2018. We had a negative effective tax rate for the 3 months ended June 30, 2018, of 6.1%, which is lower than the federal statutory rate of 21%, due primarily to the impact of certain losses, including the TRS sale and the shutdown of our Argentina gelatin plant that provided no tax benefits. Excluding the impact of these losses and other second quarter discrete items, the effective tax rate is 27.7%. We also paid $10 million of income taxes in the second quarter. For 2018, we are projecting an effective tax rate of 25%, including our 50% share of Diamond Green Diesel's 2017 biofuel tax refund. If the biofuel tax refund is reenacted for fiscal year 2018 before the end of the year, the effective tax rate is projected to be 15%.

Finally, we are projecting cash taxes of approximately $15 million for the remainder of this year. Moving to our balance sheet. Our cash position ended the quarter at $104.1 million. Our leverage ratio for the second quarter 2018 was 3.31, down from a 3.71 in the prior fiscal quarter, primarily due to the company paying down $44 million on our debt obligations, the receipt of the $25 million Diamond Green Diesel dividend and favorable period-end foreign exchange translation on the 515 million euro-denominated bonds. Working capital improved in the second quarter versus the first quarter but remained higher than fiscal year-end 2017, primarily due to elevated inventories. Our liquidity remains strong with approximately $950.4 million available under our revolving credit facility, and we expect -- continue to expect to pay down a total of $100 million during 2018. CapEx was $139 million for the first 6 months of '18 compared to $127.8 million for the 2017 6-month period.

Finally, we settled our refinancing tender of our previous EUR 515 million 4.75% notes due May 2022, by issuing 3.58% euro notes due May 2026, thereby extending maturity, lowering borrowing costs and maintaining a natural hedge for our euro-denominated cash flows. With that, I'll turn it back over to Randy.

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

Hey, thanks, Brad. Clearly, we're watching record crops mature in the U.S. while we are seeing significant droughts in parts of Europe and Australia. Tariff threats and counter retaliations continue to create uncertainty and several disruptions. But overall, demand globally remains robust. Global meat production, in fact, continues at record levels. Our capital growth projects are creating momentum in new regions and expanding our market share in existing geographies. As part of our World of Growth Strategy, we're focused on building, acquiring and developing businesses and geographies where we can achieve a top 3 market position within 5 years for food, feed and fuel. One of the most notable projects is building a second train at our Diamond Green Diesel joint venture. We are nearing our final investment decision on the Phase 3 expansion of Diamond Green Diesel to take it to 600 million to 700 million gallons annually, and at fully funded the final cost estimates and the detailed engineering requirement. We expect to make a final decision and announcement on it later this fall. Overall, 2018 is off to a great start, and we are carrying solid momentum into the third quarter. Our teams continue to focus on safety, seamless execution and providing the best products and services to our customers. We have built significant momentum during the past several quarters and continue to take specific critical actions to improve the performance across our portfolio of businesses. We remain committed to growing our businesses and deploying and rationing capital when appropriate. We're also committed to our corporate social responsibility, and we have enhanced our disclosures around environmental and social and governments metrics. As we talk about our sustainability commitment and the impact of energy greenhouse gas emissions and water usage, we have worked on collecting data to support our key performance metrics in these 3 areas. We included a few slides this time in the appendix section of the quarterly earnings presentation to describe the significant impact Darling has on carbon capture and water production by the nature of the protein conversion process to service the meat industry and through our renewable diesel production at Diamond Green Diesel. We will continue to provide meaningful metrics for measuring our success and continue to look for improvement. As a testament to our World of Commitment efforts, we are pleased to see that we are ranked #2 in the Russell 2000 Green Revenue Index as of June 2018. As I've said in the past, Darling was green before green was cool. To close, this quarter demonstrated the value of our core business structure, our innovative drive to invest in new technologies, our efforts to optimize operational efficiencies and the commitment of our management team to take steps to drive value for shareholders while creating value-added services for our customers. My hat is off to the team who continually executes against the plan to put Darling Ingredients in a position to capitalize on food, feed and fuel markets as they emerge and grow around the world. With that, Brandon, let's go ahead and open it up to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Heather Jones with the Vertical Group.

Heather Lynn Jones - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Nice quarter on the core. I want just to focus my questions on Diamond Green. And I was wondering if you could give us a sense of the magnitude of the hedging loss and the hit from, I think, you said the supply chain disruption. Just if you could give us a sense of those items in the quarter.

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

Heather, this is John Bullock. Remember, when we buy our fat, we have to buy it long before it actually moves out as a finished product. And we had, primarily, in the heating oil market with that. Because we're not allowed hedge accounting on that particular transaction, we get the money back one way or another as we move the finished product out. And I think the number in Q2 was just a few million dollars on the hedging loss. As far as the supply chain disruption, yes, we made some accommodations to some of our customers for a little over $2 million because of -- just the timing of Diamond going down. And we wanted to make sure that we -- because they're long-term customers, that we maintain good relations.

Heather Lynn Jones - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

And what about the operating expense? Because when I look at the $1.05 and then look at where the LCFS average for the quarter, I mean, your $1.05 came in well below just the LCFS much less production economics. So I'm just trying to -- it seems like those operating costs were meaningfully higher-than-normal. And just trying to get a sense of what that was. And how should we be modeling that for the first part of Q3?

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

So I'll just give you the dynamics here. Our higher fixed cost per gallon because of lower gallons would've been $0.05 a gallon. Our higher cash processing cost because of some demolition expense that we had that we expensed rather than capitalized. And we also took the opportunity to take our existing tanks and to clean them out to make sure that we have them well conditioned ahead of the expansion of Diamond, it was another $0.04 a gallon. The supply chain adjustment was $0.08 a gallon. And your hedge and LIFO adjustment was $0.03 a gallon.

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

But I think it's also important, Heather, to also to clear up a couple of things. Number one, as we said, we are not receiving 100% of the LCFS market today. I think eventually we will, and we're optimistic in our ability to negotiate that. So remember, just as we scaled into the road and pipeline contracts, when we started up Diamond Green Diesel, as it transitions now away from those contracts to the LCFS markets, the percentage of those markets that we're receiving continues to increase and will continue to increase in 2019 and 2020. And so that's a little bit of it. I think as we go back and just to kind of reaffirm what I tried to say in the original script was that we believe that we will achieve the $1.25 -- and it looks like -- the $1.27, $1.28 for the -- per gallon as an annual run rate by the end of the year as we scale into the markets more production and the higher LCFS and get some of the onetime nonrecurring operating costs associated with the kind of an extended shutdown behind us.

Heather Lynn Jones - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

So are you saying $1.25 run rate by the end of '18? Or you'll achieve a $1.25 in '18?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

No, no, no. We're saying annualized for the year if you take the gallons produced by the EBITDA sold, it will equal or exceed $1.25 a gallon is what we're looking at. That's my -- that's just the basic weighted average math of the first quarter, second quarter, third quarter and then the full run rate achieved in the fourth quarter.

Heather Lynn Jones - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

So was there -- could you give us a sense of when we should -- when we could do production economics? So let's just say ULSD, minus some transportation costs, minus operating costs, minus feedstock and then add the LCFS and add the RIN, when that be the calculation that we would look at to estimate your margins as opposed of there being some deduction given to partners, et cetera? Like when will that be the math for Diamond Green's EBITDA per gallon?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

So you're asking -- a shorter way of asking is when are we going to receive 100% of the LCFS.

Heather Lynn Jones - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Yes, yes.

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

Nice job.

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

Heather, this is John. Obviously, our specific contractual relations we have with our customers we would consider to be confidential and we would respect their desire to have it be confidential as well. I can tell you that each year, as we go through this, we receive a greater and greater percentage of that LCFS. We see that pattern happening '18. We know it's going to happen in '19 and we're in the process of making it happen in 2020 as we speak. So we are receiving a greater share of what has been a rising LCFS price ever since we started the market. The LCFS market, as you will recall, early on, we had to share with the pipeline contracts that we had in place. They're all off at this point in time and done. So now we are marketing to the LCFS market in California as well as other LCFS markets around the world. And we are receiving a greater and greater share. It's going to be very difficult for us given the confidentiality that we have with our customers to provide guidance on exactly what percentage of that LCFS we are receiving. But it's a vastly improving percentage each and every year.

Heather Lynn Jones - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Okay. And that's understood. I just want to make sure, are we, is there -- besides the amount you split with your partners, customers and all, is there any other part of the earnings equation at Diamond Green that has changed materially? Or is it just that number and that's going to increase going forward? Is there any other thing that's changed in DGD economics?

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

No. The thing that is changing for Diamond is what we get in relationship to the RINs and what we get in relationship to the tax credit. All of that remains as has been in the past. What's changing is that we are receiving a larger share of the LCFS. That's been a pattern that has happened every year. It started in '17 and continued in '18, will continue in '19 and will continue in 2020, we believe.

Operator

Our next question comes from Tom Palmer with JPMorgan.

Thomas Hinsdale Palmer - *JP Morgan Chase & Co, Research Division - Analyst*

You mentioned in the earnings release that you're considering an even larger Phase 3 expansion at Diamond Green Diesel. Could you discuss the considerations that will ultimately determine the right plant size to construct? And does the size of the plant in any way affect the time line for final approval and completion?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

Tom, this is Randy. No. I think we started out with preliminary engineering at the 550, maybe up to 600 level. We're looking right now as it's basic vessel size and hydraulics of the facility for a little more capital in the sense to take it on up to -- the maximum size could be 700 million of another train here. So that's -- we're looking at the cost differential between, if you will, 600 and 700 now. And we'll see what it comes out here as we -- I want to say by the end of September, 1st of October, the final detailed engineering cost estimate is due in. As everyone knows out there that's involved in heavy manufacturing, the price of metals, steel, aluminum, copper continues to be highly erratic and volatile. So we're trying to do the best we can to bring in the cost estimate that -- for approval here. I think it's -- I think at the end with the day, from our perspective -- and I can't speak for Valero -- but if you look at the margins that are achievable in here and the cost per gallon that it cost to put the expansion here all in of -- I think around $2.50, $2.60 a gallon is what we spent all in now on the 2 75 train that we'll be able to come in well below that on the cost per gallon on the major expansion or the Phase 3 or as we call it the Super Diamond within the family here. I think it's pretty simple to look at that if you're saying it costs you $2, $2.25, whatever it is at the end here to build a facility and your margins are somewhere between $1.30 and $1.50 it's really not a hard decision as long as the regulatory environment that's out there continues to be as positive and as we think it will be moving forward here. So we see global demand around the world. This is not just a California play. This is a global play. The logistics of a facility located on the water that can load out by ship, by barge, by pipeline, by rail is going to give us a significant advantage to -- with our supply chain of the lowest cost and highest carbon feedstock in the world for production. I think it's -- I can't tell you it's 100% go right now. But on an Excel spreadsheet, it looks pretty darn attractive.

Thomas Hinsdale Palmer - *JP Morgan Chase & Co, Research Division - Analyst*

All right. And I just had a quick follow-up on the unit economics. I just want to make sure we don't get ahead of ourselves here for the third quarter. How much of these costs that weighed on second quarter in Diamond Green Diesel should recur on the third quarter? I just wanted to clarify that piece.

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

While the supply chain issue is largely over in the second quarter, maybe a little bit of a hangover in the third quarter. The higher cash processing cost, we're obviously not going to be operating at 100% in third quarter because we're still in the commissioning phase at this point in time. We don't anticipate it's going to be nearly as much as we saw the second quarter, and right now, the third quarter where we see the market being would put us, as Randy said, well back in line, on track to make the $1.25 for the year.

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

Yes. I think, Tom, as we said, you can take $1.19 a gallon, $1.05 a gallon. And then if you plug to $1.25 on the -- to $1.27 on the back half of the year, you can back into this thing pretty easy.

Operator

Our next question comes from Adam Samuelson with Goldman Sachs.

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

Maybe continuing a little bit on Diamond Green and the expansion and the impact on the market and there's both the nearer-term impact of going to 2 75 and then further down the road going to 600 million to 700 million gallons. I just wanted to talk a little bit of the impact it had in your feedstock markets and fats, and thinking about how that spread -- the used cooking oil spread and the poultry grease and tallow spreads to soybean oil and food grade vegetable oil starts to look like? And do you start to see some of those spreads narrow and so of the margin -- if some of the upside, comes out of Diamond Green goes into the base business? Can you talk about and more broadly, how much of those non-edible fats at this point are not going into biodiesel or renewable diesel production? Just how much do you think starts to pull into the vegetable market?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

Yes. I think, number one, that's a lot of good questions hidden in there and I'll do my best, and then John will help me out here if I either step inbounds or out of bounds on some of the stuff that we believe. Number one, as we've said all along, Diamond Green Diesel was invested in by our board on the belief that it would add value to our fats and used cooking oil stream. And that was a strategic decision made years ago, almost, what, 5 years plus now. It's done that. If you look at it, we've seen fats move up slightly above the caloric equivalent to corn. Clearly, it's hard to see right now given with Diamond Green down, but once it comes back up, it will be apparent again. But we've moved the caloric relationship anywhere from $0.03 to $0.05 above the old Darling, if you will. So we've had a very positive impact in my sense on that moving forward. The second thing is, today, somewhere less than 40% of the fat that's being processed the Diamond Green Diesel comes from at Darling system. That's why we're so comfortable biggie-sizing Diamond Green and going to the next phase. And at the end of the day, will we have a positive impact in the core business? Yes, we firmly believe we will, as we start to need 5 billion, 6 billion pounds of fat or 40% of the production of the U.S. of waste cooking oils, used cooking oil, corn oil down there. So I think we'll have a pretty -- we'll have some impact there. How much it will be? We'll wait and see. Now the next question -- which makes this very different than the biodiesel business that is primarily plus 50% dominated by veg oil or soybean oil -- is that given the carbon status of both used cooking oil and animal fats, they are the preferable feedstock for the California and the global reduction programs for carbon in the world. So just because feedstock goes up, doesn't mean that the margin compression. Is very, very different. I think we remain fairly optimistic that we'll be able to manage that spread on out over time and receive not only a bigger portion of that, if not all of the LCFS premium. But we'll be able to maintain a lot of that margin even if feedstock moves up going forward. So I don't really see much of an issue here. I mean, what we said, and as John and the Valero team have laid out the second train, it's being built adjacent as we show in the picture in our earnings call slide to the facility. It creates another access by the CN railroad. We're going to be opening up a ship loading and unloading facility there. So the facility has both inbound and outbound logistical arbitrage ability to originate not only fats from the U.S., fats from Europe. We're one of the largest producers. Fats from Australia, fats from South America to facilitate that facility. At the end of the day, it can also obviously run soybean oil. So if you said in a perfect world, at the end of the day, if we ran animal fats and used cooking oil up to veg oil equivalents, we can run that product, too, and at the end of the day, there is a pathway for soybean oil, although it's, what, 50% or whatever versus the 18% and 23% that used cooking oil and animal fats have. So that's still an option. John, do you got anything you want to add to that?

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

No. I think a couple of he questions here have been around. As we analyzed the supply and demand of having a 600 million to 700 million gallon renewable diesel facility. And we have done this in great detail over the past year, not only us but Valero. And we've looked at the marketplace.

We looked at the raw material supply. We've looked at the facility. We've looked at the location. And we're comfortable that as long as the cost estimate comes in line and as long as the government programs remains supportive of renewable fuels that Diamond Green Diesel is not only capable of but is an ideal location in which to put a 600 million to 700 million gallon facility.

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

That's a lot of helpful color. Just to follow up on the base business and the cap outlook. Can you remind us the CapEx outlook for this year kind of maintenance versus growth? And any thoughts on what the growth capital kind of on the books for 2019 looks like at this point?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

This is Randy. And Brad will correct me if I'm wrong here. But essentially, we still look at the base capital. Admittedly, as we grow the number of facilities out here, that number starts to edge up a little more. But I think 1 85, 1 95 is the maintenance CapEx. This year, I think we have a 3 34 program that includes the (inaudible), the Wahoo, the facilities that includes the finish out of the Denderleeuw digester that started up here in the second quarter. It includes some other expansions, the Hixson, Ontario. It includes the Peptan plant in Angouleme, France. It includes the Amparo pep and spray dryer in Brazil. So those are all of the projects or the big ones that are out there. So that's it for right now. So 3 34 -- I suspect we'll be down a little bit next year. I think if we say what's the target? Kind of 2 50. And then that moves around, give or take. We continue, Adam, to look for the world and look around the world for opportunities to grow. But that's kind of the organic side of the expansion projects right now.

Operator

Our next question comes from Craig Irwin with Roth capital Markets.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

So Randy, I wanted to get your view on the potential conversion for the biodiesel tax credit from what it is today, $1 a gallon blenders credit to what many in the industry have asked for, which is producers credit. The obvious benefit is it would push Neste out of the California market and make many more of those LCFS credits available to domestic producers, and hopefully, tighten up the market. Do you see this as likely? Or is there something Darling is advocating? What are you hearing from your representation?

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

Yes. This is John Bullock. We support the tax credit. We believe it's the right thing for American farmers and American consumers. The form of the tax credit, we're willing to accept either a blenders or a producers tax credit. Do I think it's likely and do we think it's likely from our representation in D.C. that it will convert to a producers tax credit? No. It's highly unlikely that, that's going to happen. Simply because there's too many conflicting interest when you change it from a blenders to a producers tax credit. And once these programs get structured in a particular faction, it is often difficult to change them.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Understood, understood. And not to flog (inaudible) that's already been covered a couple of times here. But the feedstocks for the expansion, the next phase of it -- of Diamond Green. Would you consider more vegetable oil? Is this something that maybe soy or canola could have an advantage for you? There's people that say that canola oil, particularly in the West Coast, should be nicely profitable into LCFS markets. How do you evaluate feedstock supply for the next phase of Diamond Green or Diamond 2. Global fats, this is going to be the big, big source of demand for the market, particularly in the U.S. If you could share a little more color there.

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

Yes. I'm hearing the music of a giant sucking sound down there and it's just music to my ears. I think at the end of the day, we sit back and we look at it. You got to look at it from the customer's eyes. Meaning the purchaser of the fuel additive. And obviously, they're going to want to pay more for the UCO product that we can make. Then they'll pay a little bit less for the tallow product that we make, at least, today. And then the pathways for that veg oil as you're talking about are quite a bit up, what, 0.5, or 50%. John knows the exact numbers. So at the end of the day, we're going to fill up Diamond Green Diesel with as much UCO and animal fat that we can. I think, obviously, the facility has had its choice of buying the best and most favorable economically and quality-wise feedstocks over the first 5 years of its life. The next billion pounds of fat that heads down there with the expansion, it'll dip into a little more of our high acid material but probably not all of it as it is still be able to originate corn oil and UCO. And then once it goes on up to the 600, 700 level, it will clearly, in my opinion, take the majority of the low-quality animal fat as long as the metal counts in them are managed down there. And then from there, we'll see if it needs to buy any veg oil. So John, do you got a different opinion on it or...

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

No. I think the important point about Diamond is the location and the process, meaning that we can process any type of fat that's available to us out there or nearly any type of fat that's available to us out there and the location means that we can competitively supply any of the low carbon fuel markets in which we are currently going to or want to go to. So that puts us in a position where as the market moves forward -- and we recognize that we will be substantially increasing the demand for fats. But we also know that the demand for Low Carbon Fuels is increasing around the world. And quite frankly, the prices for those Low Carbon Fuels are increasing around the world. The facility at Diamond is massively flexible. It's got the ability, as Randy said earlier, to bring fat in by rail, truck and water. And we can move the renewable diesel out by water, rail or pipeline. We're going to have the ability to hit whatever is the best markets. And we're going to have the ability to utilize whatever is the best feedstock. And that means that, that facility can adapt as the marketplace adapts around us. And that is why we believe long-term, it can be a great, great asset and have sustained profitability.

Craig Edward Irwin - *Roth Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Okay. And then just a quick last question on the future asset. So does the potential for aviation fuels to participate in the renewable fuel standard factor into the potential format and output of Diamond 2 or the Big Diamond? And are you hearing anything from the market about the possibility of us having maybe blend rates of renewable hydrocarbon diesel, green diesel into jet fuel as a way to bring down the excessively high sulfur counts and lack of environmental compliance today?

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

This is John. Absolutely. We hear a lot of talk about that. And I think there is going to be a lot more renewable diesel that is going to be used in jet fuel. At this point in time, the expansion plans, the current expansion plans for diamond and the super diamond expansion plans do not include processing jet fuel. The economics simply aren't there that make it better than supplying road fuel. If those economics become better so that it is desirable to sell jet fuel, it's a relatively minor conversion to be able to make that plant capable of that. But at this point in time, we have -- up to this point in time, we have not seen anything from an economic perspective that tells us we're better off making jet fuel than we are making road fuel.

Operator

Our next question comes from Ken Zaslow with Bank of Montréal.

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

Just a couple of questions. One is how much of the LCFS credit that moved up, do you think that has any impact on you guys because of you guys taking capacity off? Or do you think that is -- what do you think the key dynamics of LCFS credits to current levels will be?

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

Well, this is John. The key dynamic to the LCFS levels is that it went from 3.5% to 5% on the gasoline pool. It still held at 3.5% until the litigation clears for this year. And then next year, it's going up even further. So what's happening in California is, as we have an increasing LCFS demand, as those targets continue to improve and increase going forward, up to now to 20% by 2030, that means that more credits are going to be required to fulfill the market for the deficits that are being created by the use of petroleum fuels. And we are going to see that pattern continue going forward. There's absolutely no doubt that California is going to need a significantly greater credit generation to meet the goals in which they have established and in place until 2030. That's the driver. Diamond being down for 30 or 45 days or 50 days or whatever, that's just a temporary blip of the -- LCFS, in our opinion, is not up because Diamond is down. It's up because of the demand that's being driven by the program established by California.

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

John, could you comment for the call here a little bit on the discussion on CAPA standard and what's going on in California and the challenges?

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

Yes. Obviously, that's been a lot of press recently that the EPA is going after to California as waiver. Really, the issue here as we understand that California is going -- that the EPA is going after is today, there's different engine requirements in California -- and other states that have joined California -- than there are in other parts of the United States. The automobile manufacturers obviously don't like that because it means that they have to manufacture a couple different types of cars to be able to sell into the various markets. We don't see that particular issue as having a negative impact on what's happening with the LCFS program. In some ways, it may actually have a positive impact because it means that the renewable fuels have to do more of the work to reduce the carbon emissions that the state of California has legislated that they want to have happen. And so there's been a lot of discussion, a lot of smoke around this particular issue. We don't see that as fundamentally changing what's going to happen with the LCFS program.

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

And then my -- usually, you give a little bit of an outlook for the food and feed EBITDA for the rest of the year and into 2019. Can you give a little color to how you're thinking of that progress throughout the year?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

Ken, have I ever given guidance?

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

You usually give a lot of color.

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

No. I think as we go back and kind of dissect the script a little bit and to talk about the segments, you know I see a pretty consistent operating environment for the segments going forward into third quarter. Third quarter is always a little bit of a challenge in the sense of fat quality in North America. I mean, we've been hotter than hell this summer. The plants get a little challenged there. We've seen fat prices kind of rebound a little bit late in June. We're starting to capture a little more of that. But conversely, we've seen what I'm going to call the high-end proteins or species-specific proteins. Their premium margin structure is contracted a little bit. A little bit of that is driven by just by the supply push that's going on. The summer pet pack season that goes on. And then at the end of the day, we got a little bit of what I'm going to call tariff overhang or hangover that's going on out here. No one knows exactly with the roulette that the Trump administration is playing is are they really going to and inact and when that happens. So you got a little bit of pressure on proteins right now. Fats are improving. I think we'll call a bottom of fat prices in Europe right now. So I think we'll see some improvement there. And at the end of the day -- the Food segment -- clearly we had a lot of noise in those Food segment numbers with the Hurlingham asset going down. So I see improvement there for the quarter in the Food segment. And then the Fuel segments are the most consistent operating units. And so at the end of the day, it should be pretty consistent.

Operator

Our next question comes from Bill Baldwin with Baldwin Anthony Securities.

William Lewis Baldwin - *Baldwin Anthony Securities, Inc., Research Division*

We might as well get back to Diamond Green Diesel. That's been the subject of the day here, Randy, and John and Brad. But Randy indicated that an additional $75 million to $100 million dividend perhaps could be coming this year. Is that for Darling? Or is that combined for Darling and Valero?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

That would be to Darling entity. I think we have affirmed that we think we'll pull up to $100 million, maybe a little more out of it this year. We're still going through the final accounting, if you will, of what the expansion here. Obviously trying to get up to run rates and go from there. That doesn't really address what if the blenders tax credit comes back in retro. I mean, as I commented before, we remain optimistic. Our team will be involved with meetings again next week, educating the different representatives and senators on the importance of it to our industry. And there just feels like there's momentum within the parties right now to get something done before the midterms. Whether that happens or not, who the heck knows. But no, short answer to your question is we're affirmative we think we'll 100. We could have a little more out of there depending on the timing here of both the run rate and whether or not the blenders tax credit comes in.

William Lewis Baldwin - *Baldwin Anthony Securities, Inc., Research Division*

And Randy, does that assume that this expansion that's being completed here this year is funded out of cash flow or are you going to be incurring some additional debt on the joint venture to support both the CapEx and the dividend?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

No. I think right now, while the -- the final cost estimate is nowhere near complete. The assumption underneath it is, is we will fund it out of cash flows of the business. And so that's one of those things that says we should have, obviously, the dividends are fairly well known for '18. The dividends depend on both the LCFS markets and the blenders tax credit for '19. But there will -- there should be significant dividends in '19 again. And then '20 will be the year that we pay for the new factory.

William Lewis Baldwin - *Baldwin Anthony Securities, Inc., Research Division*

And while we're talking here, looking out a little bit. How do you see the product out of Diamond Green Diesel being impacted by the IMO 2020 regulations, assuming they go into effect on low sulfur bunker fuels for the maritime vessels.

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

Yes. This is John. We love demand for diesel fuel because obviously we plan to diesel fuel. So we believe this is going to be a strong demand element for diesel fuel. As we all know, diesel fuel is the very foundation for our pricing structure out of Diamond Green Diesel. So we see it as a positive and can't wait for 2020 to get here.

William Lewis Baldwin - *Baldwin Anthony Securities, Inc., Research Division*

So while it would be hard to quantify, you would expect some kind of additional premium or at least increase pricing for your product when that becomes effective in 2020.

John Bullock - *Darling Ingredients Inc. - Executive VP of North America Specialty Businesses & Chief Strategy Officer*

Yes. It's hard for me to know exactly what each of these components will look like for 2020. And there are -- there's always so much volatility around the individual components around global fuel. I've kind of learned over the years not to get too precise in terms of what I think it's going to happen with each individual component. But what I do pay great attention to is whether or not the trend is favorable in terms of the pricing for our product and the margin for our product. And I would definitely classify this development as positive for the pricing and the margin of our product.

Operator

Our next question is a follow-up from Heather Jones with the Vertical Group.

Heather Lynn Jones - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

Just 2 quick follow-ups. One, you mentioned species-specific plants in your feed business. And I'm just wondering, I know you made a lot of -- have taken a lot of steps there. And I'm just wondering if you could just give us a sense of what proportion of your plants now are species-specific?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

I don't know that I could give you an exact portion, I mean, what you're -- I have not thought through that from that perspective, Heather. I mean, I can tell you that we have realigned a lot of our factories --I'll just kind of -- both here and in Europe to make sure that we're making the products that the major retail pet food companies and aquaculture companies around the world want. And so that's code for saying that at the end of the day, some of it -- you can't -- you've got to separate the poultry, if you will, from the route material that we pick up at grocery stores here in the U.S. in North America. So, I mean, over the last couple of years, we've converted San Francisco to an all-white or poultry meat plant. LA, the big expansion out there is both -- we got a red meat side and we'll soon -- here by fourth quarter, have a full-blown chicken line out there. Fresno is all beef. Tulsa is all pet food beef. Bellevue is all pet food beef. So at the end of the day, I don't know, probably 50%, 60% of the factories now where we can that are non -- what we call non-city plants are going species-specific to the degree we are. We just completed a -- taking feathers out of our Turlock plant and putting in a feather line there and we have done several other modifications in Europe to make -- what I'm going to call a more higher-quality, more digestible, more preferred products. So it's all about getting a little more margin here. The plants that struggle, and as I made in my comments and I don't -- struggle is probably too strong a word -- but the ruminant meat and bone meal is the least preferred protein in the world today. So really, if it's what's driving the export side or if you look at the pricing relationships there, they are down historically to their normalization or normal spread to soy meal and that's because at the end of the day, we're all trying to serve really poultry markets the Pacific Asia pack rim area today. So at the end of the day, we saw more material in Europe that was traditionally going to be incinerated or put to fertilizer now come back into the feed markets. And that product has been off the market for 20 years and for the European side, which were very much a part of to immediately go out and try to market that product after they had different uses for many years that weren't necessarily feed. And now to tell everybody else that it's okay for feed has caused quite a bit of havoc in that market. So that's driven a lot of our behavior to make basically poultry, porcine and beef facilities.

Heather Lynn Jones - *The Vertical Trading Group, LLC, Research Division - Research Analyst*

And then my final question is just on Diamond Green, the fats buying. So like how much fat did you all -- how much supply did you bring in to the takedown of the plant? Because we have seen fats pricing go up. But once the facility is online, it's a pretty dramatic increase in the feedstock demand for the entire industry. And so I'm trying to get a sense of when should we expect a more meaningful step up in fats pricing?

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

Heather, if we'd known your address, we would have parked a couple of trucks and rail cars in your house. So obviously, so going down in early June and coming up here right now. And then John referenced that we took some both demolition expense and cleaned out a bunch of tanks there. We kind of went down and left some empty and now we're back, filling back up. We also had quite a bit of material in offsite storage here to take advantage of what we saw to be -- would be a rising feedstock market. So I think while I can't speak for -- and I don't want to tip our hand to when our team will be back in the market to buy. But at the end of the day, we went down with a pretty good pipeline. As John said, we've always got 60 days inbound to us down there at any time. So sometime here, later this quarter, we'll be -- it'll start ramping back up again.

Operator

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

Randall C. Stuewe - *Darling Ingredients Inc. - Chairman & CEO*

All right. Thanks, everybody. Great questions today, I look forward to bringing you up to speed on our progress here in November. So have a great summer and holiday season. Thank you.

Operator

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