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Darling Ingredients, Inc. (DAR)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Darling Ingredients, Inc. Conference Call to Discuss the Company's Fourth Quarter and Fiscal Year 2022 Results. After the speakers' prepared remarks, there will be a question-and-answer period, and instructions will be given at that time. Today's call is being recorded.

I would now 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.

Good morning. Thank you for joining the Darling Ingredients fourth quarter and fiscal year 2022 earnings call. Here with me today are Mr. Randall C. Stuewe, Chairman and Chief Executive Officer; Mr. Brad Phillips, Chief Financial Officer; Mr. John Bullock, Chief Strategy Officer; and Ms. Sandra Dudley, Executive Vice President of Renewables and U.S. Specialty Operations.

Our fourth quarter and fiscal year 2022 earnings, news release and slide presentation are available on the Investor page under the 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 or other statements about future events. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results can materially differ because of factors discussed in 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 statement.

Now, I will hand the call over to Randy.

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

Hey, thanks, Suann. Good morning, everyone. Thanks for joining our fourth quarter and fiscal year 2022 earnings call. On February 3, 2023, I celebrated with my team my 20th anniversary as Chairman and CEO of Darling. Many of you've heard me tell the story of my early days here. At the time, we had 600 employees in 20 locations throughout the United States. Brad and I were paying utility bills out of a shoe box, prioritizing the ones that needed to be paid first to keep our operations running. Our stock was trading about $1 per share. We had to figure out how to move from surviving to thriving. We had a plan.

As I sit here today 20 years later, I can't help but smile when I tell you we are now 15,000 employees strong in more than 260 locations on five continents. We have 15,000 of the most dedicated and talented employees that come to work every day because they know their work matters, not just to themselves and their families, but to meeting the critical needs of our world. What they do every day is making our world a more sustainable place for our future generations.

We provide two very needed solutions to the world: food and clean energy. It's no doubt that Darling Ingredients has transformed over the last 20 years and, in the process, we created our own unique platform with a deep moat surrounding our castle. We have delivered superior earnings growth driven by our global platform, vertical integration and diverse segments.

In 2022, we closed on three important acquisitions and are in the process of completing two more that will continue to strengthen our foundation for growth in four key areas: the core rendering business, hydrolyzed collagen, green energy and soon to be sustainable aviation fuel.

2022 also marked the fifth consecutive year of record earnings at Darling Ingredients. Combined adjusted EBITDA for fiscal 2022 was $1.541 billion as compared to $1.235 billion in 2021. Looking at our segments in detail, for fiscal year 2022, our Global Ingredients business came in at approximately $1.1 billion EBITDA. The Feed Ingredients segment ended the year at $810.1 million. Our Specialty Food Ingredients segment earned $256.7 million EBITDA, while our Fuel segment earned $536.6 million EBITDA, with approximately $443.5 million coming from Diamond Green Diesel.

Now, turning to the Feed Ingredients segment in detail. Globally, raw material volumes were up 27% in 2022 as compared to 2021. I'm happy to report that while we are still very early into our 1,000 day integration plan for Valley Proteins, as well as the acquisition of the FASA Group in Brazil that closed in mid third quarter, we realized an increase in gross margins in the fourth quarter of 2022 as compared to third quarter 2022 despite our Tacoma, Washington and Ward, South Carolina plants being down from a significant fires late last year.

On February 14, we announced an expansion of our Bellevue, Nebraska plant, which will handle all the raw material from a new 2,000 head per day beef processing facility being built by Cattlemen's Heritage Beef Company. Our expansion, which will be completed by the end of 2024, will add about 30% more rendering capacity to our Bellevue plant.

We also announced on February 21 that Panda Express has chosen Darling Ingredients as its preferred nationwide provider for used cooking oil recovery services. Darling will collect and recycle used cooking oil from more than 2,400 Panda restaurants in the United States. These projects, coupled with our strategic acquisitions, illustrate how Darling is continuing to build its market presence and strengthen its vertical integration to derisk the supply chain [ph] with (05:36) Diamond Green Diesel.

Now turning to our Specialty Food Ingredients segment. Our strategy is to continue to increase our product sales in higher value hydrolyzed collagen, which today represents about 25% of our collagen sales within the Food segment. To accommodate that growth in the market, we are adding more hydrolyzed collagen capacity in our existing processing facility in Epitacio, Brazil, which is due to come online at the end of the first quarter or early second quarter this year.

And we are super excited that our previously announced acquisition of Gelnex should close some time in the second quarter. Gelnex operates six facilities, four in Brazil, one in Paraguay and one in Portage, Indiana in the US, and has the capacity to produce approximately 46,000 metric tons of gelatin and collagen peptide products. Gelnex is a very well-run business and will be immediately accretive. Depending on when it will close, I estimate that Gelnex should add anywhere between $75 million and $100 million of EBITDA to our 2023 earnings. As we modify and bring our technology to these facilities, I anticipate we could see the Food Ingredients segment approaching an EBITDA of $350 million to $400 million over the next two to three years.

Now moving to our Fuel segment. Our record year was driven by the strength of our DGD joint venture, higher sales volumes and prices in Europe and the continued expansion of our European green energy business that is performing extraordinarily well. Diamond Green Diesel set another sales volume record in the fourth quarter with the successful commissioning and startup of our new Port Arthur, Texas renewable diesel plant. The plant came online mid-November and was completed nine months ahead of schedule and under budget. For the fourth quarter, DGD sold 208 million gallons of renewable diesel and recorded $1.40 per gallon EBITDA. For fiscal 2022, the joint venture sold 754 million gallons of RD at $1.18 per gallon.

Our latest expansion brings DGD's annual production capacity to approximately 1.2 billion gallons and 50 million gallons of naphtha. As many of you know, on Jan 31, we announced our entrance into the sustainable aviation fuel market. Expected to be completed in early 2025, the project will allow us to upgrade about 50% of our production at Port Arthur to SAF and is estimated to cost around $315 million. With the completion of the project, DGD is expected to be one of the top SAF manufacturers in the world. Ultimately, if the market develops as we anticipate, additional capacity could be built in Norco, Louisiana. We're very excited about this project as we believe the conversion gives us tremendous optionality and once again deepens our moat as we assist the world in decarbonizing.

Now, with that, I'd like to hand the call over to Brad to take us through some financials. And then we'll come back and I'll give you some thoughts on the balance of 2023 here. Brad?

Brad Phillips

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

Okay. Thanks, Randy. Net income for the fourth quarter 2022 totaled $156.6 million or $0.96 per diluted share compared to net income of $155.8 million or $0.94 per diluted share for the 2021 fourth quarter. Net sales were $1.77 billion for the fourth quarter 2022 as compared to $1.31 billion for the fourth quarter 2021 or 35% increase in net sales. Net income for fiscal year 2022 was $737.7 million or $4.49 per diluted share compared to $650.9 million or $3.90 per diluted share for fiscal year 2021. Net sales were $6.53 billion for fiscal 2022 as compared to $4.74 billion for fiscal 2021 or 37.8% increase in net sales.

Operating income increased 18.1% to $249.2 million for the fourth quarter of 2022 compared to $211 million for the fourth quarter of 2021, primarily due to a $67.7 million increase in gross margin and Darling share of Diamond Green Diesel's earnings increasing $53.8 million quarter-over-quarter, which more than offset depreciation and amortization increasing $36.6 million and SG&A increasing about $24 million quarter-over-quarter, both primarily due to the FASA and Valley Proteins acquisitions.

Also, a $21.1 million asset impairment charge was recorded, as the company made a decision to close the Peabody, Massachusetts collagen location in 2023 in order to optimize our global collagen network. Additionally, in the fourth quarter of 2022, we incurred $2.7 million in acquisition and integration cost.

Operating income for fiscal year 2022 was $1.03 billion as compared to $884.5 million for fiscal year 2021. The increase in operating income was primarily due to a $287.6 million increase in gross margin and a $20.7 million increase in Darling share of DGD earnings year-over-year, which more than offset depreciation and amortization increasing $78.3 million and SG&A increasing about $45 million for fiscal year 2022 as compared to 2021, both primarily due to the acquisitions of FASA and Valley Proteins.

For the year, there were $29.7 million in asset impairment charges for fiscal 2022 as well as $16.4 million in acquisition and integration costs, primarily related to our acquisitions of Op de Beeck, Valley Proteins and FASA, as well as the previously announced pending Gelnex and Miropasz acquisitions. Total other expenses increased approximately $34 million quarter-over-quarter and $71.6 million year-over-year, primarily due to increases in interest expense of $31.2 million and $63.5 million, respectively, from increased debt.

Turning to income taxes. The company recorded income tax expense of $146.6 million for fiscal year 2022. The effective tax rate was 16.4% and cash tax payments for 2022 were $113 million. For 2023, we are expecting the effective tax rate to remain about the same, around 16%, and cash taxes to increase to approximately $180 million.

As mentioned last quarter, in August 2022, President Biden signed the Inflation Reduction Act, which includes a new 15% alternative minimum tax based upon book income, a 1% excise tax on stock buybacks, and tax incentives for energy and climate initiatives, among other provisions. We do not currently expect the new book minimum tax and/or excise tax on stock buybacks will have a material impact on our financial results.

The blender tax credits, which are refundable excise tax credits, have been extended two years through December 31, 2024. After 2024, the Clean Fuels Production Credit, a non-refundable income tax credit, becomes effective from 2025 through 2027. The Clean Fuels Production Credit will be available to producers of qualifying on-road and aviation transportation fuel. We are assessing these tax incentives which could materially change our pre-tax or after-tax earnings and impact our tax rate in future years. We will continue to evaluate the applicability and effect of the act as more guidance is issued.

Now turning to debt. The company's total debt outstanding at fiscal year 2022 was $3.38 billion as compared to $1.46 billion at fiscal year-end 2021. Our bank covenant leverage ratio at the end of the year was 2.54 times as compared to 1.57 times at fiscal year-end 2021. We continue to maintain strong liquidity with $1.31 billion available on our revolving credit facility as of December 31, 2022 as well as $800 million of undrawn term loans to be borrowed for the anticipated closing of the Gelnex acquisition.

Capital expenditures totaled $134.1 million in the fourth quarter and $391.3 million for fiscal 2022. The company repurchased approximately 336,000 shares of its common stock for $22.5 million during the fourth quarter, which brought the fiscal year total shares repurchased to 1.9 million for approximately $125.5 million, leaving the company $374.5 million remaining in its share repurchase program as of fiscal year-end 2022.

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

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

Hey thanks, Brad. Well done. No doubt 2022 was a great year for Darling Ingredients and we carry tremendous momentum into 2023 as we continue our laser focus on the integration of our new businesses around the globe. While fat prices have eased in Q1 due to turnarounds and unplanned downtime by global renewable diesel producers, we should see improvement as these situations remedy. Global protein demand for animal production and pet food supplies remains robust and modestly stronger than last year.

Capital investments in 2023 are estimated to be about $565 million, with more than 20% allocated to expansion projects to drive new profitable growth. These projects include expansion of our green energy business in Europe, growing capacity at our existing US rendering plants to accommodate both customer growth and increase waste feedstock supply for renewable diesel production and increased spray dry capacity for hydrolyzed collagen production.

With respect to Diamond Green Diesel, we expect sales volumes to be about 1.2 billion gallons in 2023, making DGD North America's largest renewable diesel producer. DGD's superior logistics, Darling's vertical integration and access to global waste feedstocks combined with our pretreatment technology positions DGD as the premier renewable diesel provider in the world.

Recognizing LCFS prices were lower in 2022 compared to 2021 and the RVO created some noise in the market, sending feedstock prices lower, our performance in 2022 shows that DGD is profitable and will continue to be profitable. For 2023, I expect DGD to sell 1.2 billion gallons of renewable diesel at a minimum of $1.10 per gallon.

Our plan for 2023 is to build on our growth strategy and continued success. We expect to grow earnings between 15% and 20% by the end of the year, and we're still giving guidance of $1.8 billion to $1.85 billion in combined adjusted EBITDA. And those numbers don't include the closing of the Gelnex acquisition until we see it happen. We finished the year with a bank covenant leverage ratio of 2.54 times. And with the anticipated closing of Gelnex shortly, our debt ratio will peak slightly over 3 times. But as we expect DGD to start distributing regular dividends, we anticipate being sub-3.0 by the end of the year.

Make no mistake, our financial priorities will be to pay down debt and work toward investment-grade. We're committed to continuing our opportunistic share repurchase program, as Brad said, with $374.5 million remaining as approved today. And finally, with the large acquisition behind us, after we close on Gelnex, we will continue our laser focus on integrating all our businesses.

Darling Ingredients offers tremendous shareholder value. There are very few companies that can show consistent strong earnings growth while setting high standards for sustainability. Darling Ingredients is the only publicly traded company that eliminates waste from the meat industry and upcycles those products to their highest value.

In December 2022, we committed to the Science-Based Targets Initiative, undertaking significant Scope 1 and 2 emissions reductions in the mid-term, aligned with the 1.5-degree Celsius pathway and achieving net zero by 2050. We are currently in the process of quantifying our Scope 1 and 2 reduction targets, while account for the recent growth of our business and completing our Scope 3 inventory which will guide us on where we need to focus our reduction activities.

Additionally, we are in the process of completing a new materiality assessment as we know our footprint and stakeholders have changed over the past two years. As I've said for many years and before, we were green before green was cool. This year, we will process approximately 16 million metric tons of raw material that could have gone to the landfill or been incinerated. We recognize that our carbon avoidance story is why many of our shareholders believe and invest in our company. We are actively researching how we can calculate our carbon avoidance number, report it and hopefully one day monetize it in the form of carbon credits. I feel very good about our progress and I'm even more excited about the opportunities ahead.

So with that closing, let's go ahead and open it up to Q&A and we'll try to answer your questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] And the first question will be from Derrick Whitfield from Stifel. Please go ahead.

Derrick Whitfield
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good morning to all and thanks for taking my questions.

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

A

Good morning.

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

A

Good morning.

Derrick Whitfield
Analyst, Stifel, Nicolaus & Co., Inc.

Q

For my first question, I wanted to focus on your feed business. With the improvement you experienced in margin sequentially despite seasonal and weather impacts with UCO, could you offer some perspective on how we should think about your trajectory of margin recovery over the next couple of years as you bring additional Valley plant up to Darling stack?

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

A

Yeah. This is Randy, Derrick. I'll come in a high level and then Brad and John can assist if I miss over something. But, I mean, clearly, as we've tried to articulate to people we're 200 days into a 1,000 day integration plan at Valley Proteins. Their margins were under half of what ours were. And so, when you put together their business with our USA business, you can see the margin pressure and the progress we're making. I mean, it ranges from renegotiating raw material agreements, optimizing plant labor situations, the systems at full capacity, they were moving material around in ways they shouldn't have, and then ultimately moving to our customers where they were exporting, they're now shipping Diamond Green Diesel and you can see that coming through.

You're going to see in Q1 and Q2 continued progress there. I mean, I do want to say, as always, we talk about fat prices, fat prices are down a little bit in Q1. I mean, they're driven by – obviously, people were trying to position against Diamond Green Diesel startup and then also the amount of global fat we're bringing in along with our downtime and three or four other people's downtimes around the world and turnarounds. And so, the fat just backed up a little bit. That'll remedy itself, as we said, as we go forward. So there may be a little pressure there in Q1. But remember, in Q2, DGD then gets the benefit of those lower fat prices and that translates back through in the Fuel segment.

So, as always, I want people to think about the total offering, not just down to a segment level because it can move around from time to time. John, anything you want to add there?

John Bullock
Executive Vice President & Chief Strategy Officer, Darling Ingredients, Inc.

A

No, I think the Valley is exactly what we thought we were getting is a huge block of volume that's very well geographically positioned. We can already see tremendous improvements that are happening as we get the Valley close together with our US rendering folks. It's going to take a little time, but they're moving at an extremely fast pace. We're very, very excited what we're seeing out of that acquisition.

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

A

Yeah, Derrick. And I would add, I mean, as people were looking at the performance in Q4, the Ward, South Carolina plant lit up on fire on Thanksgiving Day or evening. I can't remember which. It's a total loss. Clearly, we were insured around the horn at Tacoma and in Ward with business interruption. But there are rules around that as – accounting rules as when we can recognize that. And just for example, in Q4, in December, the Ward, South Carolina plant transferring the volume around to keep the customers happy was around $4.5 million. So it's a pretty easy bridge to see where we're headed to.

We had a little bit of bad luck there, but it's going to be built back bigger, better and badder here and be online towards the end of the year. But the system is being able to handle it now. And then hopefully sometime later this year, Brad will say we can set up an accrual for the BI payment that's expected.

Derrick Whitfield
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Perfect. That's great color. And perhaps for Randy or Sandy with my follow-up, maybe if you could elaborate on the market opportunity. In your prepared comments on SAF, I know you've referenced $0.75 as a breakeven in the past, which is clearly covered by the SAF BTC. However, I suspect the market will bear a greater premium and there's probably some optimization you could pursue at DGD 3 as well.

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

A

Yeah. And Sandy and I will tag team this and she can give you – I'll give you the view from my chair. Number one, there's a lot of promises being made out there on SAF by a lot of people, and there's no gallons. So, these will be the – what I'm going to call the first real gallons made to a system that's going to have to decarbonize and move forward. It also gives us tremendous optionality. And the optionality piece is, while the industry and the analysts industry wants to sit there and tell us all this capacity that's being added out there in the RD world, we're going to move the next step. We've always been the first-mover there and we'll control that optionality.

The margins Sandy can comment on, but long term, what we've learned here is, is that we'll have the flexibility to arbitrage between the products. And I suspect over time we'll make that decision to add another SAF unit as the world moves forward. The beauty with Port Arthur is that it can make the product. It can ship the product to California under the proposed intrastate rules that are being promulgated. It can export the product. So, Sandy, what else do you want to add on? What gets you excited about SAF?

Sandra Dudley
Executive Vice President-Renewables and U.S. Specialty Operations, Darling Ingredients, Inc.

A

I think that SAF for us, as you've mentioned, it just helps us diversify our book. So, not only are we able to offer new products, but we're also able to participate in different markets than we've participated in before. And as you say, that gives us optionality. I think that there's a lot of support out there behind SAF, too, that we're seeing that I think will eventually increase the premiums that are available within that market. I mean, we have the Inflation Reduction Act that was passed. I think that's very positive for SAF. We just saw that California in their scoping plan that they are considering instituting an intrastate jet mandate. And so, I think that that's a positive thing for us.

And then, what we've seen lately is we've seen a number of SAF tax credits. So, Illinois passed one. Washington is considering one. We're seeing Norway increasing their SAF mandates. We're seeing more states with LCFS proposed programs such as New York, New Mexico, Vermont, Minnesota. And so, I think that there's just so much going on in that space that's positive for us.

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

Yeah. And I think just to kind of close off the loop, obviously, until you sell something, you don't know what the margin is, but we believe that there's just a ton of momentum out there in that market that gets us really excited. And to be honest, we wouldn't make the investment if we didn't believe the margins would be equal to or superior than what we're doing in the road fuel market today.

Derrick Whitfield
Analyst, Stifel, Nicolaus & Co., Inc.
Q

That's very helpful. Thanks for your time and responses.

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

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC
Q

Yes. Thank you. Good morning, everyone.

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

Morning.

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

Morning.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC
Q

So, Randy, in your prepared remarks, you kind of talked about making sure to consider the kind of balanced earnings might shift between Feed and Diamond Green depending on kind of where prices are and where the RD margins are. And so, I'm just trying to get a sense, the full-year EBITDA guidance is minimum of $1.10 a gallon. And you talked about upside in the second quarter because fat prices have come down and that will accrue into DGD. But, I mean, am I wrong to think that spot margins certainly in the first quarter are comfortably north of that $1.10 a gallon? And so I'm just trying to get a sense of where kind of quarter-to-date margins have been tracking and would seem like that's trending in the right direction into the second quarter based on kind of some easing feedstock prices. And then I've got a follow-up on the Feed business.

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

Okay. No, it's fair question, Adam. And you're reading the breadcrumbs really well there. Ultimately, as we look at Diamond Green Diesel margins, remember, the $1.10 we put out there is what we believe the competitive advantage is that 1, 2 and 3 have against any other producer today. If you want to see the advantage, look at HollyFrontier DINO's RD gallons and earnings for fourth quarter. So there it is, again, as we show people what we do for a living.

Number two, yes, the margins – spot margins are better than what we're getting for the full year. Remember, Diamond Green Diesel, one, was down for a catalyst turnaround here February 3. It's back up at capacity. So, at the end of the day, we're getting up, that's back online. Number three is still in the process of getting up to the full rate and where we believe it can go. And our partners, Valero mentioned on their call logistic challenges. I mean, clearly there's no secrets out in the world. We got a lot of cars sitting down there waiting to unload and to get up to rate there. And so, ultimately, at the end of the day, we're going to pick up incredible momentum in the Diamond Green Diesel system throughout the year.

The other piece that I want to kind of put out there to let everybody noodle on is you can't be bearish fat prices if you're bullish renewable diesel capacity. It just doesn't work that way. And so, at the end of the day, you've got to pick or choose the crap table where you're going to place your bet here. Is that RD capacity coming online, then you got to get bullish fat prices, which is bullish our base ingredient business. If you don't believe that capacities coming online, then there's adequate fat to run number three in all of this and we'll be running full ways fat at great margins. So, end of the day, people have to decide what they truly believe here. What we've proven is $1.40 a gallon in Q4. And as I've said before, the numbers do the talking. So, let's go to the Feed segment, Adam.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC
Q

Okay. That's really helpful. So, then in Feed, I was hoping you could kind of just break down a little bit more the contribution from Valley and FASA in the fourth quarter. Kind of from the K, it imply that the net loss of Valley seems to have actually gotten bigger in fourth quarter and maybe there's an accounting noise kind of in there. But can you help us think about kind of the earnings contribution in Feed? It seemed like it degraded through the quarter in part because of the fire and the capacity. And what that implies going through the first quarter?

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

Adam, one thing. This is Brad. So, on the net loss mentioned in the K and footnote 3, that is predominantly – and Randy referenced it earlier, the Ward facility, a sizable facility, we also had a insurance deductible charge taken in the quarter. So that contributes to that number being higher than the Q3 rate on that. But other than that, on Valley, Randy?

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

Yeah. I mean, ultimately, we're making great progress there. And clearly, we're near business case at our timeline. Remember, our 1,000 day integration plan, we're at our business case very close without the Ward fire. In January, we made a lot of adjustments to raw material procurement agreements that will kick in here in Q1. Those were contracts that had to be renegotiated. We're seeing some unique things as the poultry industry changes diets to adjust for the renewable diesel demand for animal fats now. Where they're used to feeding animal fats in their diets, they're taking them out and substituting alternative ingredients and changing different attributes of the rendering materials that we're getting. That has to be accounted for in your procurement formulas.

And so, we have done that in Q1, and that will start to flow through here towards the end of Q1, early Q2, and predominantly Valley plants on the Eastern Shore are poultry plants. And so, those are sizable numbers as we go forward. The FASA business is running classically right on business case.

John, anything you want to add?

John Bullock
Executive Vice President & Chief Strategy Officer, Darling Ingredients, Inc.

A

I think the most important thing, as you look – and I understand as we get dips and as we bring – dips in pricing here and there and as we bring these facilities on, it's not always a straight line. But the underlying strength there is the volumes are exactly what we thought they were going to be. And as long as those volumes remain there, we are going to be able to get the Valley profitability over our timelines within where the Darling system operates and we're going to be able to have the type of profitability we anticipated on all these acquisitions. So the underlying strength there is our volumes, right.

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

A

Yeah. And I think the other thing, Adam, that isn't very transparent and it's hard to break out. But in Europe, we were paying €210, €230 per megawatt hour for electricity. We're down to €50 now. And so, the gas prices ran up hard on us that you can't make raw material adjustments that quick in Europe. They've come back off. We're now back to $2 natural gas or plus burner tip distribution in the US. So, gas prices impact Q4 a little bit too. And it's always hard to see how that flows through.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. I appreciate all that color. I'll pass it on. Thanks.

Operator: The next question is from Dushyant Ailani from Jefferies. Please go ahead.

Dushyant Ailani
Analyst, Jefferies LLC

Q

Hello and good morning, and thank you for taking my questions. My first one is trying to understand the CapEx cadence going forward. I know you talked about, I think, roughly $565 million for 2023. How do we think about 2024 considering just the Valley integration?

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

A

CapEx?

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

A

Yeah. I mean, clearly, we gave a number of around $125 million that would have to go into those Valley plants over the next couple years. We're about halfway through that now. So, a portion of that number is FASA, the two plants under construction. We got a plant under construction in Turlock, California, another line under construction in Boise, Idaho. We're going to start permitting the Bellevue, Nebraska plant. We got the Epitacio spray dryer. We got a wastewater plant in Brazil. And then we've got the green energy expansions in Europe of the Op de Beeck Belgium digester and the sun digester. And all of that's rolled into there. And so, like we said, about 20% of it is growth projects that would meet our 15% to 20% hurdle rate. And the rest of it is just maintenance and standard CapEx between fleet and operating plants.

Dushyant Ailani
Analyst, Jefferies LLC

Q

Got it. Thank you. And then my second question was just wanted to talk about the margins for the Food segment. I think it was down quarter-over-quarter. Any kind of drivers around that and then how do we think about that going forward?

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

A

Energy prices, as Randy mentioned earlier, in Europe.

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

A

Those will rebound. And clearly, I can tell you we're off to a good start this year. I mean, the chart in the earnings deck, the growth of that Food segment just gives – is really the story that we're doing. Clearly, it's a multi-continent strategy. China had a great year. South America had a great year. The US had a great year. And Europe struggled a little bit, especially in Q4 with energy prices and raw materials because of the reduced porcine kill. So that should remedy itself a little bit in Q1. But, overall, we're set to have a really good year in the Food segment this year.

Dushyant Ailani
Analyst, Jefferies LLC

Q

Thank you so much. I'll pass it over.

Operator: The next question will be from Tom Palmer from JPMorgan. Please go ahead.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Good morning and thanks for the question. I wanted to clarify the guidance a bit. So, it sounds as if temporary downtime at RD plants, including at DGD, are contributing to the fat and UCO price weakness we've seen. So maybe could we just clarify the expected duration of DGD's turnaround? It sounds like DGD, once back up and running, is number two down right now. And then, is the message that the first quarter because of this might be a little bit below kind of that $450 million quarterly EBITDA run rate implied by guidance and then starting in 2Q we see a more substantial rebound?

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

A

Yeah. I mean, clearly, Tom, I mean, just going around the horn, DGD 1 was down for 18 to 20 days here. Number three, we don't have the logistics down. I mean, we got a couple railroads embargoed. We're trying to get the logistics up there. I understand Geismar was down. I understand Neste Rotterdam was down for over a month and that was 800,000 tons there. So, as we've said, the feedstock market is a global market. And clearly, what the Port Arthur and St. Charles facilities were originating from around the world. But as I said earlier, it's not going to take much to turn this thing as if you believe any of this capacity that all of you guys write about is truly starting up. I mean, I read a startup on [ph] PBO (37:40) for Q1 here. I read a startup for Vertex for Q1. HollyFrontier has been trying to start up for a year, only ran 54 million gallons at three plants. So, like I said, pick your poison here. But any of those facilities come on, it's positive. And once we get DGD 3 up at rate or above rate, you're going to see it change pretty rapidly here. Sandy, anything you want to add?

Sandra Dudley
Executive Vice President-Renewables and U.S. Specialty Operations, Darling Ingredients, Inc.

A

I think the great thing about DGD 3 or DGD in total is that, even despite what's going on here with feedstocks is we're taking in different feedstocks from around the world. And I think that that's been a huge benefit to us, bringing in those internationally because we're able to take advantage of the lowest-priced feedstocks available in the world because we do have those capabilities. And so, I think it will just increase margins as we go further on to the year.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you. And then maybe just a quick follow-up on the cash flow. The K mentioned a capital contribution to DGD in the first quarter. Maybe just an update on kind of the capital needs right now for DGD and maybe the timing of when we might start to see the distributions. I did see you're guiding for some DGD back to Darling starting this year.

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

A

Yeah. Tom, this is Brad. Yeah. So, you heard earlier [indiscernible] (39:08) at the end of the year with the cold weather, with the kind of startup on number three, with working capital and whatnot. That contributed to the contribution, no pun intended, on what we did here of $75 million per partner and up to the filing here. And so, the outlook is, as Randy and Sandy have mentioned, number three is working its way up to capacity as we speak over the coming days in this month. And as that occurs, we will see DGD become debt-free and would anticipate distributions starting some time by midyear. I would frame it that way if not earlier.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Great. Thank you.

Operator: And the next question will be from Manav Gupta from UBS. Please go ahead.

Manav Gupta
Analyst, UBS Securities LLC

Q

Hey guys. I actually wanted to follow up on something you said and I completely agree. There are some small players out there who are claiming they can produce SAF [ph] they've never (40:23) never actually produced RD and what's interesting is they've gone ahead and signed like 500 million, 700 million gallons of contracts out there. And as you pointed out, these are not real gallons. There is no SAF behind them. But you will have the real gallons. So, my question here is, let's say, if Delta, American and all these airlines come to you and say, please sign a 400 million, 500 million, 600 million gallon contract for [ph] 8 or 9, 10 (40:47) period, would you be open to such contracts because you have the real SAF gallons versus these guys?

John Bullock
Executive Vice President & Chief Strategy Officer, Darling Ingredients, Inc.

A

Yeah. This is John. I think you're hitting on something that we see in the SAF market, which is there's a lot of promises for SAF gallons out there that, quite frankly, we don't really understand how people are going to commercialize and bring to the marketplace. So, we believe we're going to be one of the real players in the marketplace and one of the few real players in the marketplace that are going to have physical gallons available for folks. I think with all the promises that have been made out there, that's going to put us into an ideal position. How we commercialize, how we do in terms of signing contracts [ph] with some folks (41:31) and so forth, that will evolve over the next year or so for us. I wouldn't want to prejudge and essentially say, listen, we're willing to be taken out by one individual counterparty. We're just going to have to see what the market develops, but there is no doubt and we can already see it starting to churn in the marketplace.

People are going to start going from phantom gallons to real gallons, and when they do, there's basically only two doors that people can knock on to get those real gallons, and we're one of them. So we're looking forward to those conversations, we're engaged in those conversations with the counterparties out there. We want to try to turn this into a situation where it's a real advantage for the folks that actually do end up signing the SAF gallons with them because we think they're going to be in a really advantaged position in the marketplace versus their competitors. We think that'll evolve over the next 10 to 12 months.

Manav Gupta
Analyst, UBS Securities LLC

Q

I think phantom gallon is a perfect word for that. My follow-up quick question here is just going back to the guidance. The guidance of $1.8 billion to $1.85 billion does not include Gelnex. So, if you do close that, there is still strong possibility that by the time with slightly higher fat prices and stuff and Gelnex in there, you could still be looking at probably $1.875 billion to $1.9 billion. That cannot be ruled out I'm just saying at this point of time.

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

A

Yeah. That's true, Manav. I mean, until we get antitrust clearance and know the exact close date, I'm just not going to put a number out there. But we're telling you that it should contribute between $75 million and $100 million this year if we get to close that and that we think we're going to get here.

Manav Gupta
Analyst, UBS Securities LLC

Q

Perfect. Thank you for that term phantom gallon. I'm sure I'll write about it. Thank you, sir.

Operator: And our next question will be from Matthew Blair from Tudor, Pickering & Holt. Please go ahead.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Hey good morning. Randy, I was wondering if you've been following the recent LCFS workshops from CARB? And if so, do you have any updated thoughts on where these future LCFS credits are headed?

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

A

Yeah. I'm excited about it, but I'll let Sandy answer it.

Sandra Dudley
Executive Vice President-Renewables and U.S. Specialty Operations, Darling Ingredients, Inc.

A

Yeah. I think we're very excited about the proposed increased stringency among the CARB program going from 20% in 2030 to a reduction of 30%. As you know, as you look at what CARB's modeled itself, in 2024, I think they're around $110 per metric ton and then going in 2026 to the [ph] 200,000 ton or (44:12) meeting the cap and then beyond that further. So I think that that's very positive in terms of credit prices. I think that it's very positive in terms of green premiums for us. And obviously, we're very supportive of that.

There was another thing that CARB also proposed that I think that we're really excited about and that's the LCFS obligation for intrastate flights. I think that that would really support our SAF market and when we come online in 2025 provide just additional demand, et cetera, from that program. And I believe that the jet market there is about 400 million to 425 million gallons. So we're excited about both of those things and I think that that's only good news for DGD and Darling.

John Bullock
Executive Vice President & Chief Strategy Officer, Darling Ingredients, Inc.

A

Can I add here? I think one of the really interesting things, there is always so much wringing of the hands on what's happening with LCFS credits in California, whether or not we're going to get an extra couple hundred million on the RINs market. The reality is when you look at what's happening on the policy front around the world, Europe, Canada, California increasing their LCFS credits; Washington State, coming on; New Mexico, considering; New York, considering implementing on a regulatory basis; a variety of tax credits that are going in in places like Illinois regarding SAF and other states are considering similar. We are in an explosion environment on the demand for low carbon fuels. And what the marketplace is seeing is that they can source low carbon fuels without the credit prices being massively high.

This is great news for Darling and great news for Diamond Green Diesel is more demand for the waste fats in our base business. And what it means for Diamond Green Diesel which, quite frankly, when you take all these announcements and so forth that are out there, if you believe those announcements, there would be a massively more renewable diesel in the marketplace today than there is. The reality is there's more renewable diesel in the marketplace today because of Diamond Green Diesel 2 and Diamond Green Diesel 3, and there's not much else out there right now.

So the fact of the matter is, we see these policy developments as absolutely being perfect for the vertically integrated low carbon strategy we put in place. I'm a little surprised that there's not more excitement about the low carbon demand market that's developing out there than there is. We seem to obsess over the details and kind of miss the forest on this.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Sounds good. And then circling back to the Feed margins, I remember that Q3 was impacted by just the hot weather, which led to increased spoilage. So, I guess, is the way to think about it that the benefits that you got back in Q4 from cooler weather were just completely offset by the negative impact of these two fires? And can you quantify the total fire impact? I think you said $4.5 million for Ward. Was there a similar impact at Tacoma? I'll leave it there. Thanks.

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

A

Tacoma is a much smaller factory, but probably a couple million in the corridor would be my guess. Remember – and Q4 is where the global energy prices that ran up flowed through to. So, at the end of the day, tonnage was strong, protein prices were strong. And you have to go into our financials and you can see how much fat is actually inbound to Diamond Green Diesel. Remember, we don't recognize those profits that are in there. And those numbers are much bigger now, the amount of fat that Darling shipping intracompany than it's been in the past. And so, that's part of it, too, that's down there. We don't try to trade a segment for $10 million in a quarter. And there's at least that, there's $15.5 million deferred going to Diamond Green Diesel right now. And that's a big number from in the past.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Great. Thanks for all the color.

Operator: And the next question is from William Baldwin from Baldwin Anthony Securities. Please go ahead.

William Baldwin
Analyst, Baldwin Anthony Securities, Inc.

Q

Yeah. Thank you.

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

A

Hello Bill.

William Baldwin
Analyst, Baldwin Anthony Securities, Inc.

Q

Good morning. Good morning. Thank you for the time here. Just a quick question. I know it's early in the game, but what's the thinking as far as the feedstock that would primarily you think would be used for SAF? Is that going to be similar to the feedstocks we're looking at for the RD or would that broaden out and include low carbon ethanol and things of that nature?

Sandra Dudley
Executive Vice President-Renewables and U.S. Specialty Operations, Darling Ingredients, Inc.

A

I think in – this is Sandy – in terms of what DGD does and what feedstocks at sources, it would be very similar to what we're using for renewable diesel. So, when we produce SAF, we're not only producing SAF, but we're also producing renewable diesel at the same time. So, we don't anticipate deviating from that model. So, it's going to focus on the waste feedstocks that's going to be your animal fats, your used cooking oil, your corn oil. And the great thing about it is, is we've begun sourcing worldwide, and so we just have a plethora of different feedstocks that are available to us. And we have the great unit that can handle all of those feedstocks. And it's in a great location here [indiscernible] (49:54) easily source those feedstocks as well. And so, we don't anticipate it changing. It should be very similar to what you've seen in the past.

William Baldwin
Analyst, Baldwin Anthony Securities, Inc.

Q

Okay. Thank you. One additional question on feedstock. Does poultry fat find its way into the formulas for DGD's feedstocks?

Sandra Dudley
Executive Vice President-Renewables and U.S. Specialty Operations, Darling Ingredients, Inc.

A

Yeah. Poultry fat is one of the feedstocks that Darling uses. Typically, when we're talking about it, we're talking about animal fat, so we lump it in with that category. So, it is something that we do use.

William Baldwin
Analyst, Baldwin Anthony Securities, Inc.

Q

Thank you. Appreciate your time.

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

A

Thanks, Bill.

Operator: And the next question is from Ben Bienvenu from Stephens. Please go ahead.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Hey thanks. Good morning. I want to revisit the sustainable aviation fuel topic. Obviously, a huge market opportunity for you guys, and you're moving in a meaningful way with your announced investments. Can you talk about kind of what the factors were that prompted that announcement now? I know you guys have been studying this for a while, so maybe it was just reaching the end of the due diligence process. But if you could help us think about, as we look down the road, what are the key things you'll be focused on as you consider potential incremental expansions beyond even what you've been out today or earlier this year, excuse me?

John Bullock
Executive Vice President & Chief Strategy Officer, Darling Ingredients, Inc.

A

Yes [indiscernible] (51:23) so the question is why now on SAF?

[indiscernible] (51:28)

John Bullock
Executive Vice President & Chief Strategy Officer, Darling Ingredients, Inc.

A

Well, obviously, the Inflation Reduction Act being passed is a huge trigger in relationship to that. We had been going through – when we made capital investments in this area, we're kind of the only guys in the renewable space that actually come in on time and on budget or ahead of time and on budget. We're very careful. Our partners, Valero worked to an extremely careful capital deployment process in which we understand our costs and what we're going to do, so the plan will work.

We were at the point where we had completed that and we were waiting for the right policy signals and we saw that with the Inflation Reduction Act. But more than that, I think what we see now is a total commitment from the airline industry here and around the world saying that they need SAF. And when we looked around the marketplace and said, where's the real gallons of SAF, we came to the conclusion that we could be one of the few suppliers out there that's actually not selling phantom gallons. And so, we just thought it was an excellent time to put ourselves in a position to begin the discussion with airline partners and other partners who fly packages around the world who may want to be the guys that are able to back up their claims about SAF – usage of SAF. We think the timing is perfect, seem like the right time to go on Port Arthur.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Okay. Great. And then I want to ask just about the tallow market. Obviously, you talk about the incremental or potential demand associated with RD expansion, but we're also in a troughing beef cycle, which I would think would further tighten feedstocks available that should be great for your tallow pricing in your Feed Ingredients business. Can you talk a little bit about what you're all expecting around the beef cycle and the potential incremental pricing power that could give you guys in your animal tallow business?

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

A

Yeah. Ben, this is Randy. I mean, clearly, what we once saw again was the fragility of the global, what I'm going to call, waste fats or animal fats business. Remember, if you take the bushel a corn, even at $6 or $7 a bushel, divide it by 56, times 3.25, it says waste fats are worth about $0.40, $0.45 in a feed ration. So, once we went offline with the turnaround, once DGD 3 was unable to unload as quickly as we wanted to, once [indiscernible] (53:57) went down, all of a sudden you put an, as I always call it, through the supply chain team, we put an air bubble in the IV line again in the supply chain, that'll remedy itself. It has to and it'll happen very quickly.

I mean, you saw palm oil. Remember, this is a global business. We were so proud that we finally achieved parity with global fats and oils [indiscernible] (54:21). And then we found out how fragile they are again. But at the end of the day, you can't stay a big premium to palm oil for a long time. And you can't stay a big premium to soybean oil. And US soybean oil can't stay a big premium to the rest of the world unless you're going to build the RD capacity and it's truly running. And what you've seen out there is what we've been telling you, we don't see the RD capacity. They may have some steel up and some of it may run at reduced rates. So, I mean, clearly, like I said, you can't have it both ways.

On the animal side number, the poultry numbers are still very strong. The porcine or pig numbers are strong. We're seeing some movement in Europe on pig numbers a little bit. And the beef numbers, yeah, they said the cow and calf herds are small since 1962 which is when I was born, which is hard to believe. But at the end of the day, our plants are still seeing just – we're full. So I really don't see much of a cycle here. Now, remember, we do process for some of the big names out there, but the little guys always seem to stay full versus the big guys when there's any type of contraction of herd size out there. And so, ultimately, at the end of the day, I see – I mean, over 20 years, we've seen a 1% or 2% change in raw material volumes in any contraction year. We're not seeing that now. Anything you want to add, John, that I missed?

John Bullock
Executive Vice President & Chief Strategy Officer, Darling Ingredients, Inc.

A

No, our volumes remain very strong at this point in time. Obviously, we realize the cattle herd is cycling a little bit. The other thing that I think we have to keep in mind is we have a global footprint on sourcing. Obviously, FASA puts us in the middle of Brazil and that's a large cattle area. And so we're diversified now on the origin source of where we're sourcing all of our raw materials. And that helps us. That stabilizes our footprint, gives us opportunities when one country is going down a little bit, oftentimes another country is going up a little bit. So raw material supply looks extremely good.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Yeah. Okay. All very helpful commentary. Thank you both. Best of luck.

Operator: And ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to Randy Stuewe for any closing remarks.

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

Once again, thanks for all your questions today. As you know, we'll be attending several investor conferences this March, which are listed on our website. As always, if you have any questions, reach out to Suann. Stay safe. Have a great day. And I look forward to being back in front of you here this spring to give you a progress update. Thanks again.

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