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Darling Ingredients, Inc. (DAR)

Q4 2023 Earnings Call

CORPORATE PARTICIPANTS

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

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

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

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

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

OTHER PARTICIPANTS

Thomas Palmer
Analyst, Citigroup Global Markets, Inc.

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

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

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

Ben Bienvenu
Analyst, Stephens, Inc.

Jason Gabelman
Analyst, TD Cowen

Dushyant Ailani
Analyst, Jefferies LLC

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

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Darling Ingredients Incorporated Conference Call to discuss the company's fourth quarter and fiscal year 2023 results. After the speakers' prepared remarks, there will be a question-and-answer period and instructions to ask a question will be given at that time. Today's call is being recorded.

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

Suann Guthrie

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

Thank you. Thank you for joining the Darling Ingredients fourth quarter and fiscal year 2023 earnings call. Here with me today are Mr. Randall C. Stuewe, Chairman and Chief Executive Officer; Mr. Brad Phillips, Chief Financial Officer; Mr. Bob Day, Chief Strategy Officer; and Mr. Matt Jansen, Chief Operating Officer of North America.

Our fourth quarter and fiscal year 2023 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 could 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 statements.

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 2023 earnings call. In 2023, Darling Ingredients delivered its sixth consecutive record year in terms of combined adjusted EBITDA at $1.61 billion. The vertical platform we have built demonstrated its ability to perform solidly despite significant volatility in the global food, feed and fuel ingredient markets.

Turning to the Feed Ingredients segment, despite lower prices for most finished goods, our global spread management process and increased volumes compared to 2022 helped to offset the impact. Our laser focus on margin management and continued strategic review of our asset mix, both segment and geographic, ensured our margins remained in alignment with our expectations. In addition, during 2023, we made the decision to close two bakery plants, Muscatine, Iowa, and Bryan, Texas.

Turning to our Specialty Food Ingredients segment. Raw material volumes increased about 11% year-over-year, primarily due to our Gelnex acquisition and continued product mix shift. We continue to see strong performance and continued growth in China and North America consumer markets and remain very optimistic about our health and nutrition business line.

Hydrolyzed collagen will continue to play a key role in our long-term growth strategy. Leveraging our extensive research and development in this area, we have successfully isolated individual peptides with targeted benefits related to various health concerns, such as glucose moderation and memory retention. The potential applications are extensive and we are excited to introduce some of these innovative products to the market later this year.

Turning to our Fuel segment, our European renewable energy segment continues to deliver very strong results. Lower diesel prices, RINs and LCFS values and a lower of cost-or-market inventory valuation impacted DGD margins for the quarter. However, DGD had an impressive year with 1.25 billion gallons of renewable diesel sold at an EBITDA per gallon of $0.81, which is still above our 12-year-old investment case of $0.79 EBITDA per gallon.

With this, I'd like to turn the call over to Brad to take us through some financial comments and then I'll come back with my thoughts on the rest of 2024. Brad?

Brad Phillips

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

Okay. Thanks, Randy. Net income for the fourth quarter 2023 totaled $84.5 million or $0.52 per diluted share compared to net income of $156.6 million or $0.96 per diluted share for the fourth quarter of 2022. Net sales were $1.61 billion for the fourth quarter 2023 as compared to $1.77 billion for the fourth quarter 2022.

Operating income decreased $90.4 million to $158.8 million for the fourth quarter of 2023 compared to $249.2 million for the fourth quarter of 2022, primarily due to Darling share of Diamond Green Diesel's earnings decreasing $118.8 million, attributable to lower RINs and LCFS values and a $60.9 million lower of cost-or-market adjustment. This decline in DGD's earnings was somewhat offset by Darling's global ingredients fourth quarter 2023 gross margin increasing $47.6 million as compared to the fourth quarter of 2022 due to continued improvement from integration work within our acquired companies, which was supplemented in the fourth quarter by reimbursement for certain cost related to Valley Proteins.

In terms of non-operating items, interest expense increased from $46.1 million in the fourth quarter of 2022 to $68.5 million in the fourth quarter of 2023, reflecting the acquisition of Gelnex earlier in 2023.

For the three months ended December 30, 2023, the company recorded income tax expense of $7.2 million, yielding an effective tax rate of 7.7%, which differs from the federal statutory rate of 21% due primarily to biofuel tax incentives, the relative mix of earnings among jurisdictions with different tax rates, state income taxes, certain taxable income inclusion items in the US based on foreign earnings and losses that provided no tax benefit. The company's effective tax rate, excluding the biofuel tax incentives, was 33% for the three months ended December 30, 2023. The company paid $24.9 million of income taxes in the fourth quarter.

Net income for fiscal year 2023 totaled $647.7 million or $3.99 per diluted share compared to net income of $737.7 million or $4.49 per diluted share for fiscal year 2022. Net sales were $6.79 billion for fiscal year 2023 as compared to $6.53 billion for fiscal year 2022.

Operating income decreased $79.3 million to $949.7 million for fiscal 2023 compared to $1.03 billion for fiscal year 2022, primarily due to a $107.3 million increase in depreciation and amortization and $105.9 million increase in selling, general and administrative expenses reflective of the acquisitions completed during fiscal years 2022 and 2023. These expenses were primarily offset by $115.4 million gross margin improvement in the global ingredients business, as reflected in the gross margin percent increasing in fiscal 2023 to 24.2% as compared to 23.4% for fiscal year 2022.

There was a $94.3 million increase in non-operating expenses in fiscal 2023 as compared to fiscal year 2022, which was primarily attributable to $133.7 million increase in interest expense for fiscal year 2023 to $259.2 million as compared to $125.6 million for fiscal 2022. The increase in interest expense was somewhat offset by foreign currency gains as well as physical damage insurance recoveries.

The company recorded income tax expense of $59.6 million for fiscal year 2023. The effective tax rate was 8.3% and cash tax payments for 2023 were $152.7 million. Now, for 2024, we're expecting a 15% effective tax rate and cash taxes to be similar to 2023 of approximately $155 million.

The company's total debt outstanding at fiscal year-end 2023 was $4.4 billion as compared to $3.4 billion at fiscal year-end 2022. Our bank covenant leverage ratio at the end of fiscal 2023 was 3.26 times. We currently have $832.5 million available on our revolving credit facility as of year-end.

Capital expenditures totaled $174.9 million for the fourth quarter 2023 and $555.5 million for fiscal year 2023. The company repurchased approximately 926,000 shares of its common stock during fiscal year 2023 at a cost of approximately $52.9 million.

The company enters fiscal year 2024, projecting $500 million in capital expenditures and is committed to applying our expected free cash flows to debt reduction. The company will continue to evaluate opportunistic share repurchases.

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

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

Well done. Thank you, Brad. 2023 is in the record books and we believe we are well positioned to once again deliver strong earnings and cash flow in 2024. We have built a well-balanced global business model between our specialty ingredients businesses and Diamond Green Diesel.

It's a bit early to guide on 2024 as the global fats and proteins markets are a bit soft. This is a result of replenished global oilseed stocks, slower consumer – global consumer demand and phantom or delayed start-ups of renewable diesel plants.

However, let me be clear, if these plants get built and become more reliable and more renewable diesel comes on the market, we should see fat prices move higher. Clearly, the incentive is there to favor low CI waste fats versus refined soybean oil. And this is going to provide opportunity for our core ingredients business and ultimately benefit Diamond Green Diesel.

Prioritizing cost management, working capital improvements and conducting a robust review of our global asset portfolio continues to be our main focus. We're taking a deep dive into every factory's contribution and reviewing opportunities to improve performance.

Now, DGD is performing well. And despite concerns about RIN markets and LCFS values, our outlook for this business remains very positive, as decreasing fat prices are expected to bolster DGD margins. We are excited about entering the sustainable aviation fuel market in the near future and anticipate margins that are well within the expectations we have communicated. We remain committed to working our way toward investment grade through slightly reduced capital expenditures this year, a focus on lowering working capital and anticipated dividends from Diamond Green Diesel.

Starting with Q1 2024, we aim to accelerate our earnings schedule and I anticipate we will release and host our Q1 call at the end of April. At this time, I'll be able to provide you more details on guidance and outlook on how I see the year is shaping up.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question- and-answer session. [Operator Instructions] The first question comes from Tom Palmer from Citi. Please go ahead.

Thomas Palmer
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Good morning and thanks for the question. I appreciate your comments about not issuing full year guidance at this point, just given some of the moving pieces, but maybe we could frame at least the first quarter, just given we're a couple months. Just any help maybe thinking about kind of the base business and then how margins look at DGD at least up to this point? Thank you.

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

A

No, it's a fair question, Tom. This is Randy. It's been so easy to kind of forecast this business the last couple years looking forward because we didn't have the fat price volatility that we've seen now. I mean, between Q4 and Q1, we've seen fat prices come off at least another 20%. They've hit bottom here is what I would say in February. With your comment about two periods in the books, I've got one on the books in January, and we had a pretty nice January on both sides of the business.

So we feel pretty good about where we're positioned. But at the end of the day, we've always communicated that $0.01 movement in fat was worth about $12 million of EBITDA in the core ingredients business annually. And so, clearly, we've moved lower. We moved lower from $0.54 in Q4 into around $0.40, and in Q1 here, we're coming back. And so that's to me a little bit where my hesitancy is, is to try to do that.

Now, what I will tell you is the DGD has now worked through its pipeline of expensive fat and we're seeing margins improve there back to where we think they should be for the year. So, I mean, at the end of the day, we came into the year seeing or left 2023 having a view that we would have a very similar year and possibly improve with all the integrations of the acquisitions in 2024 and then fat prices move down sharply.

Protein prices have contracted a little bit, but at the end of the day, that's related to kind of a slowdown in global consumer demand, some destocking. That should come back. We're starting to see that happen around the world.

So, ultimately, like I said, I think we're – I'll come back to you in April after I put a couple more months in the books here and we see that truly the DGD can widen its margins out at the lower fat prices. And clearly, that's how we see the business model tracking.

What I told to Matt and Bob and Brad is we – our year is focused on execution and simply generating enough cash and managing capital outlays to pay debt down below $4 billion this year and be investment grade. We don't have any bonds or notes coming due here until first quarter 2026.

So we're not in any issue where we need to be doing something rapidly and we have very, very favorably priced debt. We just want to – we want to create value for the shareholder, get any concern that as the commodity markets in the world cycle here that this company is a very different company than when we did the VION acquisition back in 2014, 2015. Very, very different set of dynamics now.

I think as I'll continue my rant here for a minute, clearly, the sustainable aviation piece is going to play a key role in widening those margins back at DGD. Clearly, Matt can comment it on later in the call here. We're seeing some really nice demand. And it's always the first-movers and everybody doesn't want to be the first mover here, but we're close. The margins are much better than they are in standard what I call road diesel or renewable diesel. And we're excited and we'll do our best to get that plant online here sometime later this year and hopefully be at the full rate in 2025 there. And then once again, we've changed our business model with the first-mover advantage to where we were several years ago.

So, with that, Tom, I hope I answered everything that you needed to hear.

Thomas Palmer Q
Analyst, Citigroup Global Markets, Inc.

Well, thanks for that detailed reply. Maybe I'll just follow up quickly on – you mentioned the expected distributions from DGD. Maybe we can just kind of check through some of the items that clear up to free that right? You've got the debt at DGD. And then, I don't know if you guys have commented, but any color on kind of CapEx expectations with DGD? Would it be just something comparable to 2023? Just trying to kind of frame what type of distributions we might see as the earnings do come through.

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

Yeah. I think you didn't come through totally clear in the room here, but I think you're asking about distributions out of DGD, CapEx, [ph] finish up (00:17:24). We got some debt to pay down that's there related. Do you want to comment, Brad?

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

Yeah. I will. Okay, Tom. This is Brad. Yes. So you see the debt there, it's $250 million at year end. So that does have to be repaid. So, we had the holidays, we had a turnaround in January. So, typically, with the holidays, with the BTC being at $1 a gallon, those are significant receipts that come in. But with the holidays, there's a little – a bit of a delay there usually in December on the BTC. So it backs up some.

So that, along with the Q1 turnaround there in January, kind of pushes that back a little bit. So our outlook, I would say, which is what I think you're getting at, had a difficult time hearing there, is a little bit of a deferred timeline on dividends out of DGD, but we're getting closer.

Thomas Palmer
Analyst, Citigroup Global Markets, Inc.

Q

Yeah. Thank you.

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

A

[ph] Yes, Tom. (00:18:28)

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

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

Q

Good morning, all, and thanks for your commentary this morning. With – my first question, I wanted to focus on the Feed business where you delivered a remarkable quarter from a margin perspective. First, could you talk to some of the drivers from your prepared comments? And second, maybe speak to your thoughts on the spread between waste fats oils and greases and SBO? And how that will trade throughout 2024, given that we're on the precipice of impactful legislation in 2025?

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

A

Yeah. Good questions. Clearly, the Feed segment – remember, in the procurement of raw material, when you get into a declining price environment, that's when your margins widen out. You have forward sales on and now you're buying raw material based on the current index markets at a lower price. That widened it out.

As Brad also commented, we did recover some expenses from the Valley Proteins acquisition that were part of the stock purchase agreement. And that's about all we can comment there on, and that widened it out. But nonetheless, it was – the volume's up, prices were down against the processing formulas and then a little bit of money came in related to the Valley. So that's that.

The waste fat, RBD, soybean oil comments, I mean, the first thing – and I'm going to split this with Matt and Bob here. The first thing that I think everyone needs to understand was if the industry was truly operating at the rates that everybody anticipates out there and puts in their spreadsheets, fat prices would not be where they're at today, whether it's soybean oil or waste fats.

Second, if the pretreatment capacity was as robust, and nirvana in the world, waste fats would not be a discount to soybean oil today – crude soybean oil. So it's really a fascinating environment. All we can tell you is Diamond Green sold 1.25 billion gallons. We had some volatility in margins and an LCM adjustment here in Q4, but the margins are clearly being driven by the spread between soybean oil and waste fats. What do you guys want to add?

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

A

Yeah. This is Matt. I would just say, if you think back to, let's say, six months ago, when we did see – we had waste fats at a premium to the soybean oil markets, and over the last, let's say, three months or so, they've been at a discount. Now that gap is now narrowing, which we believe that it will continue to narrow, but there's been a bit of a, let's say, price movement in the waste fats, to Randy's point, is I think it's just a reflection of some of the capacity that has not come online.

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

A

Yeah, and I would just add. I think this is reflective of the challenge in trying to predict and estimate what's going to happen. I think the things I would watch for is what does the biodiesel industry do. We're seeing biodiesel margins now underwater for the first time in quite some time. So if they don't run and operate, we're going to see weakness in soybean oil relative to other waste fats.

There's a lot of talk about new renewable diesel capacity coming online and operating and its ability to utilize waste fats, UCO and animal fats, how real is that and how able is it to use those oils. And so those are the things to watch that are going to ultimately determine what those spreads do.

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

Q

Great. And for my follow-up, I wanted to ask about the active peptide that you mentioned in your prepared comments that would address glucose moderation. While I'm getting a bit over my skis, is that intended to be an alternative to [indiscernible] (00:22:28)? And if so, could you give us some perspective on potential market size of this opportunity?

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

A

Well, we're all smiling around here because we don't want to get sued in the morning by big pharma. And we're going to be careful how we answer this.

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

A

So this is Bob. And I'll just say this product will be a nutraceutical. It won't be a pharmaceutical product. So it really – it does target a slightly different demographic. It is likely to have similar types of benefits for consumers, but, again, it's a consumable product that has a whole different profile as far as health and safety goes. That's probably the best way to answer that.

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

A

Yeah. I think that's about all we can say at this time. I will tell you that we will be launching the product, I believe, in Geneva here in May. So, we've got a lot of interest into this product worldwide. You think of the applications that it can go into. Remember, a peptide [indiscernible] (00:23:36) is water soluble. So it can go in solution. It can go into health bars, whatever you want to think. So there's lots of neat applications here that just once again diversify our product mix and ultimately, is the underlying rationale for the Gelnex acquisition that we were working on or did.

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

Q

Very helpful. Thanks for your time.

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

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Hey. Good morning. Thanks for taking the questions.

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

A

Good morning, Andrew.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

My first one is on – good morning. So my first question is on some of the kind of internal profit drivers that you guys have that are not related to market dynamics. Is there any way to quantify what that might look like, the efficiencies? You have, obviously, Miropasz, which you closed on and then Ward coming back up into 2Q. How much could that contribute incrementally in 2024? And then, does that also build into 2025?

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

A

Hi. This is Matt. I'll take a stab at that. I would say that, let's say, from an example of Ward to your question and – that plant is – will be coming up next month, and we're expecting a full run rate from Q2 on. And that will put us exactly where we need to be in terms of position in the – on the eastern region as we call it now.

And we've talked about it in previous calls. I mean, Darling has made a real effort and commitment into investing in the – call it the reliability and the performance of the operating plants. And that's something that we believe separates us from many of our, let's say, competitors out there.

And one of the things that, for example, that we benefit from, to your point, is that we call it breakdown tonnage. And so the rendering market, generally speaking, is pretty well, let's say, balanced between capacity and volume availability. But the minute that someone breaks down in the space, the whole system can get out of kilter pretty quickly. And so we've made a real effort into investing on the performance and reliability of our plants.

So when that happens, and it does, that we actually benefit from that because we actually receive this extra volume that comes to us that's, let's say, not in the plan and is – it comes with favorably priced, and we are there to receive it. And so that for us is a real competitive advantage. And that's because we take the effort and we have the balance sheet to invest the capital required to keep these plants in tiptop shape in order to not break down. So we actually are on the receiving end of the benefit of situations like that. And that's just an example.

And so we've got that all the way through our organization. And so to quantify that, that's a bit of a challenge, but – for today's call. But I would say we view that as a competitive advantage.

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

A

Yeah. I mean, Andrew, we look at it – and Matt said it very, very well there. I mean, in the month of January, we landfilled 32 million pounds out of the Ward, South Carolina region. That's we're not proud of. At the end of the day, that's huge lost opportunity. So we're excited about getting Ward on. The MCC shipped at the end of

January. We're expecting a, hopefully, end of March, 1st of April, start-up there. And then that puts a lot of ability to move tonnage to the right locations that we've been unable to do now for over a year. So that's exciting.

Miropasz closed here on the 1st of February. And that's three poultry plants. Investment case was exceeded at closed here, meaning it's doing better than we thought. When we did the original deal, we kind of redid the diligence on that. Gelnex, we have for a full year. We got Peabody down, our old bone gelatin plant, that's out of the system, the noise of that.

So there's a lot of good things that we see happen through the year out there. We're carrying large inventories. And if you can read the balance sheet, you can see the working capital out there, you could see that consumer demand slowed down around the world, and that's built inventories in several of our businesses. And so that's where we come back to. It's mainly the operational efficiency is a very important piece, and as Matt says, focused on it. But at the end of the day, the big cash driver for us next year is really getting the inventories down and managing working capital. And that's why we're so confident in the debt repayment side here.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Okay. Got it. That's helpful and I appreciate those comments. And just my follow-up is on DGD profitability kind of at a high level and I know I've asked this before, but I just want to revisit it. Historically, you've talked about kind of a dollar baseline margin over time. And I'm just curious, with everything that's going on in those markets, do you still feel like – and I know next year, as we transition to SAF that that's going to evolve. But I guess from a baseline perspective, do you still feel like that's the appropriate way to think about the business? I don't know if that's feasible for 2024 or not in your view, but just any comments around how you think about the underlying margin structure for DGD pre-SAF? Thanks.

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

A

Yeah. This is Bob. I think because of some of the things I mentioned earlier, what's going to happen with biodiesel capacity, what's going to happen with nameplate renewable diesel new capacity as that comes online, it makes it difficult to answer that question.

I think what we can say is that Diamond Green has a sustainable advantage over its competitors in the market. And we could talk about what that looks like relative to renewable diesel, relative to biodiesel. It's significant. And so it's going to maintain that advantage as we cycle through this margin environment.

I think what's a little bit different about the renewable diesel environment than what we might see in a more mature commodity environment is that there's still – it's still an evolving industry. There's still new demand coming on and new opportunities. So, as SAF demand comes on, that will cannibalize renewable diesel capacity and production and provide more support. We're also seeing more evolution in the government programs, whether it's CARB LCFS programs or just the general impact on that exports and RIN cancellations will have on RIN S&Ds.

So I think there's a lot of things that would allow this to reverse course faster than what you'd normally see in a mature commodity market, but really difficult to predict exactly what that margin per gallon is going to look like over the course of the entire year.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Great. I appreciate the thoughts. Thank you.

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

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Thank you. Good morning, everyone.

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

A

Morning, Adam.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Morning. So I guess my first question, Randy, and I appreciate the comments around there's a lot of volatility and hesitancy on providing an outlook. I'm just trying to make sure we think about that in the context of you did provide some outlook framing 3 months ago or 3.5 months ago in earnings in November. And so is it just, hey, the caution comes from the decline in fat prices that you've seen over the last several months that gives you pause or the lack of response – full response to RD margins? Just you did provide some other commentary with the third quarter earnings and you're refraining to do that today. And I'm just trying to make sure we understand kind of actually what's changed.

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

A

Yeah. No, it's a very, very fair question, Adam. I mean, if I look back at the November call, we had incredible momentum with fat prices still in the $0.55, $0.60 a pound range. And when you do guidance in this business, you really need to stop the world and say if that price holds and the tonnage holds and DGD margins are X, this is what it's going to generate. It's really that simple. It's a five-minute exercise.

What's changed now is if we had [ph] 1718 (00:32:25) out there before, fat prices are down $0.20 a pound. I said earlier, each $0.01 is $12 million. So you could say fat price potentially $2.50 below that. So that would – you can do the math [ph] there, 1.450 to 1.550 (00:32:40) is the run rate today.

Now, the hesitancy to go out there and crystallize that for you is I don't believe fat prices are going to stay there, but I don't know when they're going to react right now. And that's where my comments were geared around the demand for fats, whether it's soybean oil. If you start to think of it, okay, a year ago, we were supposed to have DGD – or not DGD, REG or Chevron, whatever the heck you want to call them, Geismar online, that's 250 million or 275 million gallons. That's 2.5 billion pounds. P 66, the phantom plant of the future, I mean, what is that thing? Is it 4 billion pounds, is it 5 billion pounds, is it 6 billion pounds of fat? You still got two lines down at Martinez. When are those coming back online? Vertex can't seem to run consistently. Not sure what's going on with the restatement up in Montana right now, but they don't seem to be running very consistent. They're buying refined soybean oil.

So there's just a lot of moving parts out here that are really hard to put your finger on right now. I mean, as I've learned in this business, we've always said, and you've been around me long enough, the only thing you can control in this business is the balance sheet. And so that's where my comments were, is Brad and I are convinced, we can pay down $400 million of debt this year, be investment grade and be ready to rock and roll as this thing goes again.

And then, the SAF margins, as Bob commented, we have a lot of interested parties. We are in the margin discussions. They're complicated. It's a very different business selling SPK, blending it with Jet A. And so those things are happening. I'm confident here by the end of first quarter, I suspect we'll have some deals done. Don't know how much transparency we can provide at that time. But as we've said, the margins are $1 to $2 above renewable diesel. That's 250 million gallons. That's another $250 million to $500 million of additional cash being generated.

Brad said, as he said, Adam, we're going to be delevered there to zero shortly. Lots of moving parts there. The BTC, the government didn't pay the BTC for a month here as they went on holiday. We've got a huge receivable out there from that.

And so, end of the day, I think we're set up very nicely. I think it's going to be a year of growing earnings from Q1 forward here. As everybody – as we remind people in January, we had a pretty good January, but end of the day, we lost, I think, four or five snow days in North America where the plants couldn't even operate. We got curtailed on gas.

So there's a lot of noise there that hopefully as we get towards what I always call in the baseball is parts open, this business really starts to hum again. Bob, anything you want to add?

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

A

Yeah. I just – I think you really hit on it, Randy. When you go back to November of last year and you looked at the market factors, a lot of what we saw was within our control. And when we sit – as we sit here today, we can't control what the biodiesel industry is going to do with its capacity. We can't control the renewable diesel's ability – industry's ability to run and operate.

And so it just makes it a lot more difficult to predict right now what's going to happen, but what I would add is that Diamond Green Diesel produced over 1.2 billion gallons last year. That was more than anyone did anywhere in the world and with a capacity utilization rate that is second to none anywhere. And so, as this cycle changes, they've proven they have the operational capacity to capitalize on margin improvement in the industry.

So I think we're optimistic. It's just very difficult to predict exactly what margins are going to look like, given all these variables that are outside of our control.

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

A

One of the things, Randy mentioned, with DGD and the dividends, as we think about the people on the call here, and I know you know this, Adam, and most of the sell-side analysts, if not all, know this, we have a formal policy there for distributions and that is measured monthly. It is not subjective. So that takes – makes it like clockwork as we look at that and there's obviously a large receivable there from the BTC, not large CapEx to speak of. We're through that one turnaround SAF being paid for.

So that's why my comment earlier is we are getting much closer to starting that dividend train, if you will. But I was just kind of wanted to make the point that it is not a subjective calculation and there's potential there each month as we look at that at the end of each month.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. That's all very helpful and appreciate it. There's a lot of color. I'll pass it on. Thank you.

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

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

Q

Hey. Thanks. Good morning. I hate to do this again. But, Randy, if I just do Q4 and I just run rate it, just farmer's math, and say I throw in $100 million from things that's – from acquisitions that did go a full year and plus the other new plants, I get to the $1.5 billion. Is that a baseline?

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

A

Yeah. I'm going to answer that. Yes, if the things go right that we see out here. I mean, our goal is to exceed our performance in 2023 and that we're doing a whole bunch of things out there to get there. And I mean, at the end of the day, I saw fat price trades last night that were up already $0.04 a pound over January.

So, yes, I mean, at the end of the day, we should pick up momentum there. The volatility – remember, the model is built around Feed segment reductions and volatility are offset by the super machine down in the Gulf Coast that buys 3 times more fat than we make. So, as the price goes down, they have to work through their pipeline. They have not worked through their higher priced fat, which was reflected in our Q4 earnings in January. It looks like they'll be improved in February here. And so if those margins widen back out, then it offsets any softness that the Feed segment may deliver here. Bob, anything else?

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

A

I guess the one thing I would just add, when we think about the Feed segment, in particular, is Matt alluded to this earlier with the breakdown comments that he made. We have a competitive advantage – we believe we have a competitive advantage because we keep our plants well maintained. And we're benefiting from that today because we've just gone through a high inflation cycle.

And so the book value of our assets and the fixed cost that we operate with are lower than new replacement. And so as we reprice contracts over time, we're seeing wider margins on the assets that we've had in our books and our network. So I think that's something that as we look out to the 2024 and 2025 will benefit us.

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

Q

Thank you. A follow-up, just the new crush capacity coming on, is that going to weigh on fat prices? And then, I know that it's very complicated as we switch over to the producer tax credit, but can you just maybe remind us, if you can, quickly just how you're advantaged and how you think that impacts overall supply in the marketplace? Does that curtail some supply or what happens as we switch to next year? Thank you.

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

A

Matt, you want to take crush? And Bob, you want to take...

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

A

Yeah. So I would say from a crush capacity increase, a lot of that is, I would say, priced in and known and is not going to have a significant weight on current market prices. So, as we think – I look at it a little bit more from the other side and what's still to come is the demand side, as some of these RD plants that have not been able to run. [ph] Now, obviously (00:41:12), many of these will get things figured out and will improve their run rates and that will increase on the demand side.

So, in terms of looking for a heavy downshift in soybean oil prices, I think most of that's already priced.

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

A

Yeah. This is Bob. Specific to the producer tax credit, so that's due to take effect in 2025. The benefit that Diamond Green Diesel has is that unlike the blenders tax credit, imports of biofuels won't have access to that and the producers tax credit will be CI-adjusted support, whereas the blenders tax credit is the same per gallon irrespective of what the feedstock is.

Our calculations show that if you're using a canola oil or soybean oil to make your renewable fuel, then you'll essentially get zero from a producers tax credit. So that's Diamond Green's advantage. It can utilize lower CI score feedstocks. It will get that producer tax credit and it has an advantage over the imported biofuels.

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

Q

Thank you, guys.

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

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Hey. Thanks. Good morning. So I want to ask about some comments that you all made late last year as it relates to – or excuse me, earlier this year as it relates to changes that you can make in the Feed segment to provide some insulation from commodity volatility. Can you help us think through what some of those adjustments might be and the timeline that might take to put those changes in place?

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

A

Yeah. I'll take a little bit of this. I mean, essentially, you've got US, Canada, Europe and Brazil in the Feed segment there. Each one has a different process of margin management. In North America, or in the US specifically, it's clearly about 70% of our raw material in the US is procured under fixed margin with a sharing of upside. And so, when the prices come down, there's us to share, but there's a fixed margin that ensures cash flow and profitability.

Similar in Canada, but more exposure to commodity up there, Europe probably weigh less in the sense of commodity exposure as they are able to move their raw material procurement values or prices down as they need to adhere to keep their margins. Still not – they'd rather have $1,000 or $1,200 a ton fat, an $800 a ton fat, but we've seen fat there recently trade in the 900s again. And you kind of got to do the math, that's in the mid-40s. That's where the US has now moved back to.

In Brazil, we've got our challenges there in the sense that we bought a private company that didn't have the same ambition that Darling has towards margin management. And so culturally teaching the procurement team down there to go back to the slaughterhouses. We're in process there. That will add value over the year.

As we look back at 2023, as we had a great first half of the year in Brazil and then we had a challenge as prices came down around the globe to get the procurement team to react and realize that it's okay to do that.

So lots of – I know that's a longwinded answer, Ben. At the end of the day, it really comes down to reaction time and then the lag that that it flows through. So fourth quarter, higher price sales, lower procurement costs. Now we've got lower sales in Q1 and lower procurement costs. Anything else you guys want to add? Okay. We'll stick with that...

Ben Bienvenu

Analyst, Stephens, Inc.

Q

Very helpful, Randy. That's great. Thanks, Randy. Very helpful. Maybe shifting gears a little bit and thinking about the Food Ingredients business, a really strong year. Really, it's been a strong – as far back as you can look, it's been exceptionally strong. As we look forward, can you help us think about the growth runway ahead? What kind of growth CAGR in terms of new dollar sales that you expect to deliver on that business and CapEx projects ahead?

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

Yeah. So, really, at the end of the day there, in Suann's slide deck, I still think one of the greatest stories is that quarterly run rate of the Food segment, and of course, then, obviously, you get the see the split of 85% basically being the collagen/gelatin business and a little bit of it being CTH and the edible fats business that we have in Europe there.

As we look at that business going forward, clearly, we get a full year of Gelnex. Clearly, I made comments that we're – the consumer demand in the world is lighter at this moment, maybe a little delayed recessionary, but it's improving. January was a good January, really at the run rate. So, long term, as Brad and I have always said, we thought we'd hit around 3.25% this year. I think what we were last year, what we...

Brad Phillips

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

A

3.21%.

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

A

3.21%, all right. So we are pretty darn close calling that one within 1% as we did. We still believe that business sort of trajectory over the next three years will break 400 million. That's the launch of the – additional of the new peptides and growth of hydrolyzed collagen, shutdown of a [ph] fired (00:47:17) asset in Massachusetts, finishing up some CapEx. We've got our fifth spray dryer online in Epitacio, Brazil now.

So lots of good things happening there. I know when the guys presented the peptide plan for just the glucose moderation peptide, they have a five-year plan there of getting that to be over $100 million brand. And that's just one of what I would say probably 6 to 10 peptides that can be launched out there with very limited capital to convert the factories that we've already spent the money on.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Okay. That's great. Thanks so much.

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

A

[indiscernible] (00:48:00)

Operator: The next question comes from Jason Gabelman from Cowen. Please go ahead.

Jason Gabelman
Analyst, TD Cowen

Q

Yeah. Hey. Morning. Thanks for taking my question.

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

A

Morning.

Jason Gabelman
Analyst, TD Cowen

Q

I wanted to ask first on the Feed segment. It looks like gross margin was 24% of sales for the full year, but there was obviously some noise in there with the South Carolina plant down and then with the Valley Proteins reimbursement. I was wondering if you could either give some sort of where gross margin percentage would have been in 2023, excluding that noise or where you expect it to go in 2024.

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

A

This is Randy and Brad can help me here. Clearly, we took a reimbursement on some expenses that were incurred during the whole year, right? But 24%, we've always said somewhere between 23% and 25% is where that segment should operate, given really any type of pricing environment just being driven by the lag of when the procurement formulas change. Brad?

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

A

Yeah. The other thing there, Jason, so, yeah, you had a – we can't get into that number, but a little bit of lift there in Q4. But a little bit back to Randy and Matt's comment earlier in that segment, we still have Ward that's going to be coming on. We had the margin management improvement that's definitely going on at FASA, at Valley Proteins has been and is continuing. So that's where we feel extreme confidence to be in that mid-20s range at least kind of right at – there as we move forward...

Jason Gabelman
Analyst, TD Cowen

Q

Got it.

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

A

...for Feed.

Jason Gabelman
Analyst, TD Cowen

Q

Got it. Great. And then on the DGD business, you mentioned that it looks like biodiesel economics are now potentially underwater. Have you seen any capacity reductions from biodiesel plants based on whatever real time data you have? That's – it's a bit harder for us to see from the outside and would be a good indication that maybe margins are bottoming if you start to see some rationalization in biodiesel production. Thanks.

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

A

Yeah. I think I'll tag this with Bob. I mean, clearly, what we do as a team every day is we run an analysis industry-wide of whether it's waste fats, whether it's renewable diesel, whether it's biodiesel, it's refined soybean oil, crude soybean oil. And we run all the fats and look at them. And clearly, what we've seen is if you're in the biodiesel business and you're running soybean oil today, you're negative.

Now, if you remember, a lot of that biodiesel capacity is still with the integrated crusher that's out there. And they have three choices. They can put it in the [indiscernible] (00:51:02) to be exported. They can run it through their biodiesel plant. They can run it through their vegetable oil refinery. And at the end of the day, all they care about is what's the cents per bushel or dollars per bushel that they make in a crush margin and they don't care which asset it runs through. The freestanding guys are clearly the ones that are vulnerable right now, and I'll let Bob comment about that.

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

A

Yeah. So I think, first, I'd say we haven't seen a significant reduction yet. I think this industry, as Randy alluded to, it's largely egg-based and they do a very effective job at hedging and protecting margins for a certain period into the future. So, when margins go negative, they don't necessarily turn it off right away. But it's something that you expect to see down the road.

As Randy said also, the crushers are going to look – the integrated companies are going to look at it a little differently. They're going to look at a full integrated margin and make decisions. We see about 60% of the industry, though, is standalone and they are more vulnerable to just an absolute biodiesel margin.

The other thing I would say is crush margins have come down a lot as well. And we're seeing a significant amount of soybean supply on the market due to large harvest in Brazil and Argentina. And so the crush margin environment today isn't anything like it was over the last four years. And so really that whole biodiesel industry, it's just – it's got more challenges from a margin standpoint than it did and we'll see how all that plays out as we go forward.

Jason Gabelman
Analyst, TD Cowen

Q

Great. That's really helpful. Thanks for the color.

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

Dushyant Ailani
Analyst, Jefferies LLC

Q

Hi, guys. Thank you for taking my question. I just wanted to quickly talk about just the LCFS market, the – a meeting was supposed to happen, but I think it's been pushed out. I don't know. I just wanted to glean from you guys what you guys are hearing on that end.

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

A

Yeah.

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

A

Hi. This is Matt. I'll try to – I mean, we see from our contacts and a lot of what we read in the news in terms of what's to come. We know that that is – I mean, first of all, fundamentally, the LCFS is something that is very supportive for the industry. Now, what – how this plays out in California is still remains to be seen. Obviously, we know what came out of last year. Now, what additional changes are forthcoming from that remain to be seen. So we remain optimistic and we believe that the – what is in print is a good thing, but what other changes are still to come is a little bit hard to pin down.

Dushyant Ailani
Analyst, Jefferies LLC

Q

Got it. Thank you. And then just going to SAF, I know that, Randy, you mentioned roughly $1, $2 above renewable diesel. Just want to understand what would you need to see going into 2025 once SAF capacity is online to maybe think about maybe converting more RD to SAF.

[indiscernible] (00:54:23)

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

A

I think Dushyant's asking what's the gating decision for FID on a second – on expanding SAF.

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

A

So that's a question that we are asking or working on right now. We do have that in the engineering phases right now. One of the things that we are looking to, as Randy mentioned earlier, is the commercial contracts against the SAF 1 plant. As you know, that's 250 million gallons of ARD that's going to come off the market. But we really want to see, call it, a proof of concept in that and have a high degree of confidence.

The SAF 2, if it is to come to fruition, will be something in a larger scale. There'll be a little bit larger investment as well. But it's something that is absolutely on our radar and it would not surprise me in the next coming quarters if we don't have some good news in that space.

Dushyant Ailani
Analyst, Jefferies LLC

Q

Thank you. I'll turn it over.

Operator: The next question comes from Matthew Blair from Tudor, Pickering, Holt. Please go ahead.

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

Q

Thank you and good morning, everyone. Randy, how are you thinking about a potential dividend from Darling in 2024? Do you need to hit investment grade first or is that something that's on the table?

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

A

Yeah. I mean, clearly, it's a discussion point at all times in the board room. Clearly, our focus this year is to get the debt down to make sure that everybody thinks we've de-risked the business on commodity cycles. As I've said, this is a very different business than we've had in the past. It's a massive cash generator. Remember, we still – we've got debt at DGD and then we've got to finish up the SAF outflows on that project.

So, end of the day, this year, we'll be focused on just paying down debt to the end of the year. And what I shared with the board and what I share with other people is, remember, we have some really favorably priced bonds and notes out there. The first one that comes due is in April of 2026, and that's the European note. It's in, what, low 3s, 3%...

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

A

Yeah, 3.625%.

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

A

3.625%. And then another year later comes the 5-and-something, 5.625% or whatever...

[indiscernible] (00:57:04)

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

A

Yeah, on the US bond. So, we're not in any rush to do anything there. We're going to build cash. Once we have cash and the revolver is paid off, we have all kinds of flexibility to do what we want to do. Clearly, we set in motion and done opportunistic buybacks. We will buy back our dilution of our executive compensation programs. And we'll – as we see that the dividend start to come in from DGD and we're getting to our leverage ratios we want, that the market expects, then it gives us a chance to do some things.

I mean, clearly, we paid for Miropasz here about 26 days ago, that was $110 million. And so, end of the day, we're just trying to run the business, walk through, what I'd say is just a debt, remember, in global businesses like this, when you have these big super cycles, big mountains are followed by deep valleys. And so, end of the day, we're navigating out of that, making the adjustments we need. But end of the day, when we look at 2024, we'll get $400 million plus out of the debt. And then when you go to 2025 and you got SAF and you don't have any other projects going on out there, then all of a sudden, it's pretty amazing how much cash you're generating. And that's when the dividend discussion becomes an absolute reality or you're just going to trap too much cash on the balance sheet.

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

Q

Sounds good. And then just regarding the Valley reimbursement. So it sounds like you don't want to quantify that benefit in Q4. Could I just ask why?

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

A

Yeah. Matthew, this is Brad. So there's a confidentiality agreement there. So I'll say we've resolved certain outstanding cost and expense items under a post-close escrow arrangement, which we booked in Q4. That goes back to prior to Q4, some costs. So it's not just cost in Q4, but there was a confidentiality arrangement with the seller there.

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

Q

Great. Thanks for the color.

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

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

Great. Thanks, everybody, for all the questions today. As always, if you have additional questions, please reach out to Suann. Stay safe. Have a great day. We're off to Scotiabank's conference, be presenting tomorrow there.

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