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Darling Ingredients, Inc. (DAR)

Q2 2023 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 Second Quarter 2023 Results. After the speakers' prepared remarks, there will be a question-and-answers period and instructions to ask a question 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 second quarter 2023 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 Mr. Matt Jansen, Chief Operating Officer of North America.

Our second quarter 2023 earnings news release and slide presentation are available on the Investor Relations page under Events and 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 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 us for our second quarter 2023 earnings call. By all accounts, Darling Ingredients had a fantastic quarter with a record $508.3 million in combined adjusted EBITDA. Excluding a one-time $18.5 million inventory negative impact due to the Gelnex acquisition, our combined adjusted EBITDA would have been $526.8 million for the second quarter.

As I discussed in our last quarterly call, we told you lower fat prices translates into lower EBITDA on our Feed segment. However, it is more than offset by increased earnings in our Fuel segment due to the sheer scale of our platform. This quarter, for the first time in our history, you were able to see the strength of the vertical we have built to leverage the Diamond Green Diesel machine. The power of our integrated waste fats and oils business, combined with best-in-class renewable diesel production capacity was clearly on display this quarter.

Now, turning to the Feed Ingredients segment in detail. Globally, raw material volumes were up just over 15% compared to second quarter 2022, primarily due to our Eastern USA and South American rendering acquisitions that closed last year. While we saw a softening in global fat prices, protein prices and specialty ingredients demands, continues to be very strong.

Despite lower fat prices, our gross margins held flat compared to Q1 2023 due to our continued integration efforts. I am pleased to report that these integration efforts are nearly complete. I feel very good as we head into third quarter.

While it's normal to experience some margin degradation due to the extreme summer heat, we are very well positioned to handle the challenges that summer rendering brings. Capital investments have been made, yield adjustments and raw material procurement modifications have also been put in place and completed, and we've now optimized our finished product sales opportunities.

Turning to our Specialty Food Ingredients segment, the global collagen market and gelatin business remains robust. If we exclude the one-time purchase accounting inventory negative impact of $18.5 due to the Gelnex acquisition, Food segment EBITDA would have been $89.8 million for this quarter. Our integration efforts are going very well. We have cross-pollinated our organizations to form one, and we're excited about the scale and long-term opportunities these markets offer us.

Moving to our Fuel segment, Diamond Green Diesel had a record quarter with more than 387 million gallons of renewable diesel sold at approximately $1.28 per gallon EBITDA, clearly benefiting from the lower feedstock prices.

Darling received $101.4 million cash dividend during the second quarter and subsequent to the quarter close, we received another $62.2 million in cash dividends from the joint venture. DGD completed its turnaround, DGD 2 completed its turnaround and is back to normal production and DGD 3 has been running very well and above nameplate capacity.

We continue to believe 1.2 billion gallons of renewable diesel sold in 2023 is very achievable. Construction is progressing very nicely for our first SAF plant in Port Arthur and we anticipate completion during late 2024 if all things go as planned.

Now with that, I'd like to turn the call over to Brad and then I'll come back and continue with an outlook for 2023. Brad?

Brad Phillips

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

Okay. Thanks, Randy. Net income for the second quarter 2023 totaled $252.4 million or $1.55 per diluted share compared to net income of $202 million or $1.23 per diluted share for the 2022 second quarter.

Net sales were $1.76 billion for the second quarter 2023 as compared to $1.65 billion for the second quarter 2022 or 6.5% increase in net sales. Operating income increased $78.1 million or 28% to $356.7 million for the second quarter of 2023, compared to $278.6 million for the second quarter of 2022, primarily due to Darling share of Diamond Green Diesel earnings increasing $139.3 million. This more than offset a $20.8 million decrease in the gross margin of our global ingredients business, which as Randy mentioned included a one-time $18.5 million negative impact due to purchase accounting for inventory related to the Gelnex acquisition.

Additionally, depreciation and amortization and SG&A each increased about $29 million as compared to the second quarter of fiscal 2022, primarily due to the Gelnex and FASA acquisitions.

Now, moving to non-operating results. Interest expense increased from $24 million in Q2 2022 to about $70.2 million in Q2 2023, primarily as a result of increased indebtedness due to the acquisitions. Other income increased $5.4 million, primarily due to insurance proceeds received for the Ward, South Carolina facility fire.

Now, turning to income taxes, the company recorded income tax expense of $40.7 million for the second quarter of 2023. The effective tax rate for the second quarter is 13.8%, which differs from the federal statutory rate of 21% due primarily to biofuel tax incentives and the relative mix of earnings among jurisdictions with different tax rates. The company also paid $49 million of income taxes in the second quarter.

For the six months ended July 1, 2023, Darling recorded income tax expense of $67.7 million and an effective tax rate of 13.2%. The company has also paid $88 million of income taxes as of the end of the second quarter.

For 2023, we are projecting an effective tax rate of approximately 14% and cash taxes of approximately $50 million for the remainder of this year. The company's total debt outstanding at second quarter 2023 was $4.5 billion as compared to $3.4 billion at year-end 2022. Our bank covenant leverage ratio at the end of the second quarter was 3.11 times.

We continue to maintain strong liquidity with $956 million available on our revolving credit facility as of quarter end. Capital expenditures totaled $123 million for the second quarter 2023 and $234.3 million year-to-date.

The company repurchased approximately 153,000 shares of its common stock for $9.1 million during the second quarter. Stock repurchase year-to-date is approximately 926,000 shares for a total of $52.9 million.

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

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

Hey, thanks, Brad. Our business remains robust around the world. Fat prices have bottomed and are moving up and I expect continued improvement in the back half of 2023. Protein demand and pricing remains consistent with Q2, and Q3 volumes for Diamond Green Diesel will be lighter compared to Q2 due to the planned turnaround at Diamond Green Diesel 2.

For the year, we are once again reconfirming our guidance of $1.875 billion combined adjusted EBITDA. Our global ingredients business is strong and DGD has completed all turnarounds and should be operating above nameplate for the balance of the year.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question is from Manav Gupta with UBS. Please go ahead.

Manav Gupta
Analyst, UBS Securities LLC

Q

Good morning, Randy and team. So we saw a lot of commodity price volatility during the quarter. Still when we look back, you gave a guidance of $485 million to $525 million on your 1Q call for 2Q and you actually came in at the top-end of that guidance, beating the guidance. So the question is, help us understand the integrated business model a little better and how DAR is able to withstand the volatility better than most other RD producers. And again, with this beat and higher fats and UCO prices, is the decision not to raise guidance here, just being conservative?

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

A

Okay. I think, no, I appreciate the comment, Manav. And I think that was one of the two or three points we wanted to leave the stakeholders with today was, we provided the guidance. We came in at the high-end of it. Ultimately, fat prices were down somewhere between $0.05 and $0.07 a pound, little more actually in Brazil and little more in Europe. And that translates on an annualized basis to $70 million to $80 million of EBITDA run rate into our system.

You know, divide that by 4 and you're down about $20 million in the quarter. And if you look at the Feed segment, volume was about 100,000 tons lighter than prior sequential quarter and earnings were off, I think, about $26 million. So it was all fat priced.

Now, as we said, the reason we were comfortable in trying to put out the guidance there was, because the Diamond Green Diesel machine is about four times larger than the Darling machine and it originates from around the world and was able to both benefit from the lower fat prices that Darling provided, but also from around the world. And so, it was very – it seemed pretty straightforward to us. John, you want to add anything to this?

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

A

Yeah. I think the interesting thing and probably the hard part looking on the outside of the Darling is, the second quarter of this year is, really, the first quarter that you've been able to see, Darling with the vertical integration at renewable and in scaled state now where we've added so much extra feedstock supply around the world with our acquisitions and Diamond to scale from essentially 300 million, 400 million gallons to 1.2 billion, 1.3 billion gallons.

This is your first look at that. And what you see is, quite frankly, when fat prices go up, Darling wins. When fat prices go down a little bit, Diamond wins. But the bottom line is, now we're consistently hitting on that $450 million to $550 million EBITDA run rate, which is exactly where we told the Street we were going to be when we went into the scaling process a couple of years ago.

Manav Gupta
Analyst, UBS Securities LLC

Q

Perfect, sir. My quick follow-up here is, you are moving ahead with the SAF projects, positive updates there. It's still early, but do you think on a per gallon profitability basis, you will be more profitable in SAF than RD? So I'm just trying to understand, if you make like $1 in EBITDA margin in RD, do you actually think you can make like $1.75 or $2 per gallon in SAF, fully understanding it's very early in the process.

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

A

Yeah. Manav, this is John. Absolutely. I mean, we think that the SAF market is a market that there is an insatiable demand for and an extremely limited supply. And quite frankly, most of the alternatives that have been promised to the airline industries around the world for SAF are pie in the sky, don't exist ideas. So we're going to have insatiable demand for our SAF. We already see that coming to us. We're going to be receiving a premium for this product.

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

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

Q

Good morning, and congrats on another solid quarter.

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

A

Thanks, Derrick.

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

Q

For my first question, I wanted to ask a question on your prepared comments on the record temperatures we're seeing across several of your operating areas. As you noted, your feed margins have historically compressed during the summer due to lower fat yields. What have you experienced so far in Q3 and how should we think about your general preparedness this year versus last year?

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

A

Yeah. Always the challenges in summertime rendering are that the free fatty acids go up, meaning that the raw material degrades as quick or quicker than you can get it processed into the plants. And so, therefore, some of the premium markets that you're serving, you're not able to achieve that.

So far, we've made it through, I think we're in the month of August now. So we've made it through almost one-third – a little over one-third of the summer with very limited issues around the world so far. So at the end of the day, we're watching, as I said, Derrick, we're watching fat prices. They bottomed. They're coming back up. I mean, the US is moving a little quicker up than the rest of the world.

I think we've just completed a board meeting yesterday. The European side feels like it's moving up now. Clearly, there's been some unplanned downtime throughout Europe in the RD business that made fat available and made it available to Diamond Green Diesel.

And then, obviously, Brazil got a little bit behind here the system and we've been bringing in a lot of Brazilian. But at the end of the day, it's a normal summer. It seems hot. What we're seeing a little bit more just color for everybody out there is, just the slaughterhouses, the animal numbers are not as large as they were last year.

And so, at the end of the day, the extra tonnage that sometimes we get in the summer times from the integrated slaughterhouses breaking down has not been as great as it was last year. But at the end of the day, I would tell you that's good news and bad news. The bad news is, less tonnage. The good news is, it's less stress on the system here for us. And we've been able to kind of survive a little better than we got punched in the nose last summer. But third quarter is not over yet, but that feels pretty good right now.

Matt, anything you want to add?

Matthew J. Jansen
Chief Operating Officer - North America, Darling Ingredients, Inc.

A

Oh, yeah. Thanks, Randy. I would just say that compared to same quarter last year on Q3 [ph] over (00:16:45) the last 12 months, the team has worked really hard in getting some of the wrinkles ironed out and getting some of the efficiencies improved, especially, in some of the Valley assets. And so, we're in as good a position as we can be to go through this warm and seasonal period.

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

Q

Great. And then, as my follow-up, I wanted to ask if you could elaborate on your comments on the fat market as you look into the second half and even beyond. How would you frame the supply-demand fundamentals over the next several quarters? While global collection efficiency has improved, I can't imagine it's improved to the level where you could cover 1 billion gallons of RD demand that's already in construction in the US and existing SVO-focused operators that would likely want a lower CI feedstock to qualify for CFPC credit.

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

A

Let me answer the question this way. As long as you have the most efficient, best machine in the industry, you're always going to be able to source the fat you need. And quite frankly, that's what we have at Diamond Green Diesel. So supply of fat is always out there for us, because we're in the right place with the right pre-treatment capabilities and the ability to market to the different markets to maximize the value of our finished product, we're going to get the fat.

And so, we're not worried about the fat supply. And what's interesting about it is this, we operated at production levels of 330 million gallons, 340 million gallons in Q2, which quite frankly, if you take 340 million and multiply it by 4, you get a number that's over 1.3 billion gallons and we source the fat for that into our machine without a problem. So the reality is the shortage is a problem for people in bad places with bad machines. It's not a problem for a person in the right place at the right machine.

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

Dushyant Ailani
Analyst, Jefferies LLC

Q

Hi, team. Thank you for taking my questions. My first one is on free cash flow with DGD distributions coming in. Could you just remind us on how you would prioritize free cash flow for the next year, possibly?

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

A

Yeah, Dushyant, this is Brad. Yeah. So 164, we've now received as of today year-to-date, we do anticipate additional distributions between now and the end of the year. As we've said before, our number one priority along with integration is really to continue through the end of this year at a minimum to de-lever. So we do anticipate, you see we were at – we decreased our leverage slightly here in Q2 and we'll see the cadence of that continued through the end of the year to where it will be clearly below 3 times at year-end, if not before.

Dushyant Ailani
Analyst, Jefferies LLC

Q

Brilliant. Thank you. And then, my second question was just on the DGD capacity. I think you guys have mentioned that barring the turnarounds, you have been operating above nameplate capacity. So is there a new, I don't know, limit that we can think of for DGD in terms of what's the capacity you can think of?

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

A

Yeah. This is John. Well, I mean, if you take a look at what we did in Q2 and multiply by 4, you'll get a number well in excess of 1.3 billion gallons. We're always going to have -- you know operational hiccups is never going to allow you to run at 100% pure capacity. But the reality is, Diamond Green Diesel, I think, we've got 1.2 billion gallons out there as the capacity for Diamond on an annualized basis, even taking into account scheduled downtime and some operational inefficiencies from hiccups here or there.

It's pretty easy for somebody to do the math and figure that 1.2 billion gallons a year is way low for what that machine can produce on an annualized basis. Certainly, 1.25 billion gallons shouldn't surprise anybody on our capacity on what we can produce this year. And I wouldn't be surprised if there are years that Diamond can't do well in excess of 1.3 billion gallons.

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

A

We're always trying to make sure we're aligned with our partner. But I think in their call, about 10 days ago, they actually acknowledged that it can run in excess of 1.2 billion gallons, but they didn't raise it. So, I don't want to be the guy that raises it. But as John says, 4 times 340 million gallons kind of gives you the reality of what's out there.

Operator: The next question is from Sam Margolin with Wolfe Research. Please go ahead.

Sam Margolin
Analyst, Wolfe Research LLC

Q

Hey. Good morning, everybody.

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

A

Good morning, Sam.

Sam Margolin
Analyst, Wolfe Research LLC

Q

So, you guys always have a really good perspective on competitive capacity, where in sort of the eighth inning of commissioning or startups on some of these high profile projects. I think what's interesting is that, the margin spread between an advantaged facility like the DGD system versus sort of a marginal facility that might be using pre-treated soybean oil is very wide. It's reminiscent of like 2021. So are you seeing anything like as far as feedstock competition or I guess, other facilities in the market sort of pulling away the advantage feedstocks or do you think that the startups we're seeing now are mostly on the pre-treated side and aren't really affecting you right now?

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

A

Well, I think there's a couple embedded, relevant points here that you pointed out. Number one, feedstock markets are moving up a little bit for us right now. They probably move up more if there wasn't so much re-sale material out there available from the guys that can't run, that bought it and they have to resell it. You've seen a compression in the RBD soybean oil versus the crude spread right now, because they're having to resell RBD out there, because they can't even operate with, you know, what I'm going to call champagne in the sense of processing.

The other thing that becomes very and should be very obvious to the listeners is that, Diamond Green Diesel is a real estate play. It's a real estate play on the Gulf Coast that gives it access to all feedstocks in the world and allows the commercial team to optimize the lowest price fat in the world.

Today, the lowest price fat in the world is Brazil. And so, more boats are coming in from Brazil. Europe's moving back up and given some turnarounds over in the eastern part of the world, we're moving feedstock from there too. So ultimately as it affects when I think about the whole business model for us, it's allowing us as Darling specialty ingredients supplier to provide fat to some that can try to pre-treat. There aren't many out there yet today.

And so, ultimately we own the arbitrage that we've always talked about. I think about a year ago, if I reflect everybody on here, said there was going to be a feedstock shortage and how we were going to allocate it. And I think I'd made the comment. It would be okay if I didn't supply a pound of Diamond Green Diesel, because it means they can buy it for cheaper and I can sell it for more.

And so, ultimately that arbitrage exists today and we're moving product both from the world into the DGD system and we're selling [ph] ex our (00:24:43) quality products out to other people. John, anything you want to add to that or...?

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

A

Yeah. I think it's always interesting to read all the press reports about all of the capacity that's going to be coming up in the next quarter. We've read those press reports now for three years and quite frankly, every quarter, the same companies come out and talk about how next quarter we're actually going to get there. It's hard to run a renewable diesel machine. It's like riding a unicycle.

These things are much more difficult to operate. I think, people find that out over a period of time. I think it's also interesting that everybody always adds up the stated capacity that's coming online and assuming that those guys are going to run efficiently. Many of those people are running two and three catalyst turnarounds a year and they've got to figure out their machines. These guys are smart. Some of them will figure it out over a period of time.

And then, when you shorten the list on the amount of people that actually have put in pre-treatment systems or put in pre-treatment systems that are actually capable of pre-treating the material to protect the catalyst in the machine, that list starts to shrink really, really, really fast. So there's a lot of discussion about capacity out there.

Quite frankly, most of the capacity that's being discussed are competing with us. They're in an entirely different business than we are. We're comfortable with the business we're in and we love the vertical lock that we have between Darling feedstock and Diamond Green Diesel. It allows us, as Randy says, we own the arbitrage. It allows us to maximize profitability, regardless of what happens in the marketplace and that's the position we're in.

It's exactly where we said we were going to be. We're extremely comfortable with the machine. Extremely proud of all the hard work from the people in Darling and the people in Valero that have allowed us to create this machine.

Sam Margolin
Analyst, Wolfe Research LLC

Q

Understood. That's super helpful. I actually don't have a follow-up, so thanks very much.

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

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Hey, good morning. Thanks for taking the questions. My first one, I guess, I'm hoping that maybe you could compare and contrast kind of the back half of the year outlook with the front half of the year. And I guess where I'm coming from is, if I annualize that first half EBITDA, take out that Gelnex charge, you'd be running ahead of the guidance, which is great. You also had in the first half lower fat prices, only one quarter of Gelnex, values getting better DGD's ramp. So I guess, is there anything where you expect things to get worse in the back half for some of the strength to not hold? I'm just trying to make sure that I understand the back half outlook relative to the front half.

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

A

No, I think, number one, it's very difficult to try to predict this thing segment-to-segment, quarter-to-quarter. And so, I think, we've been pretty darn close in the last couple fiscal years. Clearly, as I would point out to you, I think, third quarter I would suggest to you is going to be weaker than Q2. Why? Because fat prices may be moving up, but the quality of summer rendering is always weaker.

And historically, over my 20 years, that's just proven out. Gelnex will contribute fully in Q3. And so, the Food segment is going to be strong, if not stronger. The Feed segment should improve slightly from where it had today. And then, ultimately, the question is, how many gallons can we get through the DGD system in Q3? DGD 2, I believe, went down in July and just – yeah and came back up in the first week of August here.

So we missed 20-something, 24, 27 days of production there against the – as John said the 344 production in clearly in Q2. So clearly, the contribution of DGD by pure volume with margins holding or improving in DGD will be less in Q3. And that's where we kind of say the core business, specialty ingredients business, right now 40 days into the quarter looks stronger than Q2 and DGD just has less gallons. So that would be the way that I would frame it.

John, anything you want to add to that or...?

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

No. That's exactly right.

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

Okay.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.
Q

That's super helpful. Thank you. And then, maybe just one follow-up, on the DGD margins, obviously there has been a lot of volatility. There is always a gap relative to what we would calculate or other numbers out there. You are talking about Brazil being the cheapest kind of feedstocks right now. So, could you just from a level-setting perspective, how should we think about the DGD economics today or through the back half? Just, there's always that gap and so any help would be helpful. Thanks.

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

Yeah. I think John and I will tag this. I mean, clearly, we watched heating oil or crude oil and heating oil move back up sharply here. Hopefully that will widen a little bit of margin. There's no lack of volatility, as John says, in that business. Spot margins have ranged from $1.20 to $1.50 in there. And I think for the end, the balance of the year, I think, somewhere, I don't know. John, what do you want to put out there, $1.20, $1.25 for the balance years what looks pretty achievable?

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

Yes, right. I mean, at the end of the day, we're always going to see volatility on Diamond's margins on a quarter-by-quarter basis, because you have a massive amount of feedstock going to it. A lot of different markets that we're selling into. And then, we've got heating oil moving around. We have RINs moving around. And by the way, the disastrous news on the RIN pricing that came out after the RVOs came out, the RIN market is up about $0.08 a gallon since that point in time.

So all that's right in play with what we thought it was going to be. The margins move around a little bit. You kind of see, because of the supply chain being so huge and fairly long, kind of a lead lag type of a thing that happens on a quarter-by-quarter basis. I've said it in the past, don't get too excited about really high earnings from Diamond on a quarterly basis or a little less per gallon from Diamond on a quarterly basis.

Because when you even that out over the last 12 months, you kind of come to the conclusion that Diamond is running about that $1 a gallon, $1.25 a gallon. The only difference is, we used to make 300 million gallons of this stuff and now we're making 1.2 billion to 1.3 billion gallons of this stuff. And that math adds up quite differently.

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

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

Thanks. Maybe a question on margins. As we think about your Feed and Food business, you've had material acquisitions in both of those. It's Valley Proteins and a couple others on the Feed side and the Gelnex on the Food side. You held margin – gross margin flat in the feed business sequentially.

Food was down a little bit, but adjusted for the inventory charge, it looked like it would have been still around 26%. As we think about those, post these acquisitions, should we still expect, is the Food – the right way to think about the Food margins still kind of in the 25%, 26% and maybe the same on the Feed side or are there – post-acquisition, are there things that would drive those margins one way or the other?

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

A

Yeah. I mean, I think, take the Feed segment, I think the gross margin percentage held quarter-over-quarter. Clearly, that's indicative of the progress that has been made in the North American Valley Proteins integration acquisition. I mean, there were many things, as we said, that had to happen there from changing of raw material formulas to yield adjustments to labor attrition, and just operating reliability and efficiency and many of those things are happening. Still some work to do there.

While we feel that we've got our plan complete, as we've reminded people, some of the raw material formulas are not changeable in that system till the end of this year, one more next year, and then one in 2026. So that was always the 1,000-day integration plan that they laid out there.

But long story short, the margins in that business have now improved quite a bit. You've seen that. So, I think we're pretty consistent there. In the Food segment, yeah, I think, what you're seeing is pretty symbolic of what's achievable there. We continue to move our product mix more towards the collagen peptide. That what's driving those margins there.

And clearly, as we told people, the Gelnex margins were consistent or better in many of the different products and geographies that we didn't operate in. And you'll see over time that work its way through. So now, I think, Ryan, I think, it's pretty symbolic and that would be consistent with my comments of two, three core ingredients being better than Q2 core ingredients.

Ryan M. Todd
Analyst, Piper Sandler & Co.

Q

Great. Thank you. And then, maybe one follow-up on – you just made some comments about it briefly, but the final RVO guidance came out during the quarter. Any thoughts on – takeaways from that final guidance, what it means for your business, and maybe the biofuels sector in general as you look forward over the next few years?

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

A

This is John. Yeah. I mean, at the end of the day, it was interesting because when we saw that RVO rule coming out internally, we were like, well, that's great. Kind of in-line with what we were hoping for. And then, all of a sudden, the marketplace had all sorts of headlines about disappointing, terrible, awful, rotten. And of course, the RINs market has gone up since that RVO, dip for a couple of days and went right back up.

The reality is this, while the 650-page document that the EPA puts out every year is massively painful to read through, when you do so, what you see is this. They've been fairly effective at managing to a 20% RINs bank on a forward-look basis and that will keep the marketplace in $1.25 to $1.75 RINs prices, depending on what the psychology of the moment is.

The only time [indiscernible] (00:35:15) is when the EPA came right out of left field with the small refinery exemptions and hit the marketplace with a big destruction of demand for RINs that the EPA was unable to predict in their previous rulemakings.

So at the end of the day, this thing's been condition stable, right where the EPA has managed it to or wants it to be, it seems like, which is a very nice market for us. It's a very adaptable market for the marketplace. The cost out there is not too great for folks. And we're able to market the product and have a nice margin out of it. So it works very well. We're very pleased with how that RVO came out. And renewable diesel in particular, it's great positioning within that RVO profile that just came out. So we liked it a lot. We were surprised when the marketplace didn't.

Operator: The next question is from Adam Samuelson with 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 Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Morning. Maybe, John if I could maybe follow on that last kind of comment that you just made. And if you think about 2025 and the shift to the 45Z, where existing renewable diesel producers and existing conventional biodiesel producers won't get kind of either the full or partial portion of the biodiesel tax credit that they currently enjoy. Do you see risk or a potential that, that changes the paradigm on RIN pricing as you move out? As ultimately that kind of – that gap that people are now earning on the BTC has to get filled by other parts of the different credits in the marketplace?

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

A

So the 45Z is a very interesting piece of legislation. I think it surprised people when they went back to the producer tax credit, the income tax credit late in the game as they were deciding how to extend.

At the end of the day, you're exactly right. You do see I adjust on that cash credit, so when you look [ph] at it (00:37:23) on an absolute basis, you can say, well, you're going to get less than a dollar. Here's what we loved about it for Darling. Fact of matter is, we produce in Darling low CI feedstocks. Diamond Green Diesel is capable of taking that low CI feedstock and turning it into the highest value renewable diesel in the world.

What that all adds up to is, we've always enjoyed in the LCFS programs as CI adjusted concept that maximizes the value of our fat and maximizes the value of what Diamond Green Diesel can produce. What we just saw in the 45Z was that same concept is now implemented into the federal incentive structure. That's advantage for Diamond Green Diesel over time, and at the end of the day, our margins are going to be defined by our competitive advantage versus the alternatives that can supply biomass-based diesel into the marketplace. That advantage just got greater with this piece of legislation. And one other thing to consider is, it's a producers' tax credit. That means, the product has to be produced in the United States of America. And we are the largest producer in the United States of America. Again, another huge win for team Darling.

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

A

And also, John, I think, relative to – and Adam too, by then when the producers' tax credit hit or 45Z comes into play, we're going to be in the SAF market and we hold that arbitrage at the same time that that absolutely favors low CI feedstock and low CI SAF. So, I think for anybody to say, this is a static, oh, it's less than a dollar will – as we call it internally – the green premium have to adjust to keep the marginal producer profitable, maybe.

But I think, I don't know that we spent a lot of time thinking about that right now. We just think that optimizing margins between the RD, SAF markets are going to be what drives the future profitability here and whether or not you're getting $0.75 or $1, I don't think that plays into the thinking of us around here.

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

A

And Adam, the spread, since the last time we spoke or last quarter they've ruled on or allow transferability as well under that rule. So that gives it more flexibility from a tax incentive perspective.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Okay. No, that's helpful. And if I could just follow up on capital allocation and obviously the DGD distributions happened in June, another one in the third quarter and whether that was July or August, should we look at kind of the cumulative kind of total that you've received in the last few months and kind of against the operating kind of earnings power of the business at current production rates and that being a reasonable indication of kind of how distributions will progress moving forward.

Obviously, some volatility in cash spend for CapEx in the SAF plan to the JV. But is there anything that would kind of alter that kind of payout in a material way moving forward?

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

A

Yeah. And I think Brad and I'll tag team this a little bit. I mean, obviously, it was important to me, important to our board, and also to the Street to show you the earnings power of Diamond Green Diesel and to start to bring those dividends. And so, $101 million in Q2 subsequent in July, here was another $62 million. Clearly, Diamond Green Diesel 2 down on a major turnaround for most of the month will use the excess cash.

But cash comes and goes from that joint venture as the blenders tax credit check comes in. And so, what Brad's been able to do is, move this to a monthly calculation instead of a quarterly calculation and ultimately that calculation gets made at the end of the month and then we'll see it. Brad, what do you want to add?

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

A

The only thing I was going to point out, Adam, is what Randy just hit on. And I think you know it, but big picture, I think, you're right on for the year, the cadence here should continue. But if you look at it in a real short period, with a calculation each month and you hold back some cash, you repay the – if there's a working capital on the revolving line outstanding. So when we get to the end of the year, what's the total exactly going to be?

It's hard to say Randy mentioned big BTC flows in that, in John's big machine of DGD 1, 2 and 3. Those are big cash movements, but in the big scheme of things, for this year, I'd say what we've seen all part depending on timing, particularly at the end of the year is kind of how we're seeing it for the rest of the year.

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

A

Yeah. And I think, you know, trying to put a number on it is hard Adam. I mean, clearly we're just speaking at the ultimate number of being below 3 times leverage by the end of the year.

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

A

Yeah.

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

A

And then, I think you can kind of back into that number against, you know, I've given you all the breadcrumbs of the EBITDA and all of that. And so, our leverage, we've said, we will be clearly below 3 times. That's factoring in some additional distributions, just to put it that way.

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

A

Yeah.

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

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

Q

Hey, good morning, guys. And congrats, John. I know you're around until next year, but congrats on everything. Maybe just going to Gelnex – maybe everything together Randy, you had the one-timer here. The question we get a lot is, just are we going to see more of those? And so, I know you don't have a crystal ball, but as we look out, [ph] are we (00:43:26) kind of see the light end of the tunnel with the acquisitions [indiscernible] (00:43:30) one-time things related to them.

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

A

Yeah. Ben, this is Brad. I'll just speak up here. We had smaller amounts for the other significant acquisitions. Didn't really speak to them as clearly, because they were about a third of this amount. What we'll have Q3 is just de minimis. It's really in the month of July. So [indiscernible] (00:43:54) really be even speaking toward it. So that $18.5 million is, I don't know 90% of it.

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

Q

Yeah.

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

A

Yeah. So yeah, I'll answer to your, Ben. We do have a crystal ball and we got another $1 million, $1.5 million of Gelnex [indiscernible] (00:44:09). Then that's over and we're operating now, as we said our focus is laser on finishing the integration moving to one operating computer system around the world and just paying down debt.

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

Q

And one thing I think you answered some of this in the previous question or a previous question on Gelnex, well, could you just talk to us about or just because collagen's becoming a bigger part of your business about your customer base or who customer is, and just how you guys kind of envision growth in that business? I know you talked about margin a bit, which is top-line growth as well.

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

A

Yeah. I mean, clearly the decision to acquire Gelnex was A, it became available; B, we were out of capacity in our system as we moved our product mix around from straight gelatin to a collagen, gelatin mix. And so, it became a pretty interesting opportunity. As we closed on the business and got to look or deep dive into the sales ledger, what we started to see was, it was one of the more fascinating things for me. And my food and ag career was, as always, they were doing a lot of business in geographies and also North America with customers that we weren't. So we had very little, I mean, when I say little, very little overlap. So our customer base grew.

The fun part with Brazil is, where four plants are, they're very efficient, one in Paraguay and then one up in Portage, Indiana, gives us a chance to optimize our product mix around the world and geographic movements of those products.

I think the other thing in my earlier comments was, Ricardo Cabral was the Operations Manager of the Gelnex operations. He's now in charge of all of Darling, Rousselot worldwide and their sales managers moved out of the North America and he's moved to run our European operations. Clearly, the cross-pollination of the team there is something that we're very, very bullish on.

In my case and I get to sit in the big seat here, our team has a lot to learn from them and I'm very proud of that. And I think the integration is going to go very, very well. It isn't going very, very well right now. The sales ledger is really solid. The other thing, I would comment about our global collagen businesses were, this is kind of the completion of Phase 1. Phase 2, you're going to hear more about over the coming year is, as we move into the active peptide area and we'll be talking more about the potential growth vehicles in that. And we needed the capacity of the Gelnex system to help us move to Phase 2 of active peptides.

The other piece that's underneath this business is our continued strong performance in China. And ultimately, we're going to add a little bit of capacity in China over the coming year in our northern China plant and ultimately grow that business. Clearly, the pharmaceutical or the pharma business, as we call it from bone gelatin in China is growing very rapidly as that population looks to nutraceuticals and supplements for healthcare.

John, anything you want to add to this? I mean...

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

No. I mean, the wonderful part about Gelnex, besides having a fabulous system in a fabulous location is, at the end of the day, it's always people that makes money. And we picked up a fabulous, fabulous, fabulous set of talent with the Gelnex group in South America. That's going to benefit us not only in the Gelnex organization, but as it already has and as Randy's mentioned throughout the entire Darling and Rousselot organization in the years to come. We're really excited about it.

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

Ben Bienvenu
Analyst, Stephens, Inc.
Q

Hey, good morning. Thanks for taking my questions. I want to maybe ask a little bit in the context of, as you highlighted the benefits of vertical integration to the model, despite what was a lot of volatility in the first half of the year, you demonstrated really solid earnings power from the business and some consistency that I think is quite remarkable. And so, as you think about this business now being a cash machine and wanting to grow it over the next decade, do you like the proportions of the various segments of the business today and how they intertwine? And how do you think about allocating capital in a balanced way to maintain this competitive advantage that you have down the road?

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

Yeah. This is Randy and I'll tag team with the team here. I mean, I think a little bit – I spend a lot of time looking at geographic concentration. I mean, clearly, we placed a pretty sizable bet in Brazil. I think we've been bullish Brazil for a lot of years here, I mean, waiting on the right opportunity to enter the core rendering in the gelatin, collagen business and grow it there.

So clearly, we've increased our exposure there. Why? Because we continue to believe that that country possesses land, water, and people and the ability to produce more animals. And that's where we want to be. So I mean, clearly, we place that bet. We will continue to grow in Brazil. We'll continue to expand the rendering business. I mean, it's a very, very large country, north to south, east to west. And so, it'll give us a lot more opportunity. We're bringing on a couple more plants as we speak right now there.

I mean, as I look at our total portfolio, clearly, I still think as political tensions potentially ease over time, China deserves a deeper look and then ultimately Africa over time. So the question becomes, what is our growth strategy? Clearly, green energy in Europe. You'll see some additional digester growth from us, potentially this year in that area, both expansion and greenfield. And then, ultimately SAF 2.0. I mean, clearly, Diamond Green Diesel 1 and 2 were not laid out as aptly as number three for the addition of a unit.

But we're studying that right now for seeing where it fits. And ultimately that decision will depend on how the market develops. I love John's word, insatiable demand. I'm hoping for insatiable margins. And then, we'll build number 2.0 there. Core rendering. I mean you saw the Butterball announcement, there's a couple more out there that we're working on right now both domestically and internationally for rendering plant growth.

And then, ultimately as the gelatin, collagen, we talked about the active peptide market and where we're moving there. So we feel really good about the trajectory of growth for this business. Ultimately, the real estate side, you have to remember as we said on the Gulf Coast, I mean, no announcement here on DGD 4.0 or DGD number 4, but clearly our confidence now in originating global feedstocks gives us the opportunity as that market grows or as the SAF market grows to consider that investment.

And then ultimately as Brad, as we get back to 2.5 times leverage is where we want to be, which should be nearly achievable by the end of 2024, we've got to start evaluating cash allocations and what we're going to do with it. And that, once again, puts the dividend on the table as a board decision that could be made at that time. Brad, John, anything you guys want to add?

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

A

No, it's perfect.

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

A

Okay.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Okay. Very good. Thanks, Randy. My second question is just related to LCFS markets, what you think the runway ahead is for potentially changing compliance standards and what the considerations are as you look to like the California LCFS market and what they're thinking through to make that determination?

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

A

It's John. I mean, obviously, they're going through the mapping process right now to try to figure out where they go. I think one of the things that's great news out of California is CARB has figured out that their program works spectacularly, that they have the ability to accelerate the mandates going forward and that they know that quite frankly, it's $75 to $85 a tonne credit. That's probably a little low to create that type of additional incremental low CI feedstock they want in the marketplace.

We would anticipate that they'll come forward with a rulemaking that's going to show a very good demand increase in California and we really like the direction that that's going. I think CARBs had all the right signals sent to it, that it can substantially increase those mandates going forward and we would anticipate that they would. They do a nice job on evaluating the future and capabilities of supply and what the demand looks like. But the pattern really seems set that we're in a good position to have growth there.

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

A

[ph] Matt (00:53:56)?

Q

Hi. Can you hear me?

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

A

Yes. Go ahead.

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

A

I think we lost our operator, but go ahead, [ph] Matt (00:54:08).

Q

My apologies. Hey, I wanted to follow-up on the recent Butterball announcement. It sounds like you'll be building a new poultry rendering plant that would raise your feed volumes by about 3%. Could you talk about how this deal came about and whether there might be additional opportunities for Butterball? Thanks.

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

A

Well, this is a model that we've started. I think it's probably somewhere between five and seven years ago now with Peco Foods in Pocahontas, Arkansas and Case Foods in Waynesburg, Ohio. And ultimately, it gets to, as we said, this is a transportation logistics business on one hand with a perishable item, that's half water to two-thirds water in some cases.

And so, we were hauling Butterball a long way and it just made to our factory. As you know, clearly a year ago today, we had Armageddon in the sense of trying to handle all the poultry tonnage in the new Valley system. And so, we were either going to have to build some additional capacity in the Delmarva on the East Coast to handle the tonnage and Butterball just became a candidate, because of their tonnage internally and then our ability to [indiscernible] (00:55:24) third-party tonnage into a site, takes some pressure off of our site, give them improved economics, and help them grow. So these are just really fabulous deals. I mean, you saw us announce, what, Heritage Cattlemen's or Cattlemen's Heritage up in Nebraska, that's the same type of deal. And it's just really gets down to a transportation savings.

Trucking is not as cheap as it used to be. So as you look at the concentration of tonnage and we're always looking to optimize our system and say, okay, whose spend and what money on freight. And then, does it make sense to build a plant? And in this case, their land, their building, our equipment and a long-term agreement and better economics with our expertise to both operating, rendering capacity, and or marketing of our product line around the world.

Q

Sounds good. And then, do you have more color on the Food segment in Q2? I guess, we were a little surprised to see it down quarter-over-quarter even with Gelnex rolling in. I understand there was the inventory hit, which would just be one time. But is the Gelnex annual run rate still in the $110 million to $120 million EBITDA range? And could you talk about how things are going so far in Q3 for Food?

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

A

Yeah, I mean, Q2, I mean, you've got to add back the $18.5 million and you would see that it was up nicely quarter-over-quarter, representative of the Gelnex contribution. Remember, there's three components in the Food segment. There's the Rousselot business. There's the edible animal fats business. And then, there's the casings and heparin business and, edible fats, follow the rest of the animal fat complex down. So there's a little bit of reduction there. And then, the casings business was a little bit lower, quarter-over-quarter. That's related to the Russian Ukraine issue and the Russian sales that aren't in there right now.

So Q3, I can tell you that we're back at operating levels that we thought we would. And yes, we said that the Gelnex would contribute on the final quarter at the $75 million rate post the $18.5 million inventory charge. And we're at that run rate, at least what I saw in July here. So that's about the only color I can give you at this time with 30 days into the quarter.

Operator: The next question is from Tom Palmer with JPMorgan. Please go ahead.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Good morning. And thanks for squeezing me in. I just wanted to ask on CapEx expectations at Diamond Green Diesel. The Q2 figure is below your depreciation expense, but I know you've got the SAF project ramping up. So just any color on maybe how that progresses in the back half would be helpful?

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

A

I'm not sure I understand the question, Tom. Can you just repeat that?

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Capital expenditures. Sure. Just your capital expenditure plans, the Diamond Green Diesel in the back half, they were rather low in the second quarter. But I know the SAF project is starting to ramp up.

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

A

Oh, I got it. So, yeah. No, we will see an increasing CapEx run rate out of the SAF project, but the majority of that still next year is when we see the majority of the CapEx on that. But I think the bigger point on Diamond Green Diesel in terms of cash flow out of it is, it's true we have a little money we're going to spend each year on turnarounds and we have some money that we are spending on the SAF project. But compared to the cash flow that we've had going out as we've been building Diamond Green Diesel 2 and Diamond Green Diesel 3, these aren't even drops at the pond. So the free cash flow out of Diamond Green Diesel increases tremendously as we stop the massive expansion process within Diamond. And that gives us confidence that we'll continue to see dividends coming out of Diamond Green Diesel going forward.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Okay. Thanks for that. Maybe I'll just follow up on that dividend comment. I know you've covered some of this already, but in the past you had a more formal criteria to determine the magnitude of distributions. I think if we go back to like 2019, 2020, maybe I missed it, but it doesn't seem like there's a policy to that extent in place at this point. Maybe what kind of determines the magnitude of payouts this time around? And might we anticipate something perhaps more formal at some point in coming quarters?

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

A

Yeah, Tom. This is Brad. I think you're probably referencing a $50 million number that we – previously, a couple of years ago when DGD was smaller in terms of kind of a cash hold. That number is due to the size of the machine now, won't really speak to the specific number. But that's, I think, maybe a bit of what you're driving at. But the mechanics of that is largely – Randy mentioned we went to a monthly rather than a quarterly.

So that was a significant move a number of quarters ago. But by and large, other than those items, it's still done the same way. And we pay that revolving facility down or we have it in the calculation for to be paid down to be factored in it in terms of what the distributions will be.

And the other thing, just to tag on what John was referencing on CapEx at Diamond, just I want to be clear when we think about reference toward distributions, the remainder of the year, we are factoring in the presumed or the projected CapEx there. So hope some of that helps you.

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

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

Q

Thank you. Good morning, guys.

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

A

Hi, Paul.

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

Q

Randy, I want to go back. You've mentioned about the Phase 2 on the collagen business on the growth plan. Can you share with us that what kind of timeline and milestone that we should be watching?

[indiscernible] (01:01:54)

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

Q

And also that, I mean, on that – I mean, that if you can talk about the new business, what is the margin comparing to your legacy business so that, at least, we can have some idea how the margin improvement may apply on the overall business?

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

A

Yeah. I mean, if you think about the product line that's being marketed today of the collagen peptides, that's just an aggregation of the peptide today, meaning they've not been separated. The work that we're doing at the R&D level today, that gives us a lot of excitement is isolating and concentrating the different peptides and then doing clinicals and different studies on what kind of reaction the body, the human body gets for taking those peptides.

It is just way too early at this moment to even think about volumes or margin in that area. But clearly, I believe it'll be substantially better than commodity gelatin. The applications that are being worked on today that we've released and discussed during some of our public innovation days are absolutely, they're breath-taking. John, what do you want to add to that? I mean, you've been working in this area.

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

A

I think what you think about in terms of active peptides, this is just a continuing example of Darling as an innovation company. We're constantly out there trying to figure out, know our customer base and figure out where these new products, the demand is being created for, how we can develop supply chains at higher margins to be able to supply these [ph] market chains (01:03:37) active peptides is a continuation of what we've been doing over the past 10 years.

It takes time to develop these and it's not always a straight line. Everything doesn't happen [indiscernible] (01:03:45) this is going to happen this day and something else is going to happen this day. We've got a doggone good track record and we've got a phenomenal organization out there working on the innovation stream. We think there's just a tremendous opportunity in the active peptide world.

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

A

Yeah. I think Paul, if you think about it, I mean, today you're seeing a really broad product grouping out there that from vital proteins, in the sense of just taking collagen peptide and putting it in solution or in a protein bar. But it's just listed as collagen peptide. The stuff that we're seeing out here that's being worked on, would be for a specific purpose joint lubricity, nail growth, hair retention, gut health. I've even heard words, dementia treatment.

I've heard words of ultimately A1C management. And so, what all that means is, while it's a long runway to get there, we're working hard in that area, but it broadens the number of products that we can use our product or put our ingredient into around the world. And given the specificity of those ingredients, it will command a premium to what we're doing today. And so, how big those markets are, we'll see. But it wasn't seven, eight years ago, we didn't know how big the collagen peptide market was. But it clearly, from our research says, this isn't a fad. This is absolutely got proven medical benefits out here and we're just excited about it and we'll see where it goes.

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

Q

Hey, Randy and John, I think you are doing research with some university on some of the products. When do you think that the first product may go to the FDA for approval or that maybe go through the Phase 1, I don't know where they are at this point.

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

There have been several patents received at this time. There are several petitions out there around the world for approval of these products, but I guess, that's all we would like to comment at this time. John, anything you want to add.

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

That's exactly right. We try not to discuss the stuff [indiscernible] (01:06:05).

Operator: The next question is from Jason Gabelman with TD Cowen. Please go ahead.

Jason Gabelman
Analyst, Cowen & Co. LLC
Q

Hey, good morning. Thanks for taking my questions. The first one is, just on the impact of fee prices to the overall business. Randy, last quarter on the earnings call, you discussed the fact that lower feed prices were a net benefit to the company's earnings. And I just want to get your understanding or your comments now that feed prices have kind of rebounded year-end and is the inverse true that higher feed prices are going to be a net negative for the overall business, or are there some offsets going on in the marketplace we should be aware of?

And then, my follow up is just on EBITDA as we think about next year, we could see if we annualize second half 2023 EBITDA, you get to about $1.9 billion, is that a fair benchmark to think about for 2024, assuming pricing remains flat, which I know is obviously a big assumption to make. Or are there some other things going on in the underlying business that we should think about as well? Thank you.

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

No, I think – good questions, Jason. This might be where I say, I got a fog in my crystal ball a little bit. But no, I think the thing that I just want to once again reiterate and try to say is, okay, fat prices globally were down $0.05 to $0.07 a pound, depending on geography. And ultimately, at the end of the day, that translates into $70 million to $80 million annually of EBITDA. Divide that by four and you get, $18 million to $20 million. And you look at the Feed segment and you say, how much was it down? It was down $26 million.

Then you say, well, what was volume? Volume was 100,000 tonnes lower than it was in the prior quarter. And so, at the end of the day, it kind of makes sense. Now as we come into Q3, remember the pipeline, whether it's coming out of Europe, Brazil, or North America, it's been priced into DGD for 45 days to 60 days already. So we won't see the pickup in animal fat prices or yellow grease or UCO until probably September into our system, because of the pricing lag.

So yes, that's going to be -- that'll play positive towards the end of Q3 and that'll carry momentum into Q4. The other thing that you look at is, we talked about, the Food segment has a little bit of fat in it. So it's down, but it's coming back. And then, you look at Diamond Green Diesel, it was offline for basically July, number 2 was. And that's a 470 million, 500 million gallon plant offline. It's going to – it's back up at capacity and we're also watching Liza crude oil is up $80 a barrel, quite a bit from what it was in Q2 and heating oil is back up.

So they're not exactly perfectly offsetting each other in the sense, but I think at the end of the day, you could have a situation where you've got higher crude oil prices, improved feedstock prices, and both businesses benefit. John, do you want to try to get in that mess-up?

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

A

No, I think at the end of the day, what you see is this. There is not always a one-to-one correlation as fat goes up and fat goes down to Darling core business profitability and Diamond's core business profitability. But what you have seen when we were producing 1.2 billion to 1.3 billion gallons out of Diamond Green Diesel, we've seen significant adjustments down in the feedstock price. And when you look at the combined vertical, what you see is extremely strong earnings.

We anticipate that's going to continue when you look at the combined vertical as we see fat prices rebound. Randy hit a very important point. Rents have been stable to slightly up. LCFS has been stable, but we've seen the heating oil market go up by $0.80 a gallon in the past five or six weeks. So, yeah, fat prices are going up, but the baseline in which we sell our renewables has been going up. So, to some degree, there are circumstances in which we benefit on both sides of the wall here as Darling and with stable margins of Diamond Green Diesel.

So the combined entity is going to see some flux back and forth, but because we own the vertical, we're going to benefit out of that vertical chain. I think that, at the end of the day, is the big message.

Operator: The next question is from Bill Baldwin with Baldwin Anthony Securities. Please go ahead.

Bill Baldwin
Analyst, Baldwin Anthony Securities

Q

Yeah. Good morning. Just a few quick areas.

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

A

Good morning, Bill.

Bill Baldwin
Analyst, Baldwin Anthony Securities

Q

Just two quick areas. I just wanted to see any color, Randy, regarding the issues that Tyson has with shutting down some of their poultry plants. Do any of your customers pick up volume in this and what's going on out there? I mean, could that potentially benefit your poultry volumes, with them shutting down some plants here in the US?

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

A

Yeah. I mean, clearly, I'm not – I don't have the inside baseball on that, but the four plants that Tyson closed are what I would consider to be older, higher labor cost plants. And clearly, speed up the chain speed at some of the more efficient plants that have higher levels of automation. I mean, John and John are have been clear about their $1 billion challenge and they're delivering on that. That's number one.

Number two is that, yes, we have picked up some volume and move volumes around on the East Coast with some of the closures that are happening. We're still seeing a poultry expansion. I mean, by no means is this symbolic of the world. This has been probably the longest, most profitable poultry and meat cycle that I think this country has seen.

And clearly, there is, though – clearly some – you're hearing it from the food companies, you're feeling some inflationary recessionary pressures here and abroad. But at the end of the day, it's really – it's not a giant deal for us. But, yes, we have picked up some volume, moved around as different people that were going to some of these plants have now decided to move tonnage around. We're always looking to optimize tonnage out there and lower freight costs when it's available. So the answer is, yes, we have benefited.

Bill Baldwin
Analyst, Baldwin Anthony Securities

Q

And just second question, Randy. I know you got a number of initiatives going on with expanding your rendering capacity with new plants Brazil and other areas. Can you quantify or give us some color as to what kind of impact this could have on your overall capacity when those plants are completed? What kind of increase in volume processing capacity will take place and some kind of timetable on when you think all of that will be completed?

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

A

It's hard to put a real number on that at this moment. The one thing we continue to wait on the Polish anti-trust authorities to close on the three poultry plants in Poland. That should happen hopefully this quarter. We've got a couple of plants coming online just starting up in Brazil, a couple more plants expanding in Brazil. Butterball won't be on until 2025. Cattlemen's Heritage won't be on till 2025. So it's a pretty good sluggish growth around the country.

But it's really a late 2024, 2025 timeframe for most of that before it would be transparent. So, I mean, you look at the last five years, I think acquisitions aside, we've been averaging growth between 5% and 7%. It feels like we're back, you know, 1% to 2% right now as the world kind of retraces a little bit. But we're still growing.

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

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

Hey, thanks everybody for your questions today. As you know, we'll be attending a few conferences in September which are listed on our website. As always any questions, feel free to reach out to Suann and stay safe. Have a great day and appreciate everybody being on the call. That concludes our call.

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