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CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

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

Benjamin M. Hogan *Inherent Group, LLC - VP*

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

David Francis Katter *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

Heather Lynn Jones *Heather Jones Research LLC - Founder*

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

PRESENTATION

Operator

Good morning, everyone, and welcome to the Darling Ingredients Inc. conference call to discuss the company's second quarter 2019 financial results.

On the call today are Mr. Randall C. Stuewe, Chairman and Chief Executive Officer; Mr. Brad Phillips, Executive Vice President and Chief Financial Officer; Mr. John Bullock, Executive Vice President and Chief Strategy Officer; and Ms. Melissa Gaither, Vice President of Investor Relations and Global Communications. (Operator Instructions) Today's call is being recorded. (Operator Instructions)

I would now like to turn the call over to Melissa Gaither, Vice President of Investor Relations and Global Communications for Darling Ingredients. Ms. Gaither, please go ahead.

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

Thank you, Andrew. Good morning, everyone. And thank you for joining us to discuss Darling Ingredients' earnings results for the second quarter ended June 29, 2019. To augment management's formal presentation, please refer to the Presentations section of our IR website for the earnings slide deck. Randy Stuewe, our Chairman and CEO, will begin today's call with an overview of our second quarter operational and financial results, focusing on year-over-year comparisons, followed by a discussion about some of the trends impacting our business. Brad Phillips, Executive Vice President and Chief Financial Officer, will then provide additional details about our financial results. Finally, Randy will conclude the prepared portion of the call with some general remarks, after which we'll be happy to answer your questions.

Please see the full disclosures of our non-U. S. GAAP measures in both our earnings release and earnings slide presentation.

Now for the safe harbor statement. This conference will contain forward-looking statements regarding Darling Ingredients' business opportunities and anticipated results of operations. Please bear in mind that forward-looking information is subject to many risks and uncertainties, and actual results may differ materially from what is projected. Many of these risks and uncertainties are described in Darling's annual report on the Form 10-K for the year ended December 29, 2018, our recent press release announced yesterday and our filings with the SEC. Forward-looking statements in the conference are based on our current expectations and beliefs, and we do not undertake any duty to update any of the forward-looking statements made in this conference call or otherwise.

Now I'll turn the call over to Randy.

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

Thanks, Melissa. Good morning, everyone. Thanks for joining us. Second quarter results reflect our diverse global platform and our integrated supply chain, resulting in overall improved earnings in a difficult macro environment. In fact, in our earnings release issued yesterday, we highlighted Diamond Green Diesel's growing earnings contribution and material impact to our business, which, when combined with our core adjusted EBITDA results, yielded a pro forma EBITDA of $159.4 million. This included $115.5 million from our core business and an impressive $43.9 million from Diamond Green Diesel. Of note, earnings included a gain of $13.2 million from a vacant China property sale and net income for the quarter reflects the absence of $54 million of onetime costs incurred in 2018 second quarter. Brad will give you a little more detail on that in his financial remarks.

Now looking to -- at our segment performance. The Feed segment faced significantly lower finished protein pricing due to unresolved trade agreements with China and repercussions from the African swine fever epidemic. Overall, we saw protein meal markets substantially lower by 25% to 30% versus last year due to a glut of protein as North American and European markets responded to the extensive hog depletion in China. Late in the quarter, fat pricing responded positively to higher corn prices in the U.S. and increased energy market demand worldwide. As market cycled higher, our North American raw material formulas lagged, but we expect forward supply chain pricing to DGD will react positively in the third and fourth quarters. Global raw material volumes remained high and were up 1.6% year-over-year in the segment.

In the Food segment, our global collagen business delivered greatly improved margins versus last year, benefiting from higher global demand, especially for Peptan, our premium collagen product. That business line continues to identify and develop new products to serve the health, nutrition and biomedical needs of consumers. In China, North America and South America, our collagen business delivered solid results, while European operations adjusted to higher raw material costs due to the reduced availability of pigskin.

Investments in new facilities to grow our collagen business should be online during the first half of 2020. Volumes and pricing in our non-collagen business lines were lower during the quarter due to growing amounts of raw materials being diverted to Chinese food markets as a result of the ongoing ASF outbreaks and the availability of lower-priced palm oil.

Our Fuel segment again performed consistently despite the lack of a blender's tax credit in North America. Sequentially, our operations reported steady results, while the year-over-year earnings came in slightly lower due to the recategorization of raw materials within the European sector. Globally, our bioenergy businesses continued to perform at a steady pace.

Now Diamond Green Diesel performed well and delivered $87.8 million of adjusted EBITDA on the sale of 70 million gallons of renewable diesel, achieving our targeted $1.25 per gallon adjusted EBITDA during the quarter. It should be noted that we have an average EBITDA of $1.25 for the last 3 quarters in a row. We're on track to meet our full year production target of 275 million gallons at an average adjusted EBITDA of about $1.25 per gallon before any benefit from the blender's tax credit.

As mentioned on our Q1 earnings call, in April, we received a $17.7 million cash dividend from the joint venture, and in July, the JV paid each partner another $37.8 million.

The construction of Phase III Super Diamond remains on budget and on schedule to begin operating on our new annual production rate of 675 million gallons plus an additional 60 million gallons of renewable gasoline by the end of 2021. Once in production, Diamond Green Diesel will be one of the largest producers of renewable diesel using low carbon feedstocks in the world, and we will be making even more meaningful contribution to reducing carbon emissions globally with our low carbon biofuels.

Now turning to politics. We remain optimistic that the blender's tax credit will be approved and implemented most likely when Congress reconvenes in September. Both parties have agreed on the form and the duration and now they must find an appropriations vehicle to attach the legislation.

Our expectation is that (inaudible) will be approved and made retroactive for 2018, it will be extended to cover 2019 production and also 2020. With its reinstatement, we have the potential to receive an additional $157.4 million of entity-level EBITDA for 2018 and an additional $141.1 million for the first half of 2019. The soonest though we could receive a retroactive payment for the tax credit would probably be in early 2020.

With that, Brad will take us through a few financial highlights.

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

Okay. Thanks, Randy. Net income for the second quarter of 2019 totaled $26.3 million or $0.16 per diluted share compared to a net loss of $30.4 million or a net loss of $0.18 per diluted share for the 2018 second quarter. The net loss for the 2018 second quarter included cost of $23.5 million related to debt extinguishment for our Eurobond refinancing compared to $12.1 million of debt extinguishment costs recorded in the second quarter of 2019 related to the U.S. bond refinancing.

In the 2018 second quarter, we also recorded a $15.5 million loss from the sale of our Terra Renewal Services subsidiary and $15 million of restructuring costs related to the closure of the Argentina gelatin plant.

SG&A for the quarter was $81 million, in line with the guidance provided last quarter and lower sequentially due to a larger portion of annual compensation expenses being recorded in Q1, which occurs each year. We continue to anticipate a quarterly SG&A run rate of approximately $80 million per quarter for the remainder of the year.

Interest expense was $20.8 million for the period compared to $23 million in the second quarter of 2018. The decrease was primarily due to refinancing the EUR 515 million senior notes from 4.75% to 3.58% in the second quarter of fiscal 2018.

Now looking at taxes. The company reported income tax expense of $7.8 million for the 3 months ended June 29, 2019. The effective tax rate was 20%, which differs slightly from the federal statutory rate of 21%, due primarily to the relative mix of earnings among jurisdictions with different tax rates and discrete items, including the recognition of the deferred tax asset for which no tax benefit had previously been recorded. The company also paid $9.7 million of income taxes in the second quarter.

As Randy mentioned, Congress continues to discuss tax extenders package, including the biofuel tax credit. We are hopeful that the biofuel tax incentive, which has bipartisan support, will ultimately be reenacted during the year.

For 2019, we are projecting an effective tax rate of 30%, excluding the biofuel tax credit. If the tax incentive is reenacted retroactively for 2018 and for 2019, the effective tax rate is projected to be 15%. Finally, we are projecting cash taxes of approximately $25 million for the remainder of fiscal 2019.

As previously mentioned, we refinanced the USD 500 million notes to a 5% and 5.25% rate and extended the maturity to 2027. Capital expenditures of $167.9 million were made during the first 6 months of fiscal 2019 against the projected $300 million for the full fiscal 2019. We paid down $18 million in debt during the quarter, and our liquidity remains strong with unrestricted cash of $87.1 million and $913 million available under our revolving credit facility. Also, as mentioned, subsequent to quarter end, we received a $37.8 million dividend from Diamond Green Diesel.

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

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

Thanks, Brad. Overall, I'm very pleased with the agility of our team in responding to and successfully overcoming the headwinds in the current challenging macro environment. We capitalized on the diversity of our business, continued to identify new opportunities to maximize the performance of our assets and leveraged our global platform and integrated business structure to deliver a track record of sustainable performance and shareholder value.

We expect to see an improved second half of the year in our core business segments and a full year performance by DGD of $1.25 EBITDA per gallon. We expect raw material volumes to remain strong in North America with some leakage from Europe to China. Fat prices should further improve, while protein oversupply will continue to pressure prices as we manage through trade uncertainty and the ASF outbreak in China.

Our global collagen business is making raw material pricing adjustments to further strengthen markets -- margins, and we expect market share gains as our new Peptan product line expands to address global demand. We continue to make meaningful progress towards our long-term strategic objectives, which includes maximizing returns from DGD and executing on our existing and announced growth channel investments. The cornerstone of Darling's success is rooted in our entrepreneurial culture and the commitments of our entire team to leave positive impact on our environment and drive sustainable solutions for feeding and fueling a growing world.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Adam Samuelson of Goldman Sachs.

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

Yes. So Randy, I'm hoping can you maybe elaborate a bit more on your comments about an improved second half in the base business and talk a little bit about some of maybe the divergent dynamics in the fat side versus proteins? Kind of how maybe contract lags kind of pulled some earnings out of the second quarter. And kind of the volatility you're seeing in crop prices, especially on the corn side, corn to the upside, soy to the down, and how that kind of could influence the realizations in the back half?

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

Okay. Yes, let me -- I'll give a little bit of color on that. I mean, obviously, we'll break it into both the core business by segment here. I mean the Feed segment sequentially was pretty much flat quarter-over-quarter, while prices moved down on the protein side, anywhere from 10% to 15% in that business. And so as you have the raw material supply agreements, we were chasing markets, if you will, in a sense where what you buy today, you sell for less tomorrow until you find the bottom there. So obviously, at the end of the day, the protein side, both in Canada and the U.S. and even Europe, we were unable to make raw material adjustments or lowering what we pay for raw material to offset those falling markets. Conversely, we saw fat prices start to improve, but it really didn't happen until the end of June or mid-June. And you always have to remember that Diamond Green Diesel for our North American assets has a supply chain that's somewhere between 60 and 75 days out. So basically, we were forward sold in an improving market.

So the comments about an improving second half is, we believe that we'll see fat prices improve for 2 reasons. One, at the end of the day, continued strong demand from the global biofuel markets in Diamond Green Diesel, plus the -- we've seen an improvement in the price of corn, especially cash corn. And so we're seeing strong feed demand from the use of that. And if you look at feed demand in North America or animal production, there's no sign of any slowing yet of the poultry markets, the beef and the pork side. They're feeding a lot of wheat. And when they feed a lot of wheat, they need a lot of fat. So we'll continue to see some strong improvement there. Also, that within that Feed segment, we should see some improvement contribution from our bakery business as it fills the improvement there.

In the Food segment, we've only had one of our spray dryers or the second spray dryer for the collagen product online in Brazil now here for about 90 days. We're still working some kinks out there and getting up to speed on full production. And we'll -- so that should contribute sharply and better as we go forward.

Conversely, as we talked in the Food segment, we've seen China come in and start to buy basic pork bones out of Europe and also edible fat that has not gone into our processing system to be frozen and shipped to China. So we've seen some reduction in raw materials there in the Food segment. Conversely, pigskin also that is made into -- in Europe, predominantly for us into collagen is being frozen and sold to China now. So we've had to chase the markets up a little bit there, which caused some margin compression. We should be able to widen those margins out the back half of the year.

And then in the Fuel segment, that's just going to be fairly consistent throughout the balance of the year. And then ultimately, we remain optimistic that Congress, because both sides of the aisle have agreed on the basic structure and language of the blender's tax credit, that we'll see that come back here in the back half of the year and improve biofuel margins again. So I hope that helps a little bit.

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

A lot of helpful color. And then just a follow-up on Diamond Green and the renewable diesel margins. How does the blender's tax credit impact both the LCFS and the RIN markets, if at all, as we think about the margins kind of from, let's say, 4Q onwards if Congress actually does get the BTC passed?

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

Yes, this is John Bullock. I mean at the end of the day, obviously, the extra dollar helps with the margins. If the dollar tax credit is in effect, then dairy, the rest of the green premiums, the LCFS and the RINs don't have to do quite as much work to incent the production. However, the LCFS market is very tight. Obviously, with the very aggressive growth plans that there are in California as well as a whole bunch of other places in the world around the LCFS fields, I'm not so sure that the dollar tax credit being in effect or not being in effect is going to have much impact. That market should remain very, very strong. The RINs market will be impacted by whether or not the tax credit is there or not. It will be a little bit higher if non-tax credit and it will be a little bit lower if there is a tax credit. So at the end of the day, there is some relationship, not so much with the LCFS, I think that's strong by itself, and it really doesn't matter what the government does with the tax credit.

Operator

The next question comes from Heather Jones of Heather Jones Research, LLC.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

So I had -- my first question is on Europe. So 2 parts. When, specifically, do you expect the Food's margins to catch up for the cost pass-through on gelatin? And two, in the core rendering business, given that we're now starting to see moves in fat prices and all, do you think the move and product pricing will be enough to offset the reduced operating leverage from less raw materials? So if you -- those are my 2 questions on Europe, and then I have a follow-up.

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

Yes. I mean, the collagen business, obviously, is a multi-continent, 4-continent business. We're having strong results in China. The Peptan business is really anchored out of South America today and then strong results here in North America. China -- given the pigskin volatility that's happened and the prices have moved up 30%, 40% in Europe, that caused some margin compression in China -- or in the European plants, the couple, 2, 3 plants that we have over there, we'll see that widen back out.

So I mean if you take and you take out the Zhejiang property sale out of the Q2, I think we'll have a pretty consistent, solid run rate in that business for the balance -- in the Food segment for the balance of the year. I don't anticipate much more tonnage leaking out of the -- what I call the bone processing business and then the fat-melting business right now at this time. I think that it's pretty well saturated. We've had to make some raw material adjustments. So the Food segment, I think, is pretty representative of how it's going to move forward here.

The Feed segment, the challenge that I was alluding to Adam was that fat prices improved late in the quarter, but there's no way could they overcome the decline in protein. What I'm trying to decode for you now is, is it look -- feels like protein as I always hate to call a bottom, but feels like we're near the bottom there. We're too big of historical discount globally now to soybean meal. And that's what's given me the courage to step forward and say that we're flat now, our formulas will -- and processing agreements have adjusted now. And going forward, we should be able to widen out those margins going forward.

And then I think the thing is we're -- this is whatever, August 7, August 12, the U.S. government comes out with their crop report and there is a lot of uncertainty out there of what the status is of the corn and soybean crop. And I've never seen in my career here, the unknown and the uncertainty that we've ever had in how many acres are planted, how many are going to be harvested and what the yields are going to be this year. So I think hang on to the 12th, and we could see a surprise that would say that there's a lot less corn out there. I had the honor of traveling yesterday in the Midwest to go look, and there's a wide variation in the maturity level of the corn crop out there right now from some that was planted so late with no (inaudible), to some that looks pretty good. So we'll see where we go there. But I think that at the end of the day, it will flow through to better fat prices and stable protein prices going forward together.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

I guess I was wanting to talk about Europe specifically because there is a chance that as the ASF situation evolves that it's going to translate to increased demand here. So Europe is sort of on the front lines. So I just want to talk about specifically, like you've got lower raw material volumes there, which clearly reduces your operating leverage. So do you think that as these higher prices move to the system, do you anticipate the benefit from higher pricing to more than offset reduced operating leverage?

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

Well, let me correct you on something. The only lower raw material volumes we're seeing are in the Food segment. And that's such a small portion of the Food segment, it's really immaterial. Our CAD 1, 2 and 3 processing businesses in Europe are up year-over-year, quarter-over-quarter. So I don't see any type of change there right at this moment. I think that the view is, that the margin structures of animal production in Europe have improved. Now whether they actually will produce more animals in response to China's long-term demand, we shall see. Environmentalists have a position on that. But at the end of the day, the markets are encouraging additional production everywhere in the world to get ready to feed China.

It's simple to say, we don't know how much demand is going to come out of China for poultry, pork or even beef here. And the one thing for certain right now is it doesn't appear that it's coming from the U.S., it will come from China -- or from Europe first and maybe South America until the trade dispute is put to bed. So there isn't any really operating leverage discussion to have on Europe today as it's a -- it looks very consistent going forward other than a little bit of pressure in the Food segment.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

Okay. And my follow-up is on China. So you've had excellent visibility into what's been going on there as far as losses, the magnitude. I'm just wondered if you could update us on your thinking there, like your blood plasma supplies? I mean what is your operations on the ground telling you as far as the magnitude of the issue there?

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

Still a lot of unknowns. Our collagen business there is the food demand side and the nutraceutical and pharmaceutical demand remains strong. We saw pigskin prices run up and then they backed off. We saw hide prices run up and then they leveled off. We were able to adjust margins. So our exposure there is, is there's quite a few less pigs available that I can't really put any more detail around it.

Our blood business there is, right now, basically, treading water, running at -- operating at breakeven as we try -- basically, we used to sell hemoglobin and plasma, the red cells to aquaculture and then white cells to baby pig starter feeds. We have not -- we are keeping those products, if you will, co-mingled today, and they're going all to aquaculture and a little bit to pet food, 95% aquaculture. We've not seen any real -- there's -- I would say, our supplies of porcine blood are down anywhere from 25% to 50%, depending on where you're at in the country today. Clearly, the Chinese government is working diligently to try to build a biosecurity plan to isolate the kind of the small producer on-farm producer. So it's I think -- we have not -- there's no way that they are -- have this situation under control today. And so time will tell. But right now, our businesses are pretty steady and safe going forward.

Operator

The next question comes from Craig Irwin of ROTH Capital Partners.

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

So Randy, Diamond Green was having a heck of the quarter. I saw that the plant operated 106% utilization. Is there an opportunity for additional debottlenecking there? Can we see some capacity creep on the existing footprint without the expansion of Super Diamond?

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

Yes, this is John Bullock. We just got to the 275 million gallon level late last year. Still kind of learning the new plant or the expanded plant, as we're talking about. I think, through the first half of the year, we're running at 280 million, 282 million gallon pace. From time to time, we need to work on the unit. Our guidance still holds at 275 million for this year. As we get into next year, is it possible that we could be a little bit better than 275 million. Yes, it's possible, as we learn the unit, we may be able to move it up a little bit, but it's too early to make any predictions or calls about that. 275 million is our guidance, and we should be around there.

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

Great. That's good to hear. My follow-up is about BTC. So it's good to see you taking a constructive outlook on renewals. I share your view. You've been conservative in the past. So that's a nice change. Can you maybe share with us what the current thinking is for the use of proceeds when we get this cash in the bank? Is this something that Diamond Green will primarily invest in growth CapEx to cover that $1.1 billion CapEx of Super Diamond? Or is a portion of it likely to be dividend back and used in the core business?

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

Yes, Craig. And I mean, as you know, there is a dividend policy that exists within Diamond Green Diesel, and I think we keep a floating $50 million reserve there. So anything that comes in from that we will look at and dividend back to the parent companies as we go forward. As we said, we expect where the margin structure is and the production rates that John referred to through 2019, '20 and 21 here to support the $1.1 billion of investment in there. So we'll go ahead and dividend it back and move forward from there. And the only reason you wouldn't was if margin structures radically changed here, which we're not remotely seeing that. In fact, we're seeing margin structures even widen out from the $1.25 a gallon right now. So we feel pretty optimistic there.

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

As Brad tried to allude, and I've tried to say, it's really a timing thing, we anticipate that they're going to be -- we're optimistic they'll find a vehicle sometime after they reconvene in September. And depending on if it's September or October or November, when it comes through, then you file for the retroactive and the prospective. And then it's really -- when do they mail the check, and that could be anywhere from December to Q1 right now. So it's just really a timing deal for us.

Operator

The next question comes from Ken Zaslow of Bank of Montreal.

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

Two questions. One probably easy one, one probably a little bit longer term. The first one, if I look at the biodiesel margin -- the biofuels margins, Diamond Green Diesel significantly outperformed the industry. Can you talk about the recapturing of the LCFS credit? It seems like that was probably the spread relative to the market margins. I'll start there and then I'll ask a follow-up.

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

Yes, Ken, this is John Bullock. I think as we've talked about in the past, as the LCFS markets have developed 2.5 years ago, we didn't move anything to the LCFS markets. Now all of it moves to one LCFS market or another. And because of the demand increases that's occurred in those markets as time moves along here, we're able to get a little bit more and a little bit more of that LCFS. So I think as you look at what our earnings have been so far this year, it is fair to say that, yes, it is because, in part, we are receiving a greater portion of the LCFS premium.

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

Can you give more clarity on that? Like are you getting 80%, 90%, 40%? Any sort of range or any sort of parameters would be helpful there.

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

Yes, I understand that. And I think we've been asked that question multiple times. We have not really, I believe, given any specific guidance around that, Ken. Part of this is, this is a negotiation between us and our customers that are going on out there. Obviously, those contracts and the information contained in those contracts is confidential information. We certainly would not be in a lot of position to where we are providing confidential information from a person that we have critical -- to our customers that we have a critical relationship with. All I can tell you is that it has been improving, is improving, and looks like it will continue to improve.

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

Okay. Randy, my second question is when you talked about food and feed for the back half of the year, I understand what you're talking about, and I get it. I think a bigger question is, how do you feel the building blocks for 2020 and 2021 for those businesses are? I'm assuming you don't expect food to be at this level in perpetuity. And I'm assuming feed should have a little bit, but how do you kind of frame it? I'm not looking for exact guidance for 2020, 2021. But I mean, the idea of framework from which to help us work, and that would be great.

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

Yes. I mean, I think looking forward here, depending on what happens, and specifically in the Feed segment, we see tonnage continuing to be strong, maybe leveling off here. We've been through 5 years of growth in the tonnage side of the business in both North America and Europe now. I don't really see much slowing going on there, but maybe a little less rate. We've made a lot of investments over the last 3 to 4 years in the core rendering business, both in the U.S., up in Canada and to a degree, in Europe, to capture that volume growth such that within our supply chain, we can control more low carbon feedstock around the world to support our expansions -- and our pending expansions.

So we feel pretty good going forward that the tonnage in the core rendering business is going to continue. We think that we'll be able to widen out margins. We've been starting up a lot of plants around the U.S. over the last 18 months and trying to get established customer bases and supply bases and widen out margins. So we feel pretty good that there's a pretty aggressive program to widen out those margins. We've seen -- what we've been unable to overcome here in the short term, Ken, and this is what we think will widen out next year, is we brought -- that the poultry slaughter has been very, very strong. We've captured a lot of that growth in our new plants. And as we start to gain approvals and government approvals into those businesses for pet food allocations, we should be able to get some additional margin there.

As I referred to in Q2 here, we saw the pet food margins narrow substantial, almost $100 year-over-year from what they were. Part of that's due to the supply side driving excess supply. And then also, if you -- China was always a buyer of the low F chicken products for aquaculture, and those have been basically tariffed or embargoed, and that tonnage is forcing back margins here a little bit. So we kind of think optimistically going forward to 2020 that the core rendering businesses around the world are pretty set up pretty nicely to enjoy higher fat prices and steady, maybe improving protein prices and there would be dramatically improved protein prices if we end up with some type of crop disruption here in North America.

The Food segment, we even feel more optimistic about because we're bringing on the Peptan business. We are sold out of that product today around the world. And we've got additional capacity coming online in the first half of next year, so I feel even more optimistic as we bring those new plants online given that I know where the sales are going to go and I know the margin structure that we should do quite well there. And then in the Fuel segment, that's as pretty much steady as she goes type of segment without Diamond Green Diesel in there.

And then as John was alluding to, when you look at 2020, we're positioned well to make 275 million gallons, maybe a little more. And we think that given our ability to capture additional low carbon fuel premiums that, that should translate into even improved earnings in the DGD venture for us.

Operator

Your next question comes from David Katter of Baird.

David Francis Katter - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

You just touched on it there. I guess, 2 on margins at Diamond Green Diesel. The first is, can you kind of -- the guidance seems to imply a pretty big step-up in margin in the second half. Can you give us a little more details on the drivers there? And then second, can you talk a little bit about the change in your outlook from the Q1 call to now? Is that just where margins came in, in Q2? Or are there change expectations for the second half of the year that changed the outlook to about 25% from kind of the range we were at before?

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

Yes, this is John Bullock. I mean that's probably more of a distinction without a difference. We talked about $1.25 to $1.40 earlier in the year. We just simply said $1.25 in our most recent. We'll be in the $1.25 to $1.40 range quite frankly, pretty good July. So at the end of the day, we're not really changing anything from an outlook perspective on Diamond. We just always want to be conservative to in what we're saying about the earnings potential. So I wouldn't take any hidden meaning into the fact that we didn't say $1.25 to $1.40 for the balance of the year. We're feeling good about where we are from a margin perspective at Diamond Green Diesel.

David Francis Katter - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

Got it. And then kind of the step-up to the second half, you said that margins have been good in July. And what other visibility do you have there?

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

I mean we know who are buying our fat, we know who are selling our fuel. And so we feel good about where we are from a margin structure. I mean, I don't -- Diamond's been extremely consistent when you take out the hedge impact that we had since the fourth quarter of last year through the second quarter of this year, dead on $1.25 a gallon. It continues to run very, very well. In terms of our margin, we're right on where we think we're going to be. And as we capture more and more of the LCFS premium, we can move that up a little bit.

Now that kind of varies from quarter-to-quarter a little bit. And sometimes, I think that there's a little bit too much of a focus on quarter-to-quarter. When you go back and look at Diamond on an annual basis, what you see is more gallons and great margins and more money every year, and we have no reason to discount that that's not going to be the situation going forward.

Operator

The next question comes from Benjamin Hogan of Inherent Group.

Benjamin M. Hogan - *Inherent Group, LLC - VP*

A couple of questions. One, in the past, you guys have explained that Darling has fixed dollar margins on the core rendering business and then a minority portion of your throughput takes on some commodity risk. So my question is where within rendering might you be feeling the impact of the U.S.-China tariffs and the African swine fever that you called out the most? Can you give us some examples?

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

Yes, this is John Bullock. A pretty interesting question. I mean I think the background of this is African swine fever is a very significant event for the agricultural industry around the world. It is difficult to get a handle on exactly where all of the various threats associated with it run. It's extremely difficult because getting exact information or accurate information on what's actually happening with it out of China is impossible for the world to really know. I think, obviously, if 30% or 50% of the hogs in China are dead, that means that a significant portion of the world animal population is temporarily deceased, and there's going to have to be a reallocation around the world to meet that demand. The demand is still there though. That's the important part about this. We have just a disruption in terms of the number of animals that are currently living on the earth. The demand for the meat that comes from those animals is still there, and that's going to be regenerated from various places, Europe, the U.S., South America. And then when you overlay the current trade dispute between China and the U.S., that makes the reallocation process even that more difficult to look into.

So expect some kind of disruptions and those types of things as we go through the next 6 to 18 months. But the fundamental thing that everybody has to remember is the pigs might be dead. The demand for the meat is still there. And it's going to be met by the world market, and we are positioned to process the byproducts that comes from that meat, wherever it happens to be produced.

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

And Ben, this is Randy. I mean John's comments are spot on. I mean when you start to think about the both intended and unintended consequences, you start in China itself, and you've got less animals to feed. So the soybean processing industry there has shut down a lot of capacity. So therefore, they're importing less beans. Cargill, there was a press release out, shut down their feed meals, 6 feed meals as they couldn't find animals to feed.

And so then you say, well, if they're crushing less beans, that means they're making less soybean oil. So they're going to have to ultimately import probably additional soybean oil or palm oil or canola oil or something to feed the people. And then they were a strong importer of a lot of different proteins around the world from DDGs out of the U.S., from canola meal out of Canada, meat and bone meal out of Argentina. They're importing less. And all those products are still being processed and they have to find homes around the world within the geography typically that they're produced. So you're getting this dislocation and disruption that we've never seen before. It used to be that you could correlate meat and bone meal or mixed species meat and bone meals at $50 under soybean meal to $50 over soybean meal. And if it got $50 above, you knew you better sell everything. And if it got $50 below, you know someone was going to buy everything. We went to $150 a ton underneath soybean meal in the quarter here, which was unheard of.

So formulas or processing agreements differ all around the world for us. In Europe, we kind of set prices every 60 days with our raw material guys; in Canada, every 90 days; and anywhere from a week to a month here in the U.S. And so they could just never catch up. You could never renegotiate quick enough with how far proteins from poultry proteins, to mixed species, the ruminant, the pork proteins fell during the quarter, and that's why we're hoping and we're optimistic that they're normalizing here. And we saw them normalize quite a bit and the impact of it within the second quarter here, at least the start of the third quarter now.

Benjamin M. Hogan - *Inherent Group, LLC - VP*

Okay. And all things considered, your rendering business performed quite well, I would say, and kind of demonstrated its earnings power and stability. One more question for you. On the last call, you talked how you're in the final stages of ramping up to report on workplace safety. Can you give us an update on how that's going and maybe an example of what you plan to report?

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

Yes. In fact, we -- obviously, the way we operate is we had our Board meeting here Monday, Tuesday. And then obviously, the earnings release yesterday and then the earnings call today is pretty typical for us. Within the Board meeting this time, we presented our full CSR ESG program to the Board for approval. And it involves basically the same program that we have rolled out verbally and to a degree at the BMO conference this year of safe food, safe, clean air, clean water and then improved communities and employee awareness here. And we've now turned that into the next level as we've looked at ISS and the Glass Lewis programs and the different ratings that are out there, and we have created an ESG fact sheet that I make an eye contact with Melissa here that, hopefully, we will have out here sometime at the start of Q4, where we will start to show you the last several years. Basically, the analytics that range from greenhouse gas reduction to safety within, to water recycling on a global level that fits with SASB and some of the different consultancy and agency groups that have to approve the numbers. So I would say, Ben, hang with me. We hear you loud and clear, as the -- if -- we look at the foundation of the program as disclosure, disclosure, disclosure and with that comes a responsibility for accuracy. And with 200 and some facilities around 5 continents, we're making sure all the data is accurate and auditable before we release it here, but it's coming soon.

Operator

And we have a follow-up from Heather Jones of Heather Jones Research, LLC.

Heather Lynn Jones - *Heather Jones Research LLC - Founder*

I just wanted to go back to food because I remember being very surprised by how well it did in Q1 and I know it was down some sequentially but still up pretty dramatically in Q2, and it's just been a big step change. But I wanted to dig in more. One, I was wondering, once you are able to get pricing adjusted for the higher pigskin costs, et cetera, do you think it's possible to get back to Q1 levels? Or are we going to be more in the Q2 range? And then secondly, could you help us understand more like how much of this capacity you brought up? And how much is left to come in 2020?

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

Yes. And I think as we've talked at a high level in the Food segment, we've kind of always thought 80%, 85% of that is the collagen business. And I think that's pretty standard. Going forward, we're seeing a pretty nice improvement in the margin structure within the collagen business driven by a couple of things. And you have to fundamentally step back and look at the world and how the collagen trade flows happen around the world. And really, at the end of the day, China is an autonomous island or geography. And so we self-produce there and sell 99.9% domestic there. We've had some volatility in margins there because of pigskin supply and hide supply in the last couple of years. We've been able to widen out those margins again with better raw material pricing. And also, we have, I think, the best product as a western supplier in there from a food safety perspective, and we're being recognized for that.

Now you come to the other 3 continents of South America, Europe and the U.S. and as we've described to people, South America predominantly runs on animal hides and they recover and capture collagen out of the hide business. Slaughter has been strong down there, hides pricing has been -- and availability has been favorable, and the industry has probably 20%, 25% too much capacity in South America from a gelatin business, different than a collagen peptide, but the gelatin business.

As we brought up our Peptan or collagen peptide business and hydrolyzed collagen in South America to date, it has diverted commodity gelatin to the new product and has helped those margins improve. And once those margins in that core business improve, it dominoes and spills over into Europe and the U.S. And so as we look forward, Q1 was pretty much hitting on all cylinders. Q2, a little softer. But we look at a new run rate in the Food segment, driven by the improved margins in both the gelatin and collagen business. And in Q1, Q2 of next year, we're going to bring on 2 more plants, and you'll begin to see the impact there. So I mean I think over -- as we've always said that the Food segment has run in that $130 million, $140 million EBITDA level pretty consistently over the last 3 or 4 years. I think you could see over the next couple of years, anywhere from a 25% to a 40% improvement in that segment going forward, driven by the new demand for the Peptan product line from us.

Operator

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

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

All right. Thanks, Andrew. I appreciate everybody's questions today. Stay tuned. We'll talk to you again here in November. Thank you.

Operator

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