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DAR - Q1 2017 Darling Ingredients Inc Earnings Call

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## PRESENTATION

**Operator**

Good morning, and welcome to the Darling Ingredients Inc. conference call to discuss the company's first quarter 2017 financial results. With us today are Mr. Randall Stuewe, Chairman and Chief Executive Officer of Darling Ingredients; and Mr. Patrick Lynch, Executive Vice President and Chief Financial Officer.

(Operator Instructions) Please note, this event is being recorded. I would now like to turn the conference over to Melissa Gaither, Vice President, Investor Relations and Global Communications for Darling Ingredients. Please go ahead.

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

Thank you, Carrie. Good morning, everyone, and thank you for joining us to discuss Darling's earnings results for the first quarter 2017, ended April 1, 2017.

To augment management's formal discussion, please refer to the presentation section of our IR website for the earnings slide deck. Randall Stuewe, our Chairman and CEO, will begin today's call with an overview of our first quarter operational and financial performance and discuss some of the trends impacting our business. Patrick Lynch, Executive Vice President and Chief Financial Officer, will then provide additional details about the financial results. Please see the full disclosure of our non-U.S. GAAP measures in both our earnings release and at the end of the earnings slide presentation.

Finally, Randy will conclude the prepared portion of the call with some general remarks about the business and year ahead, after which, we will be happy to answer your questions.

Now for the safe harbor statement. This conference call will contain forward-looking statements regarding Darling Ingredients' business opportunities and anticipated results of operations. Please bear in mind that forward-looking information is subject to many risks and uncertainties and actual results may differ materially from what is projected. Many of these risks and uncertainties are described in Darling's Annual Report on Form 10-K for the year ended December 31, 2016, our recent press release announced yesterday; and our other filings with the SEC. Forward-looking statements in this conference call are based on 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.

With that, I would like to turn the call over to Randy.

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

Thanks, Melissa. Good morning, everyone. Thanks for joining us.

After a sluggish start in January, our global ingredients platform gained momentum and finished off the quarter as expected. Global raw material volumes grew 4.3% year-over-year, and we saw improved global pricing across most product lines. Our results, once again, demonstrate the consistency of our business model.

Sequentially, we delivered consistent and improved results across our Feed and Food segments and tempered profitability profile in the Fuel segment. This was due to the absence of the U.S. blenders tax credit and some onetime items recorded in the fourth quarter of 2016.

And finally, our earnings were impacted by an elevated SG&A due to the accounting for long-term incentive awards. With April now recorded, we carry good momentum into next quarter and the remainder of the year.

Now let's take a closer look at the performances of each of our business segments. The Feed segment benefited from several key drivers that aligned during the quarter and performed exceptionally well across the global platform. Our global rendering platform delivered nicely as raw material volumes remained strong and after a sluggish January, finished product prices edged higher.

Globally, fat prices remained strong while animal protein supplies remained ample.

Year-over-year, the majority of the improvement was from the U.S.A. Overall, we anticipate a slight improvement in Q2 as seasonality in our specialty Feed Ingredients business contributes positively to the segment.

In the Food segment, sequentially delivered an improved and consistent performance. Rousselot, our 4-continent gelatin business delivered as expected. However, our performance was tempered by macroeconomic issues in Argentina and margin compression in Brazil due to strong raw material prices.

Our Sonac edible fats business held margins in the midst of weaker palm oil markets while CTH, our natural casings business, had an improved performance from market tightness due to the shrinking Chinese hog herd.

Earnings in the Fuel segment are easily reconciled, both sequentially and year-over-year. Year-over-year, the lack of the U.S. blenders tax credit explains the variance. Our portfolio of businesses in this segment performed consistently and as expected.

Sequentially, the lack of the blenders tax credit and a year-end tariff true-up in our Rendac operations, coupled with the previously discussed onetime business interruption settlement account for the balance of the difference.

Now let's turn to Diamond Green Diesel. As we noted in our fourth quarter call, Diamond Green was planning and now successfully completed its second major scheduled turnaround and catalyst changeover during the quarter. The turnaround took 18 days, impacting both production and sales volumes. The facility came back online later in the quarter and is now operating at capacity.

While margins in Q1 were impacted by low production and a steadily declining heating oil market in a volatile RINs market, we still anticipate operating at a run rate of $0.55 to $0.60 per gallon for the balance of the year. Our capacity expansion at Diamond Green is proceeding on schedule and on budget with no complications today.

As a reminder, when completed, the expansion will increase our annual production of renewable diesel, from 160 million gallons to 275 million gallons. Startup is slated for late second quarter 2018, and as mentioned in the fourth quarter call, Diamond Green Diesel issued both partners a dividend of $25 million in late February.

As for the regulatory update, we continue to monitor and assess discussions in Washington on the 2017 renewable fuel standards. We believe the EPA will go through its normal rule-making process as in the past and issue the 2018 and 2019 RVOs later in the spring.

We also continue to believe the blenders tax credit will be retroactive by the year-end as in the past.

And finally, we continue to position more and more of Diamond Green's production to Low Carbon Fuel Standard markets.

Before Patrick takes us through the numbers, I'd like to take a couple minutes and give an update on a few recent events and an update on several expansions.

During the last week of April and first week of May, we closed on 2 U.S.-based bolt-on acquisitions. In the Northeast, we acquired a New York-based used cooking oil collective. This was a route-based acquisition and will fit nicely into our Newark footprint.

In the Southeast, we acquired a small regional rendering company in Miami. This will solidify our forward operations and provide additional service opportunities for us in the Miami area.

From an organic growth perspective, we have a major projects underway in Los Angeles, San Francisco, Turlock, California; Dublin, Georgia; Wahoo, Nebraska; Truro, Canada; Mering, Germany; and Denderleeuw, Belgium.

Additionally, as you noticed this week, we announced, along with Intrexon, our intention to begin construction of the largest black soldier fly larvae production facility in the U.S. later this month. We anticipate completion of all these projects later in 2017 and all these plants will achieve full operating capacity in early 2018. We expect them to be accretive to the bottom line and to enhance the company's ability to capture market share and broaden our product portfolio.

So with that, I'll now turn the call over to Patrick. And later on, I'll provide some additional color to close the quarter. Patrick?

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**Patrick C. Lynch** - *Darling Ingredients Inc. - CFO, Principal Accounting Officer and EVP*

Thanks, Randy. During the first quarter of 2017, we continue to focus on improving the 5 financial objectives that we have outlined on previous calls: Reducing debt, enhancing margins, reducing our working capital, cost reductions in both operating and SG&A expenses and deploying our CapEx effectively.

During the quarter, our cash position improved to $139.9 million, up from $114.6 million at the end of the year. We continue to target $100 million of debt reduction for the full year. Our current debt ratio is 3.46x in Q1 2017 versus 4.41x in Q1 2016.

Additionally, total liquidity remains very strong with nearly $1 billion undrawn under revolving credit facility.

Working capital management was a bright spot for us during the quarter of 2017 with improvements versus Q1 2016 in both our days sales outstanding, days in inventory and nearly even performance in our days in payables. We continue to target a $15 million to $30 million range of positive cash flow from working capital for the full year 2017.

CapEx spending this quarter was $62.3 million compared to $53.4 million in Q1 2016. The 7 ongoing construction expansion and conversion projects in various regions are a significant portion of this total.

Darling's CapEx target for 2017 is expected to be in the $240 million to $250 million range for the full year.

Our gross margin for the first quarter 2017 was 21.9% compared to 23.1% for the same period last year. Quarter-over-quarter decreases in gross margins incurred in both the Food and Fuel segments. The Food segment's gross margin compression was primarily the result of previously mentioned challenges in our South American Rousselot business and the absence of the blenders tax credit was the primary impact on the gross margin compression in our Fuel segment.

SG&A expenses totaled $87.9 million during the quarter, up $6.4 million from Q1 2016. $4 million of this increase was due to the acceleration of stock compensation expense resulting from the change in certain vesting criteria and long-term incentive awards. We expect to return to the $82 million to $83 million quarterly range for the remainder of the year.

On the effective tax rate, cash taxes and depreciation and amortization front, the company reported the income tax expense for the first quarter of 2017 of $1.8 million compared to $1.9 million for the same period 2016. The effective tax rate for the quarter was approximately 19.7%, which is lower-than-expected due to favorable audit settlement during the quarter.

Cash taxes for the quarter totaled $2.4 million, and we expect to pay approximately $25 million in cash taxes for the full year.

For 2017, we expect the effective tax rate to be 37% without pending tax reform and excluding the biofuel tax incentive.

As mentioned last time, minimal detail have been provided by either the Trump administration or the House GOP. However, we expect to comp this effective tax rate to be much lower under either tax reform plan or a combination thereof. We're continuously monitoring tax reform deployments and expect to be in a position to take advantage of opportunities that may arise. And finally, depreciation and amortization for the quarter was $71.1 million, in line with our expectations.

Now, I'll turn the call back over to Randy.

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

Thanks, Patrick. Overall, we are off to a good start and carry solid momentum into the second quarter. We will continue to focus on operational efficiencies, deleveraging about $100 million in 2017 and improving our working capital position. We remain optimistic that biofuel policy will be clarified shortly, and we are clearly positioning the company for future growth opportunities.

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

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) The first question comes from Heather Jones of Vertical Group.

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

So I have several questions, but I want to -- I was wondering if you could help us understand exactly what it was that happened with Food during the quarter like in Argentina, was it a 1 quarter tariff issue? Just I'm unclear as to what exactly happened in the quarter and how that impact the outlook for Food for the rest of the year.

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

Overall, Heather, the Food segment operated around the world just as we expected. We talked about, we had a pretty solid performance in the edible fats and then we also had a very nice performance in our natural casings business, and that was related to as we've been highlighting the kind of the shrinking hog heard in China further finally starting to feel the real impacts of that. In the gelatin business, our European, our Chinese and to a degree, our North American operations performed very nicely, a little bit of seasonality in North America, but that always comes back here. In South America, I'm going to highlight 2 things. Number one, in Argentina, it is a very, very difficult market condition down in Argentina right now. Argentina, under the current political leadership, has opened the borders to imports now, so it's actually cheaper to make gelatin in other parts of the world than bring it into Argentina specifically, Brazil to bring it in into Argentina than it is to make it there. And you've got hyperinflation back underway in Argentina today, on top of if you follow the press, you've had a couple national strikes that have going on. So we suffered from macro conditions and political unrest and strikes during the quarter down in Argentina. I don't know that I want to sit here and say that's going to get a lot better in the next quarter here, the plant is running fine. It's just when a happier production goes export and you're uncompetitive, it's very difficult there. In Brazil, a couple things went on. The margin compression that happened down there was we did not see the high availability, as we expected against the pricing that is happening on the finished products. We had margin compression there, and then that was exacerbated by the fact that if you follow the meat scandal and the reduction of slaughter that started to happen late in the quarter down there. The tightness in height pricing started much earlier than that. So we expect that to write itself here and to have a better -- if you will, Brazil is 2 large plants, Argentina is 1 in the next quarter. So overall, I'm fairly optimistic. The Rousselot model is performing very nicely globally as pigskin gelatin is tight. In the rest parts of the world, margins are up there, China is performing nicely and North America should come back with a better performance in Q2.

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

Okay. So Brazil, you expect to write itself in Q2. Are you not optimistic in Argentina? Can you give us a sense of just, so we know how to model. Was the Argentina impact $2 million, $3 million, $4 million for the quarter? I mean, how should we be thinking about that on a quarterly basis?

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

Yes, that's probably in the ballpark. I'm not going to step back and predict if we can -- I think it's going to be difficult to be profitable in Argentina for this entire year. I think Brazil will improve and go from there. But overall, the gelatin SND will make up those margins hopefully in most parts of the rest of the world.

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

Okay. And going back to Diamond Green, so on your Q1 call, you said that you believe you could do $0.60 to $0.80 for the quarter. -- I mean, for the year. At that point, I would think you would have had pretty good visibility which are Q1 margins were going to be. So that implied a very substantial pickup in margins for the remainder of the year. You're now saying $0.55 to $0.60 a gallon for the remainder of the year, so lower on a full year basis. What changed? And what is implied in your numbers as far as like antidumping, imports from Argentina like can you just walk us through what was underlying the $0.60 to $0.80 number and what's underlying now the $0.55 to $0.60 number?

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

Well, first off, let's talk about first quarter. First quarter is, we all know that the factory was down for its second major turnaround. It involved some additional work in it and equipment installed, along with a catalyst change. Expenses were a little bit higher than what we had hoped for in the quarter. I would say that would reconcile most people's numbers there. And then at the end of the day, you saw during the quarter, you just saw a declining heating oil market, you saw RINs moving all around, and you saw the improving fat prices. So we had quite a bit of things going on in Q1. I think it's important to point out that at the EBITDA level, at the entity, Q1, we put up $10 million with the shutdown against $19 million with the blenders tax credit in Q1 of '16. So if you want to apples-to-apples with production down there, it would have been $40 million, $42 million against $19 million. So overall, Diamond Green is actually off to a better start this year even if you look at it, if you assume that the blenders tax credit's come about. As far as a little bit of guiding down on the base margin in the business, we're looking at the heating oil market with crude oil coming off, RINs are starting to react a little bit and come back. And then we've seen a little bit of softness in the Low Carbon Fuel Standard at $74 a ton right now. In the biofuels environment right now, everything is, at it's been in the past, uncertain. So I don't think that there's anything that's really new out here in the sense of the level of uncertainty that's going on with the Trump administration, the RVO, the blenders tax credit, the challenge to the low Carbon fuel standard in California. The big positive now if you want to say -- okay, that's the uncertainty piece, the big positive here was that the ITC didn't announce the initiation of the antidumping against Argentina and Indonesia. And you can really start to get your mind around it and possibly get really, really bullish if those tariffs are set high enough to discourage the imports of that product. That product, if you add the 2, the numbers kind of move around, but let's call it around between 500 million and 600 million gallons. You put that back on an input basis, you're looking at 3.5 billion, 4 billion pounds of additional vegetable, animal fat used cooking oil that has to be either brought in the country or use the existing supplies to make fuel there. So you can get your mind around this thing pretty quickly, and you're going to see 1 or 2 things happen. You're going to see fat prices move up pretty significantly later in the year but probably preceding that would be an increase in RINs value at the end of the year. Something has to give here if that's the case going on here. And I think you're supposed to get a preliminary ruling here later this summer on that tariff announcements, and it looks like they have a pretty good chance of being successful there. So of the end of the day, we may be saying we're tempered here a little bit of $0.55, $0.60 a gallon, we're saying that without the blenders tax credit, we still anticipate running 160 million gallons, so we've been saying all along that's around $100 million of base EBITDA. And then you throw on another $160 million of blenders tax credit here later in the year. So not much has changed there, but we've seen vegetable oil prices run up, RINs kind of go down, come back and then heating oil fade on. So we've got a little margin compression there. But at the end of the day, we're still operating as expected.

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

So I got one follow-on to that. So one of the -- honestly, one of the most positive parts of the Darling story is Diamond Green. And so I just want to get your sense of, clearly, diesel prices have been weak, and so we're in a low here. But it does seem like you're going to get the antidumping tariffs. You have a pretty steep ramp in the compliance curve in California, and it seems unlikely that the advanced -- not the advanced, the D4 RVO is going to be reduced. So could you give us a sense of once this uncertainty is gone and if we do get antidumping and all, I mean, where do you think margins could be on a run-rate basis later this year, heading into '18?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Yes, Heather, this is John Bullock. I think we provided some information on the earnings call around the slide deck attached with the earnings here while we kind of talk about where we think this thing might be in '18 and '19. And it's not unrealistic to think with the scenario that you're talking about that a $1 in the quarter a gallon is not possible in the marketplace. There's obviously a ton of variables, and we have a lot to figure out the balance of this year as we go through the various pieces of legislation and the various court challenges. So there's a lot of information out here but all those things that you just mentioned, and you didn't even add on if they changed it to a producer's tax credit going forward as opposed to a blenders tax credit. So you put all that stuff together, it looks to us like you have a reasonable chance to have pretty dug on good margins as we head into '18 and '19.

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

And the clarification because I know everybody's want to, want to know this, the $1 in a quarter would not include the tax credit? That's just higher RINs, higher LCFS credit, those things?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Yes. The $1.25 going forward since -- so it's $1.25, and we're really not stating whether it includes the tax credit or not, so I wouldn't take the $1.25, that extra $1 on it. It's a tax credit in place that says $2.25. Remember that the RIN's pricing -- to some degree to LCFS pricing but a little bit less there and the tax credit all work in combination with each other. So when you have a tax credit and everybody knows that it's either there or not there, then you are going to have necessarily lower RINs prices. Now the issue we have with the way that Congresses handled the tax credit several times in the past 4 or 5 years, is we entered the year without the tax credit in place. The market has been trained to believe that, that tax credit will be in place because every single time we've gotten into these years, Congress has put the tax credit in retroactively. If Congress were to say it's absolutely not there and everybody in the marketplace knew it wasn't going to be there, then RINs and LCFS pricing would react and the margin would be there for the business. Our belief, as we've said continually, is that we believe that the tax credit has a very good chance of being reinstated. Chuck Grassley, Senator Grassley has put in a proposal that would have cash credit in place for '17 and then looking forward for '18, '19 and '20. Obviously, we'll see how that all works through the cash packages, the house incentive this year. If there is no tax package, then it would have to be dealt with on an extenders tax basis which is how it's been renewed over the last several years. We'll see on all that stuff, but I wouldn't take the $1.25 and put an extra $1 on top of it and say 2.25. This stuff all mesh together someplace in the $1 plus $1.25 type of margin, I would guess, as we head into '18 and '19.

**Operator**

The next question comes from Adam Samuelson of Goldman Sachs.

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

Maybe, Randy, wanted to start in the Feed business and just talk about the margin performance in the quarter. I know you talked about a sluggish January, maybe that were some lag that would result to some catch up in the second quarter. But I'm just trying to think about the operating leverage and what was a better year-on-year price environment, your revenues up 77; your gross profit, up 14, you have 20% incremental with some growth projects in there. Is there parts of the business that are facing some underlying margin pressure? I would've that the operating leverage as a percent of margins year-on-year would have been a little bit stronger given a slightly better price environment.

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

No. I think, Adam, you got to step back. I mean, there's a little bit of challenge, if you will, of transparency in the Feed segment. Remember, the Feed segment is made up of the global rendering business, the specialty ingredients businesses, the bakery business, the fertilizer business, there's a whole bunch of sub-businesses. And while a majority of it may be the rendering business, if we kind of look around the world today, European rendering was consistent and stronger than Q4. U.S.A. was about on par with where they were in Q4 because of meat and bone meal values. Meat and bone meal values in the U.S.A. continue to be a little bit soft, although the trade publications had them escalating all quarter. At the end of the day, a big portion of that product has to go out of the country and be exported. And it was just very sluggish there to start the year out, the Canadian business because of weak meat and bone meal was off to a little bit of a slow start up there. But as we came into February and March, those businesses hit full stride. When you look at the Specialty Ingredients businesses, that's all of our Pet Food businesses. The Pet Food business got out of January and February very slow and returned back to normalization here in March and just carrying on nicely in April as is the Bakery Feeds business. If you think about it, the baking season is slower in Q1 and as the ballpark opened, it picked up. So we just think it is a little bit of seasonality. The rendering business, from what you're looking at in the pricing applications in your model, you floated through correctly. But the other businesses had a little bit of seasonality and sluggishness. That will pick up in Q2 here.

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

Okay, that's some very helpful color. And as you were to look at some of those growth projects that you have under way, you had quite the list at the outset, and you talked of those being completed towards the end of this year and operational for 2018. What kind of EBITDA increment would you think that those -- that kind of growth capital can contribute next year and given '19, if there's ramp up time?

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

I don't know if I'm prepared to answer that one yet, but I will work on it. Patrick, you got...

**Patrick C. Lynch** - *Darling Ingredients Inc. - CFO, Principal Accounting Officer and EVP*

Yes, I would say ballpark right now, the incremental EBITDA contribution from our projects that we have slated here in 2017, we expect to probably $15 million to $20 million EBITDA contribution associated with those in 2018.

**Operator**

The next question comes from the line of Ken Zaslow with Bank of Montréal.

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

A couple of questions. One is, you listed a lot of onetime costs, can you quantify how much of the onetime costs were in this quarter that are not going to be repeatable? Also, how much did it cost you for the 19 days down for the Diamond Green Diesel?

**Patrick C. Lynch** - *Darling Ingredients Inc. - CFO, Principal Accounting Officer and EVP*

Sure. The onetime cost in Q1, really, that flowed to the SG&A line was related to an acceleration of some compensation expense associated with some equity, the change in some vesting criteria associated with some of the equity compensation items. Of that, of the $6 million increase, $6.2 million, whatever, on a year-over-year basis and SG&A, about $4 million of that was related to that change. And that will not continue on for the balance of the year. We expect to kind of be in the low-80s range in SG&A going forward. I don't have the number off the top of my head. I have to come back to you in terms of what that 19 days down impacted Diamond Green Diesel.

**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Yes, Ken, this is John Bullock. So basically, we lost about 10 million, 11 million gallons worth of production on the 18 days, and so if you have a $0.30, $0.40 margin in there, you're talking $3 million to $4 million of EBITDA to margins that the business was running at in Q1.

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

Just go back (inaudible) the $4 million... Yes, sorry.

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

Yes, I was going to add to what John said. As we said for Q2, we should run at the 40-million gallon run rate at $0.50, $0.55 margins there.

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

And then the $4 million in the SG&A, is that going to come back in '18 or '19, or is it done for good?

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

Well, I guess, it will depend on what the structure of the 2018 grants will look like. But that will be to be determined later on this year. Assuming that we have a similar profile, then yes.

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

Okay, okay so it's not completely onetime? It's onetime for the year, but not onetime going forward? Okay.

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

Well it will depend on what the structure of the 18 brands and so forth look like and that if they do look like the similar grants in '17, then yes, there will be a similar impact.

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

How much of your production for Diamond Green Diesel goes to LCFS at this point?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Yes, Ken, this is John Bullock. We don't talk specifically about the markets that we are going to. We have a large percentage that goes to the LCFS markets. But as we've talked about it in the past, as we go through '17, we don't get the full benefit of that because we have had some long-term contracts that work great for us going to the pipeline. As the LCFS markets have developed here over the last year that they continue to develop to the course of this year, we have to buy ourselves out of those pipeline contacts to be able to move the stuff to the LCFS markets. We still generate a positive spread on that, benefit from that, but we're not able to receive every penny of the benefit of the LCFS markets. That changes because all those contracts are up at the end of '17 through the first month of '18. And then we'll have our target fully being the LCFS markets unhindered.

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

Would you see it still the majority of the contracts now or not? Is it greater or less than 50%, I guess, is my...

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

More than -- well, yes, the majority of our materials are moving to LCFS markets today.

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

Okay. And then how is your project coming in terms of the shipments in the logistic issues to go to California?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Yes, the rail project has just completed, and we're just testing the system now.

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

And that would help you generate of the $0.75 to $0.80 LCFS, another probably $0.20, $0.30 of that, or $0.10, $0.15 of that would start accruing in the back half of the year, is that fair?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Well, again, we're going to have to transform all of our contracts across. So the full benefit of rail capability, really, comes to us in 2018, 2019. Rail freight is cheaper in California, that is ocean-going freight because of the Jones Act requirement that we use U.S. flag in a port-to-port basis. We'll start to see benefit of that roll in. But it's not 100% of the benefit for the balance this year. We're in the transition year here as we change and move Diamond from what was a traditional pipeline marketing basis to an LCFS basis. That doesn't fully happen until next year.

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

Okay. But when you said the $1.25 for 2018, does that include -- is this all the stuff that you're doing on the LCFS side, or is that additional? How do you kind of think of that?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Well, I think of it as including it. I think the expanded Diamond with the full logistic capability as we put out here, I think $1.25 is a fair number to consider as an EBITDA. Obviously, there's so many things that impact this. What happens with the LCFS? What happens with the RFS2 volumes? Whether it's a producers versus or blenders tax credit, what happens with the antidumping case? There are 1 million factors out there, a lot of them to break very positively for our margin structure, but we simply don't know the answer on how all of those policy developments will occur over the next 12 months. So $1.25 seems like a reasonable number.

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

Okay. And my last question is on the tariff to Argentina and Indonesia, I think, Randy, you said that there is a level that you think that's important to reach but you didn't tell us what the level is. What is the tariff that you would want to hear or what are the different scenarios?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Well, again, this is John Bullock. I'm not sure everybody knows, that's really what part of the adjudication process as this goes through the ITC and the DOC in terms of developing and establishing what those tariff levels are. And we just have to wait and see what they establish. It's really not what we want, it's what the international regulatory process here establishes those levels should be at. However, we have seen in countervailing duty and antidumping cases around the world that when those are levied, they tend to be fairly significant. And if you get 20% or 30% countervailing duty, and I'm just making that number up, I have no idea what the numbers are actually going to be, the $0.75 to $1 a gallon that somebody has to pace coming in the United States, and that's significant. So if this case moves forward and assuming we get successful resolution in the countervailing and antidumping, I would expect it to have a chilling effect on imports, biodiesel coming out of the United States from Argentina and Indonesia.

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**Operator**

The next question comes from Chip Moore of Canaccord.

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**Chip Moore** - *Canaccord Genuity Limited, Research Division - Senior Associate*

I guess, just back to those new projects and expansions. If we look at that $15 million to $20 million of incremental EBITDA we talked about in '18, is that a run rate? Or how should we be thinking of that as those assets start to get a full year performance behind them?

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**Patrick C. Lynch** - *Darling Ingredients Inc. - CFO, Principal Accounting Officer and EVP*

Yes, I mean it will ramp throughout the year, and that will exit in 2018 AFFO quarterly run rate.

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**Chip Moore** - *Canaccord Genuity Limited, Research Division - Senior Associate*

Okay. And I guess, on the EnviroFlight specifically, can you just remind us how that JV structure works, cost of that build out and sort of the longer-term opportunity there?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Yes, this is John Bullock. The JV structure is a 50-50 joint venture. We have 50% and Intrexon has 50%. I don't think we've released the information on what the construction cost of the facility is. It is a large commercial plant versus the pilot plant that we have been operating. However, we're still in the process of developing model #01 from a commercial perspective. So what I can say is we're not betting lots and lots of money on this particular facility. This was what I would call a logical next step in progression. It's a commercial-sized plant that's going to tell us and give us a lot of knowledge about how to run this on a commercial basis. So it's not like we're sticking lots and lots of money into this plant. It's a prudent next step in the process.

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**Chip Moore** - *Canaccord Genuity Limited, Research Division - Senior Associate*

Got it, got it. And just lastly, some news this morning I think on China allowing U.S. beef exports and maybe U.S. importing some poultry. Any thoughts there on what that could mean?

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

I saw the same headline, Chip. I'm not sure I know what to think of that, Chip. But any access for American meat products is going to be positive for the U.S. industry here and then being a current and very often traveler to China, it would be welcome to see if we can find some U.S. beef in China eventually.

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**Operator**

The next question comes from Ben Kallo of Robert W. Baird.

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**Benjamin Joseph Kallo** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I'm just trying to figure out the difference between your margin Diamond Green Diesel this quarter. And pardon me if you said this, and what you guys projected for the year. And then when you drew up that $1.25 I know there's 1 million moving parts, but does that include the blenders credit?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Yes, this is John Bullock. The $1.25 question, does that include the blenders credit? Again, it is a -- what we think is a realistic number to think about for next year. But there are 1 million moving parts if the blenders or the producers tax credit is in place next year, then you will probably see lower RINs because once that's in, that really facilitates or works together with the RINs market. So the $1.25 is a -- if you will, look as we look at it today with the 1 million moving parts, but I would not take the $1.25 and add $1 on top it and think that there's $2.25 a gallon out there. That would probably be overoptimistic. In terms of -- as we look forward to the year on this stuff, we have a number of moving components that we have to look at in relationship to Diamond Green Diesel. We have to look at the cost of the raw material and the cost of the raw material has gone up here in Q1 as we've seen U.S. prices increase. We would have thought that the LCFS market might be a bit higher than it currently is at $74, $75 a ton. I think the marketplace out there is waiting to see the resolution on the various (inaudible) cases that are currently before the courts, and that has kept the market, in our opinion, from kind of moving if you look at the SND on deficits on credits on where the market might be. Every dollar a ton is roughly $0.01 a gallon. And while we not getting all of that to the LCFS markets, we are getting a portion of that. And then finally, we've seen about 2 other things, we've seen diesel fuel market from when we were looking at this thing earlier this year to $1.65 a gallon. That moved down to the $1.50 range and recently, was as low as $1.42 or $1.43. That has an impact and then finally, we've seen the RINs market go all the way from $1.08 down to $0.90 or $0.91, and that today has rallied back to $1.03 or $1.04. Every one of those moving parts has an impact on our profitability at Diamond Green Diesel, and we have seen from Diamond Green Diesel ever since we've had it open on a quarterly basis that we see a fair bit of volatility around the margin structure on Diamond Green Diesel. However, when you look back at it on the year-on-year basis, that volatility only seems to work itself out, and we seem to come in with a relatively decent profitability. We're hoping that this year is just like all the previous years where Diamond had been.

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**Benjamin Joseph Kallo** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

But just real quick back to the March of this quarter versus what you guys predicted for the full year at Diamond Green Diesel. What was the difference?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

I'm not sure I understand the question.

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**Benjamin Joseph Kallo** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

So your margin that came in during this quarter for Diamond Green Diesel versus what you guys have projected for the full year, how do we think about that?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Well, again, this is John Bullock. We were shut down so our costs was a little bit higher than we thought they were going to be. During the quarter, the LCFS kind of dropped from what was close to $100 a ton, dropped pretty steadily during the quarter down to the low $80 a ton, so there's $0.20 a gallon or a portion of $0.20 a gallon. The heating oil market went from $1.65 and declined below $1.50, so there's another $0.10 to $0.20 a gallon on top of that and then the RINs market bounced from $1.08 to $1.09, all the way down to $0.91 or $0.92 and now it has bounced back and every $0.01 of RINs, you've got to multiply by 0.017 and then we had the fat market go up on us. It's relatively easy for Diamond's margins to move around by $0.20 or $0.25 or $0.30 a gallon on a month by month or quarter by quarter basis, in fact, it's amazingly easy with that many moving parts. The thing that we've seen so far that, again, we can't guarantee this happens this year because every year is a new year, but every year in Diamond's history despite extreme volatility during -- on a quarter-to-quarter basis, Diamond has delivered at the end of the year. The good news for us this year as opposed to the last time we were in this position where we did not have the tax credit, as a matter of fact, is all those factors that I just mentioned and particularly with the introduction of the LCFS premium, if you recall 2 years ago, when we were operating in these conditions, basically, if you excluded the tax credit, we were actually not making money at all, we're losing a little bit of money and the tax credit then came in, and it helped out the entire year. Now we are in a condition where we are having a positive cash flow a little less than what we thought it was going to be in Q1, but still Q2 looks okay. And then at the dollar tax credit comes in. So as Randy said in his build up before making $100 million before the cash credit this year and the tax credit comes in, that puts Diamond in the $260 million, which will be $100 million better or $80 million better than its previous best year. Now a lot of factors to factor into that, but if we just -- we've kind of gotten used to the volatility around the Diamond Green Diesel on a quarter-by-quarter basis because it delivers on an annualized basis.

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**Operator**

The next question comes from Tom Palmer of JPMorgan.

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

First, just wanted to ask about the LCFS market. By my math, we're seeing it translates to the revenue line, not necessarily down to the EBITDA line. Is this mainly a function of shipping costs? And I guess, going along with that, if you're running in the $75 per ton range today, is there incremental profitability to expect by shipping to LCFS markets?

**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Yes, this is John Bullock, again. Yes, there is. But again, this is complex this year because we were structured to move all of our product out via pipeline or the vast majority of our product via pipeline through 2017. So as we turn our product flow through the LCFS markets, and it's just not California, but it's also markets in Canada and around the world, as we move to those LCFS markets, we have to deal with taking the contracts that were going to move the product via pipeline and adjusting them to be able to move to the LCFS markets. To do that, that means we have to share a portion of that profitability with the folks that we had it sold to on the pipeline. So we do not get a clear look at the value, we only get a part of that value. And I really don't want to go on discussing what part of the value is because each of these deals out there are slightly different. But we don't get the full benefit of that until we turn into 2018. When we begin 2018, we will be done with those pipeline contracts, and we'll have unfettered ability to market our product to the LCFS markets, and we see the full benefits of being able to send that product to the LCFS markets.

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

Just a quick follow up. Randy, at a couple of conferences this past quarter, you discussed EBITDA run rate. It sounded like current EBITDA run rate is in the $0.70 per gallon range. I just wanted to maybe clarify the context of those remarks. Was that referring to shipments that were going to LCFS markets at the time we're running in the $0.70 range, or was it something else?

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

No, Tom. We came into the year believing that we would -- that Diamond Green with operate in that around $0.70 a gallon range, that's a combination of all markets as John said, the LCFS around the world, our pipeline contracts and then trying to arbitrage into California. And all we've done here is we still think that, that number is possible. But right now, what we're seeing today with -- as John said, with the price of carbon dropped into $74 a ton from $100 and with heating oil going from $1.65, to the mid-$1.40s and now, around $1.50 and then the improvement in our core business with the fat prices going up, we're just tempering that just a little bit for the year what we see right now. But coming into Q2 as we've said, right now, as we look out the next 40 to 60 days, it's looking like there's a $0.55 a gallon margin out there, $0.45 to $0.55 right now to be earned depending on what day and which parts are moving in what direction.

**Operator**

The next question comes from David Cook of Wells Fargo.

**David Cook**

Could you tell us how much you spend on CapEx on Diamond Green Diesel in the quarter and how much CapEx remains to be spent on the expansion there?

**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

This is John Bullock. I don't believe we've released a quarterly capital expenditure from Diamond Green Diesel. The expansion, which we've announced -- the number that we've announced on that was $190 million. At this point in time, the project looks on schedule, on budget. We monitor that extremely closely, but I don't believe we released cash flow specifically on the quarter on Diamond.

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

I mean, at the end of March, we had almost $160 million cash sitting there. David, and what we've said is it's okay if you run out the balance of the year, let's say, you're going to make another 120 million gallons, and you run at $0.55, $0.60, or you're going to generate another 70 million on top of the quarter and cash minus a little bit of carryover expenses from the shutdown that finished up in March. So that facility, that's the message to the street is that facility and will be in our -- as we hit the street this next week with our spring presentations being laying out for everyone as we show that Diamond Green -- given the environment that's in today even irrespective of the dollar a gallon blenders tax credit being retroactive is delevered when the new expansion comes online here. So it's all paid for and out of internal generation.

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**David Cook**

So with 160 of cash, 70 more on the way in '17 is another dividend from Diamond Green Diesel in 2017 possible?

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**Patrick C. Lynch** - *Darling Ingredients Inc. - CFO, Principal Accounting Officer and EVP*

It might be if we say the $1 a gallon was made retrofit late November as it has been traditionally historically. But right now, we're not planning on it today.

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**David Cook**

Okay. And then, I know you all have now reached your state of leverage target of 3 to 3.5x. So aside from your -- I think you said $100 million of contemplated debt pay down in '17. Could we expect to see more acquisitions as the primary use of cash flow?

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

Well, I think, like I said, as we kind of roll the punchline and the view that we have going forward to The Street here next week, number one, getting some clarity on biofuel policy is key to those decisions here. And if we're right or even partially right on both low carbon markets improving the RVO and all the $1 a gallon coming back initially we'd become flushed with cash, it then generates many opportunities you can create value from deleveraging. We then can take a view at the additional acquisitions around the world that we've seen or it can range to dividends to buybacks. So there's nothing off the table at this time, as we get going forward, and there's no specific use as it's said, we're going to buy out and buy somebody today. I mean, our focus has been to delever and grow. That was our mantra last year. This year is making green in '17, but we're also committed to paying down $100 million debt this year and continuing to get that leverage ratio even lower. So we have the firepower if something interesting comes that is accretive to the shareholders.

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**Operator**

The next question comes from William Baldwin of Baldwin Anthony Securities.

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

Randy, could you spend just a little time kind of going over what you're important project initiatives were in 2016 and kind of what the status is right now, how that's looking?

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

Well, in '16...

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

Your CapEx program -- I'm talking about your CapEx program that you had?

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

Yes, in 2016, we brought on the 2 rendering plants late in the year in Pocahontas, Arkansas, in Waynesburg, Ohio. Those are meeting expectations, both operationally cost-wise and earnings-wise. We brought on our 2 new wet pet food plants, and those projects have been a little slower to start than maybe we have put on an Excel spreadsheet, but they are performing nicely now here in the Q4 time. Q1 was a little bit of seasonality there, but we see that improving. So those were the big projects out there. We put the Mering, Germany plant under construction and the Denderleeuw, Belgium ecosystem just under construction. Additionally, those were the big projects, so I would say we're getting the returns out of those projects we want. That's evident in the Q1 Feed segment earnings that those projects are starting to deliver as we expected. And then we've got some very significant plant rebuilds and improvements that are going on out there that Patrick alluded to would add $15 million to $20 million of EBITDA in 2018. Some of those will come online late in third quarter, maybe early fourth quarter, and then ramp up. And so part of them will be online full speed in 2018 and part of them will be online in the back half of '18. Really at the end of the day, most of those projects were in our expected CapEx run. There was nothing right now that's under construction that really was in the anticipated CapEx plan for 2017. We closed on the 2 acquisitions that totaled about $20 million. Those are little bolt-on route efficiency and synergy projects that have really nice returns for us, and those should be immediately start to deliver a little bit of earnings to us over the course of the year here.

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

Okay, very good. Just quickly, did the Rousselot expansion in Dubuque, is it operating pretty much as you anticipated?

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

You, bet. So that one, I should mention, too, thank you for remembering. That was a tremendous deal for us. That expansion was aligned with the shattering of a major food companies, gelatin plant so that has been a very, very good deal for us.

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

Very good. And quickly, John, do you -- on your turnarounds, are those all -- those expenses, are they all capitalized on the turnaround cost at Diamond Green?

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**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

Yes, there is a small portion of them that are actually expensed. The majority of it is capitalized, but a small portion of it is expensed.

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

And do you all disclose or do you have any color to what those turnaround CapEx expenditures are at the Diamond Green?

**John Bullock** - *Darling Ingredients Inc. - Chief Strategy Officer and EVP of Specialty Ingredients*

I do not believe that we released that specific information.

**Operator**

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

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

Thanks, Gary. Thanks, everybody, for joining us. We look forward to sharing our second quarter thoughts and results here in August. Thank you.

**Operator**

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.