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DAR - Q1 2018 Darling Ingredients Inc Earnings Call

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PRESENTATION

Operator

Good morning, everyone, and welcome to the Darling Ingredients Inc. conference call to discuss at the company's first quarter 2018 financial results.

With us today are Mr. Randall Stuewe, Chairman and Chief Executive Officer of Darling Ingredients; and Mr. Brad Phillips, Executive Vice President and Chief Financial Officer. (Operator Instructions) Today's call is being recorded. I would now like to turn the call over to Melissa Gaither, Vice President, Investor Relations and Global Communications for Darling Ingredients. Ms. Gaither, please go ahead.

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

Thank you, Allison. Good morning, everyone. Thank you for joining us to discuss Darling Ingredients earning results for the first quarter ended March 31, 2018. To augment management's formal presentation, please refer to the presentation section of our IR website for the earnings slide presentation.

Randy Stuewe, our Chairman and CEO, will begin today's call with an overview of our first quarter operational and financial performances, focusing on year-over-year comparisons, and will discuss 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 about the business and the year ahead, after which we will be happy to answer your questions. Please see the full disclosure of our non-U.S. GAAP measures in both our earnings release and earnings slide presentation.

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 the Form 10-K for the year-ending December 30, 2017, our recent press release announced yesterday and our filings with the SEC. Forward-looking statements



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in this conference call 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.

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

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

Thanks, Melissa. Good morning, everyone. Thanks for joining us today. As we discussed on our 10-K call in February, we anticipated the reinstatement of the 2017 blenders tax credit during the first quarter for both our North American biodiesel operations and our joint venture with Valero. For discussion purposes today, we'll provide color about the business segments, net of the blenders tax credit. Overall, we remain highly constructive on 2018 and see growing momentum for another good year.

Now let's start. First quarter 2018 is pretty much off to a predictable start. Influencing our first quarter performance was, one, highly historical slaughter rates and raw material supplies, declining global fat prices, improving demand and pricing for our specialty proteins for both wet and dry and strong demand for our low carbon fuels, growing collagen sales, and we survived a very harsh North American winter. So let me talk a little bit about each segment and give you a little detail.

In our Feed segment, globalist slaughter volumes were up 3.2% over last year. Most notably, global fat prices remained under pressure most of the quarter due to the record slaughter, a strong global soy crush, declining palm oil prices and Argentine biodiesel flooding the European market. More than offsetting this pressure was the natural hedge we have in Diamond Green Diesel. For now, it appears we have seen the bottom in fat pricing, and we should see improvement throughout the second quarter. And then with the new demand from an expanded Diamond Green Diesel, we should see a return to more historical discounts and relationships to other fats. Once again, the significant discount our global portfolio of fats and oils experienced in Q1 gives us even more of the reason to double the size of Diamond Green Diesel.

On a positive note, the Feed segment enjoyed improving finished product prices for proteins during the quarter, especially for our higher-grade specialty pet food products and aqua feed ingredients. Mixed BC protein values also improved during the quarter. But nonetheless, inventories built and historically wide discounts to soy remain due to significant volumes we produced.

Also in the Feed segment, our global blood business enjoyed a record volume quarter, especially in China. Volume grew to all-time highs, driven by the larger than anticipated hog slaughter. And our specialty wet pet food business once again saw both volume and margin improvements.

The Food segment results were modestly improved year-over-year. Rousselot, our global collagen business, grew sales volume and improved margins year-over-year. In Brazil, earnings improved nicely compared to the year-ago period, while macroeconomic factors continue to plague operations in Argentina. Our U.S. factories had strong volumes and improved margins, while our European factories felt the pressure of a strengthening euro.

Our European edible fats business maintained robust sales volumes due to increased raw material availability, only to be offset by lower selling prices due to deflationary pressure on the global palm oil market. Our casings business, CTH, again posted a solid quarter, and continues to see robust supplies and demand for its products in all global markets.

The Fuel segment continues to deliver consistent earnings. Rendac, our European animal disease mitigation business, leveraged strong supply volumes and produced consistent results. Ecoson, our bioenergy business, returned to full production capacity, capitalizing on ample supply and continued strong demand. Our North American biodiesel business operated at breakeven during the quarter without the 2018 blenders tax credit. As I mentioned, Fuel segment earnings for the quarter included \$12.6 million of the retroactive BTC passed in February.

Now turning to Diamond Green Diesel, our 50-50 partnership with Valero. The facility reported an impressive quarter with entity EBITDA of \$1.19 per gallon on sales volume of 33.4 million gallon. When adjusting entity EBITDA for the expense catalyst swap-out during the 12-day turnaround, the EBITDA per gallon would have been \$1.28. Additionally, we loaded a large vessel at the end of the quarter that will be reflected in Q2 sales and earnings.



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Most importantly, we have successfully transitioned this facility from a first-generation road fuel supplier reliant on the RFS to a second-generation global low carbon fuel additive producer. This is a transformational change in strategy, and now provides us the opportunity not only to realize improved earnings, but also capture increased value from the Darling low carbon feedstock supply.

EBITDA for the quarter, excluding the 2017 blenders tax credit, totaled \$39.8 million. Including the retroactive BTC, the entity-adjusted EBITDA was at \$200.1 million, with Darling share being right at \$100 million.

During the quarter, DGD used a portion of its cash to retire the remainder of the JV's long-term debt totaling \$53.7 million, leaving a total cash position of \$41 million. The \$160.4 million receivable blenders tax credit is expected in Q2, and will cover the remaining CapEx of the 275 million-gallon expansion project, an increase in working capital and the issuance of quarterly dividends for the remainder of the year. Based on current production levels, we continue to expect Diamond Green Diesel production will total around 180 million to 200 million gallons during 2018, with an average EBITDA of around \$1.25 a gallon without the benefit of the 2018 blenders tax credit. At those levels, we would expect Diamond Green Diesel to distribute an estimated \$75 million to \$100 million dividend to the company during 2018.

As of today, we anticipate shutting down Diamond Green for approximately 45 days in mid-June. Once the tie-ins are complete, we will recommission the factory at the newly-rated capacity of 275 million gallons annually.

Our team continues to advance engineering and financial analysis to confirm the viability of a super Diamond Green Diesel, which expands the plant to 600 million gallons. Funding for the detailed engineering and cost estimate has been approved by the DGD board, and we expect to make a final decision on this later this fall.

With that, let's have Brad take us through some financial highlights. Brad?

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

Thanks, Randy. Before we review first quarter results, I'd like to review the impact from the new revenue recognition accounting standard, ASC 606, given its impact on our results. For periods beginning December 31, 2017, we adopted ASC 606 using the modified retrospective method. The adoption did not change the timing of recognition -- revenue recognition, as revenues are recognized at a point in time and not over time. For consolidated results in the first quarter 2018, we reported net sales of \$875.4 million, a decrease of \$46.2 million because of the new standard. There's no impact to operating income as cost of sales and operating expenses also decreased by \$46.2 million as a result of the new standard.

Moving on to our balance sheet. Our cash position ended at \$123 million, up from \$107 million at the end of fiscal 2017. Our leverage ratio for the first quarter of 2018 was 3.71, up a bit from fiscal year-end 2017, primarily due to the retirement of the remaining \$53.7 million in debt at the Diamond Green Diesel joint venture level, which Randy referred to, rather than distributing a dividend to the partners as well as the U.S. value of euro-denominated debt increasing noticeably in the first quarter due to FX.

Additionally, we had revolver borrowings to cover our normal first quarter seasonal increase in working capital. Our liquidity remains strong with approximately \$921 million of availability under our revolving credit loan facility, and we expect to pay down a total of \$100 million during 2018.

CapEx for the period was \$56.6 million for the first quarter of 2018 compared to \$62.3 million for the same period in 2017. Gross margin in the first quarter was 22.5% compared to 21.7% for the same period last year. Gross margin growth is due primarily to the inclusion of the \$12.6 million 2017 blenders tax credit, which was not included in Q1 '17 results. Gross margins also benefited from stronger protein pricing and increased global sales volumes. Those improvements were partially offset by the impact of severe weather on our rendering facilities in North America and the global impact of significantly lower fat prices.

SG&A during the quarter was flat at \$86.9 million, and included performance, compensation and retirement provisions. For the full year 2018, we project our SG&A expenses to be in the \$88 million to \$90 million range per quarter.



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Depreciation and amortization increased during the first quarter of 2018 compared to the same period in 2017 due to higher capital expenditures during 2017.

Interest expense increased \$1.4 million to \$23.1 million for the quarter, primarily due to the change in foreign currency translation rates on the company's 4.75% euro bonds compared to the previous year.

Now I'll address our tax expense for the quarter. The company reported income tax expense of \$3.7 million for the 3 months ended March 31, 2018. The effective tax rate is 3.6%, which is lower than the federal statutory rate of 21%, due primarily to the retroactive reenactment during the quarter of the biofuel tax incentive for 2017. Excluding the biofuel tax incentive and other first quarter discrete items, the effective tax rate is 30.4%. The company also paid \$7.1 million of income taxes in the first quarter. For 2018, we are projecting an effective tax rate of 25%, including our 50% share of Diamond Green Diesel's 2017 biofuel tax refund, which we expect to receive in the second quarter. If the biofuel tax incentive is reenacted for fiscal 2018 before the end of the year, the effective tax rate is projected to be 15%. Finally, we are projecting cash taxes of approximately \$30 million for fiscal 2018.

Lastly, as another step in continuing to maintain an efficient capital structure, on May 3, we settled a refinancing tender of our 4.75% euro notes due May 2022 by issuing 3 5/8% 8-year euro notes due May 2026.

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

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

Thanks, Brad. We continue to build positive momentum around the globe. Our capital projects are proceeding on schedule and on budget as we continue to transition to our World of Growth Strategy. As always, we like to remind our investors of our strategy that we will build, acquire and develop businesses and geographies, where we can achieve a top 3 market position within 5 years for Food, Feed and Fuel. These projects include greenfield plants and plant expansions. Our Mering, Germany blood plant is up and running and made its first saleable material during the quarter. Our newest Ecoson digester in Denderleeuw, Belgium is in the final commissioning stages, and will start up here later in June.

In Grapeland, Texas, the largest and newest poultry protein ingredient plant built in the U.S.A. in the last several decades is taking shape, and we expect equipment to be set in June and fully operational by year-end. Our second new poultry protein ingredient plant in Wahoo, Nebraska is also under construction and on schedule to be completed in early 2019. The construction by our EnviroFlight joint venture on black soldier fly larvae plant is well underway and should start up in fourth quarter. And our Peptan plant in Angoulême, France and our Peptan expansion in Amparo, Brazil is expected to come online during the first quarter of 2019.

Overall, we are pleased with the start, and see improving conditions for the balance of the year. We are positioned well, our business model is robust and we are poised to reap the benefits of the next super cycle. Diamond Green Diesel has, once again, proven to be to hedge and the catalyst for transforming Darling. Our leading position is North America's premier supplier of low carbon fuels has now set the stage for the future.

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

QUESTIONS AND ANSWERS
Operator

(Operator Instructions) Our first question will come from David Katter with Baird.



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

Just quickly on the further expansion of Diamond Green to 600 million gallons, what do you foresee -- what could change between now when you make a decision that will make that more or less likely your decision to proceed there?

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

David, this is Randy, and I do have John Bullock in the room with me here. I'll take the first stab at it, and John can help me if I don't say it right. I think, number one, from a macro perspective, we're very close on that decision, but it's still very much part of the process to nail down the final engineering costs, plus or minus 10%. We've funded that to go forward here, and expect that to be completed later this summer or early of the fall. So the real checkpoint is, as you guys know, obviously, with the challenging trade issues around the world, with steel, aluminum, copper pricing moving around, we're trying to make sure we have a strong understanding of both what the cost is and what the risk is there. So that will be nailed down. And then, ultimately, we'll take one final snapshot at any potential policy implications, both good or bad, and make the final go here on or around probably the end of September, 1st of October. John, is that fair enough?

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

That's exactly right.

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

Okay. Thanks, David.

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

One more on fat pricing. You guys, I think, mentioned that you think you're at the bottom here. What gives you confidence in that?

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

What gives us confidence is it just seems -- historically, it's just too low, number one. Number two, Diamond Green Diesel had 12 days down. And in the first quarter, that's a big supply chain air bubble. The market's anticipating Diamond Green to go down here in about 30 days from now or a little more. And then we've seen that stayed down around the world in 1 or 2 of their factories. And then you couple that on top of the Argentine biodiesel that was flooding the U.S., but now is flooding Europe, and it's just put a lot of fat on the market. So it's always hard to call bottom to this, David. But at the end of the day, it just feels like it's about ready to perk back up. The long harsh winter didn't really get us back into feeding rations, where we thought we would be, to take on a little bit of the surplus. The good news is slaughter is big. Our formulas in our business are working, but there's just a lot of fat on the market. It looks like it's being worked through. You take the biodiesel seasonality and the generation 1 plants, those should be coming online now and taking up a little more of the slack. So it kind of feels like that we're turning the corner here.

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

Great. That's helpful. And then maybe one more for me, and I'll hop back in queue. We've seen some volatility in RIN prices and some rumors coming out of Washington. Is there anything there that worries you yet? Or is this kind of just part of the course?

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

Yes. This is John Bullock. We -- what we're used to out of Washington D.C. is volatility around these programs. I think it seems like this is part of our quarterly call, is to discuss the most recent volatility that happens out of Washington D.C. At the end of the day, as Randy mentioned in the opening,

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we really now are so focused on what we're doing in these LCFS markets. It's become a bigger driver for us than what's happening with the federal RFS2 program. Having said that, we have full confidence that, that program's going to continue. There will always continue to be volatility around it. It is politically a very controversial program. However, RFS2 is the main demand driver for 1/3 of the corn in the United States that's produced and 1/3 of the soybean oil in the United States that's produced. And the farm lobby is strongly in favor of the renewable fuel standard. We continue to believe that program will be in place, and we'll move forward. And as Randy said, with the RINs, where they are today, we continue to have full confidence that Diamond Green Diesel will make \$1.25 a gallon with no tax credit. So what we're interested in is good margins for Diamond. We continue to have great margins for Diamond despite the volatility that always seems to come out of Washington D.C. in relationship with the RFS2.

Operator

Our next question will come from Chip Moore of Canaccord.

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

Maybe just a follow-up on that. As we get close here to the downtime and tie-in on that first expansion of Diamond Green, maybe you can talk about LCFS markets, how you're positioned there as you come up from that. I'll guess, we'll start there.

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

What position? Great.

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

We just -- Chip, we just need to know, do you have any tanks at your house that we can store a little fat in, borrow it down for 45 days?

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

Yes. As the demand from the LCFS markets, so not only in California, but around the world, continues to explode. And we see that demand every time we go out and look to create a new marketing agreement out of Diamond Green Diesel. It seems like those deals are better and better every single time that we go to market with this. And so we could not be more excited about the demand potential from the LCFS markets, both in terms of the actual volume and in terms of the pricing associated with those gallons as we move those gallons to market.

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

Excellent. And sticking with the regulatory question. Chatter on exports -- ethanol exports counting towards RFS compliance, what are your thoughts there?

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

Well, primarily, that's going to affect the ethanol around the D6 RIN. What we all have to remember about the RFS2 program is it's a nested program, in which there was a demand bucket created for the conventional overall. Then there's a separate demand bucket created for the advanced, and what's the deep-ore biomass-based diesel RIN that's into it. And even if that D6 RIN devalues, the question is, what is the S&D for the advanced RIN pool going to look like? And quite frankly, without biodiesel coming in from Argentina, and if Europe in particular takes the action that everybody thinks they are going to do to stop the biodiesel coming in from Argentina into Europe, well, that's going to mean that, that advanced pool can be a fairly tight pool from an R&D standpoint going forward. And that's really what determines the pricing at D4 RINs as opposed to what's happening with the conventional. So a lot of smoke and noise, but it's mostly around the ethanol side. There's very little that impacts the advanced side here.



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

Yes. Okay, that's great. And then on the new facilities and plant expansions underway and starting up here in Q1 for some -- maybe just remind us on CapEx for the year, any changes on those plans?

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

No, not really. We've spent, as Brad said, around \$56 million, \$57 million, a little less. And we actually spent last year, which is your basic barometer of how bad the weather was for construction this year. So we've got a \$330 million-ish type of number for this year. We're kind of -- as we look and have expanded the number of facilities, that's about \$195 million maintenance CapEx and \$135 million, \$140 million of expansion CapEx. And that's all the factories we're building. And sometime, on or about Q1 2019, they should all be online, and then produced in-force.

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

Yes. Okay, got it. And then just lastly, I mean, given leverage where it is and the cash flow coming in with the dividend, hopefully -- M&A, I know you have bolt-ons lately. How's that pipeline? And how are you thinking about that?

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

Well, I think those are 2 separate questions. Obviously, as we look at the -- at our focus here, it's continued deleveraging. And once we -- part of the strategy here was to delever or fully delever Diamond Green Diesel. So it's always -- we've been co-deleveraging both businesses, the core asset and Diamond Green. So Diamond Green is now delevered with a cash positive balance that should provide quarterly dividends that are fully transparent now to you, guys, which will just continue to knock down the debt ratio and put us at the end of the year without the blenders tax credit at around 3.0 or less. And with the blenders tax credit, if it's retro, which we did not spoke here, but we still feel there's a very high probability of that coming back online, then you're way south of 3. From an M&A pipeline standpoint, we continue to see lots of different businesses around the world that are available to us. We're just being very conservative and cautious, and we still believe the best use of our money at this time is both deleveraging and organic expansion, as multiples just aren't where they should be for us to put them in our portfolio and provide the returns that we're accustomed to delivering to you.

Operator

The next question will come from Adam Samuelson with Goldman Sachs.

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

Maybe to start, going into the Feed business a little bit in the quarter, pretty clear on the impact of the harsh winter weather, fat price environment fairly has been sluggish, and you have the offset in Diamond Green. You talked about kind of as you look forward, kind of lapping the weather -- some of the organic growth from last year and even '16 starting to be more meaningful contributors. Protein markets in particular have perked up pretty significantly in the second quarter. How to think about the second quarter just given, outside of fats, of a more constructive commodity environment and some of the organic growth that you've hurdled?

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

Yes. Adam, this is Randy. I think we had a pretty horrendous February around here, and then March came back pretty strong. And we're so close in the books on April. But the pricing and the raw material spreads that have been achieved, it looks like, in April, have brought back the -- what we're more accustomed to in that area. I think there's a couple of things. One, in that Feed segment, you've got -- the global rendering business,



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it got hit hard by the low fat prices. You just couldn't bring down raw material prices quick enough to make up for the spread loss in that business. And so I think we're getting there, and that will be reflected in Q2. We saw -- in the Feed business, we saw 2 things. One -- or the protein business. We saw a very, very strong demand for our specialty ingredients, which are our low-ash chicken meals and aqua feather meals and some different things to the -- around the world. The world is short on protein. And there's no doubt about it, right? Now obviously, with the reduction of 10 million or 12 million tons of soybeans out of Argentina, the world has got a lot of animals to feed, and they're clearly coming for protein. Crush is running very, very hard around the world. Margins are good in that business. And that's putting a lot of protein on the world market, but there's a lot of demand for it. And so we've been able to capitalize on that. The excess oil that's on the market today is what's pressured the oil. That's just the -- got to be worked through. The other piece in the Feed segment is our global blood business. It had all-time record supplies, and you don't want to say why and where. It's always interesting that we always talk about we can see what other people can see. China's hog herd expansion is probably greater than most people understood. The amount of animals going to slaughter filled up all of our blood plants, and that's a good thing there. But at the end of the day, they stop importing materials from around the world. The little cheaper meat cuts that were being sent to China ended up back in the rendering streams, and then further created volume in our plants, both protein and fat, to market. So we think that the market is now adjusted to that. Our wet pet food business, as I said, continues to grow. The pet food expansion in this country, in Europe, South America around the world continues to grow. You've seen that in the results of the companies and the acquisitions that have made by the retail companies. And then finally, as we look at the total Feed segment, we sat there and looked at it and said, the real impact that we've always talked about in there was the used cooking oil business. And the used cooking oil business is the one that has the full commodity exposure. And we've kind of said in the past that, basically, each \$0.01 of lower prices is an annualized rate of \$4 million to \$5 million of EBITDA. And you can kind of look at that and see where the market move and say, "Okay. That's pretty much the majority of the shortfall in that segment this quarter." The used cooking oil business is coming back nicely as we warm up here. There were 9, 10, 12 days we didn't even -- weren't able to run routes in the United States because of ice and snow. But what we've tried to emphasize here is Diamond Green Diesel got the benefit of those lower prices. And that's the hedge that we've always talked about in the business. That's why we invested into that asset, was to try to take some of the seasonality, cyclical and offset some of the downside when we do cycle here. So overall, I think we're setting up very nicely for second quarter right now with what I've seen going into May here.

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

Okay, that's helpful. And then maybe just a follow-up. And you alluded to this briefly in the prepared remarks, but a bit more uncertainty on the general trade outlook. And it matters for your business where some of the byproducts can get backed up, specifically for the U.S. port business being unable to -- now have a tariff on China and the impact that, that can have on the drop credit and byproduct values. How do we think about how the current trade environment impacts your business and that kind of keep inch points your watching?

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

Yes. We've had some discussions around here. I would say there's very limited impact that is really apparent today. I mean, potential impacts are you've got a lot of ingredients headed to China, not necessarily from Darling, but both in the ag industry and different ingredients from different producers out there, feather, milk, poultry meals, that if they will put tariffs on those, those will back up here for a while. But they will -- China is still short on protein. They'll buy it from somewhere else, and then we'll just have to redirect or reposition our supplies. So it's more of time being spent around here, that if we get some countervailing duties or tariffs that are put into place, can we then continue to move the product around? The one product we're having challenges within the world today is what we call mixed BC meat and bone meal. And that's just really now being fed to poultry in the pan-Asian countries. And so we're just trying to continue to develop markets for that. But relative to any other trade flows, we've seen more of the trade flow affect additional raw material supply than affect finished product pricing at this time.

Operator

The next question will come from Heather Jones of Vertical Group.



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

So the first, just sticking with China really quickly. So their prices -- because of their expansion, their hog prices have plunged. So I was just wondering, are you seeing them move into liquidation mode there on their hog herd?

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

I don't know that -- Heather, this is Randy. I don't know that I would call it liquidation mode. Remember that the meat supply always builds up prior to Chinese New Year. And then if it's not sold by Chinese New Year, then -- they then just move it to market to get rid of it and restart the cycle. We've seen a pretty nice expansion there. Remember, I think the numbers out of there are less than perfect. But essentially, they add or lose the entire U.S. hog herd in anywhere from a 12- to 15-month period from time-to-time. We're still seeing our blood plants full. I mean, really, at the end of the day, the impact for us over there is we produce a couple of products through the 5 or 6 factories we have in the blood business over there that produce red blood cells for aquaculture. Aquaculture's still booming, about ready to kick off into season here in May, June, and then the white blood cells end up as a plasma feed for baby pigs. And we're continuing to see robust demand and solid pricing for those products. So I don't know that I'm ready to call a contraction in that herd yet that would be meaningful for anybody over here or even over there. Clearly, the appetite of the Chinese consumer -- the economy feels good over there. And I just returned from there, it just feels fine to me right now.

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

Okay. And moving on to Diamond Green. So am I remembering correctly that there were still some of the old contracts in place until the end of January? And this is the first quarter where -- there were none of those in place any longer?

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

Yes. Heather, this is John Bullock. Your memory is really good. Yes, that's right. This is the first. The second quarter will be the first quarter where we do not have any of the legacy pipeline contracts in place.

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

And then if I remember correctly, you guys were talking about the super Diamond expansion being 550 million gallons, and now you're talking 600 million. Can you walk us through the thinking of what has caused you to upsize that?

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

Well, number one, again, as John says, your memory's good. Number two, I'm not sure 600 million is the right number yet. We're contemplating -- we're looking at final engineering. That's what's important. In final engineering, you're doing hydraulics, vessel sizes, and you're looking for that incremental capacity, what's the right size for the right dollars per cost per gallon to spend here? So the site that's being laid out right now has -- this is a second plant, Heather. It's got incredible logistics between a second railroad, water transportation and in-and-out pipeline hydrogen. So that number will be finalized, but I think it's safe to say it's now bigger than 550 million. And 600 million is a number being contemplated.

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

And then did I hear you say you are highly confident or believe there's a high probability that the BTC is implemented for '18?

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

That's what you heard out of me. So I still believe that. I don't know that I want to handicap it for you here. But my feelings are, after the guys that are hanging out in Washington, given all of the RIN sanity and the politicals around this, we still believe that there's a high probability that the BTC will be reinstated for '18. It will probably be put in for '19. And if you had a handicap, it's probably got some step-down attached to it after that. But I just don't think I'm ready to call it and say it's dead in the water. I think it's -- I think we've talked about our margins without it. And we'll just stay there, and we'll accept it if it comes. And now we feel pretty confident it will come.

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

Okay. And then my final question is, going back to the Diamond Green and the downtime there, so even though that downtime hasn't begun, you still believe there's been a bottom in the fats market, and it's going to improve. And just because of lower fat supply from other parts of the world, the lower crush in Argentina, all of -- seasonal increase in demand, all of these factors make you think that they should be able to more than offset Diamond going down -- Diamond Green going down for 45 days?

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

Yes. I mean, we've known Diamond Green Diesel is going down for 45 days for a year. And it doesn't mean that the lunch room's not a little interesting every day to figure out what you're going to do with that production, but I think we're well positioned, as we can be right now, for that between storage and other avenues that we've got and moving it out of our traditional markets. So a little bit of the pressure in Q1 was us just positioning ourselves to go down in Q2. So that's where our confidence is coming from. But we'd still like to store a little bit at your house.

Operator

Our next question will come from Craig Irwin with Roth Capital.

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

And first, Randy, I'll say one of my neighbors had a code violation for storing fats a few years ago making in the room biodiesel. So I'm sorry.

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

And he's now, what, growing marijuana instead or what?

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

Yes. I think it was probably about as big a fine, which was pretty crazy. So my question's really about the impact of the U.S. biodiesel market, right? So we've seen profitably in biodiesel really firmed nicely in the second quarter. April was up on a spot basis, about 30% over the average in the first quarter. May, despite what's going on in D.C., seems to be trending higher, maybe following energy prices a little bit. Can you maybe talk about how this maybe translates into fats demand and pricing today and the anticipated impact when Diamond Green is down, and then what we should think about the profitability outside the window when the plant is actually down?

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

I'm not quite sure I totally understand all of the question or different aspects. I think in relationship with the fat price, as Randy just said, we've actually had to get warm in the United States now in the past 15 or 20 days. If you see what the price of corn is, there's excellent demand coming in from the Feed sector. We typically don't see a lot of that until the weather warms up, obviously, in the summertime, excellent season for biodiesel



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because you don't have the cold flow properties working. And you have an excellent relationship right now between the heating oil market. I mean, diesel fuel has quietly climbed here to over \$2.20 a gallon on the NYMEX yesterday. That's a big increase from where it was 6 months ago or even 3 months ago. And so the relationship between heating oil and our biodiesel prices has improved. The "HOBO spread", as the trade calls it, has improved. That leads to decent margins in the biodiesel segment. And I wasn't sure I understood in relationship to Diamond Green Diesel the question.

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

So really, the most important question for Diamond Green right now is -- profits seem to be firming even today. How should we think about profitability outside of the window where the plant goes down -- up until the day before the plant goes down? Should we see -- Diamond Green see a firming profitably into that? Or are the dynamics of the anticipated shutdowns maybe going to impact that?

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

No. I think we're going to stand by. Obviously, we're through April. We're almost halfway through May. We're going to stand by our \$1.25 a gallon for the year guidance. Clearly, you can run the spot margins with \$150 a ton carbon out in California today. And the spot margins are quite a bit better than that, but we're going to stick with our estimate right now, where it's at.

Operator

Our next question will come from Thomas Palmer with JPMorgan.

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

I just had a couple of clarification questions around Feed. First off, I just wanted to get an update on segment expectations for the rest of the year. Last quarter, you had talked about EBITDA being at or above the level of 2017. So as we look at the remainder of the year, is that still the case, kind of excluding maybe some of the lag effect and things that hit the first quarter? And if so, kind of when do you see that inflection from a timing standpoint of the year-over-year increase? Would it be mostly third quarter?

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

Yes. I think, Tom, I mean, number one, we try not to give too much guidance in there because I also went into the year believing that fat prices will be firm and proteins will be weak, and I was 100% wrong. So you always have to take my guidance with a little grain of salt here. At the end of the day, we're seeing volumes remain very strong around the world in the global rendering business. That is primarily the biggest piece in the Feed segment. That will contribute nicely. Formulas did play a little bit of catch-up here. We've been chasing the market. I think we'll have an improved, will be my guess, second quarter. Third quarter, we should start to feel then the improving fat prices that should be a result of our uptime now and Neste around the world and the impact of the true seasonality in that, the biodiesel business in the U.S. So I think it's very safe, as I reflected in my comments, to say we see increasing momentum, and I think we'll get through Diamond Green shutdown. And it will have a much better third and fourth quarter in that area as we bring on projects and see some improvement in that fat value. So I think that's a fair assumption.

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

Okay. And then you also have touched on this earlier, but I wanted to just clarify. Obviously, the shutdown of Diamond Green Diesel leaves a lot of yellow grease to be placed into the market. Are you going to be building inventory on your balance sheet in anticipation of Diamond Green Diesel expansion? Will you be selling it just to potentially suppress price? Or might we see Diamond Green Diesel also build up some inventory itself?



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

The answer is yes to all of the above. That -- like we said, the shutdowns have been planned for a long time. Obviously, the window keeps getting narrowed down as we get closer. So it probably won't be precisely perfect. But the inventory that was going to go down there, number one, will go down full. Number two, will be full in our own storage. And number three, we've got sales to offset that, that have already been in play. So obviously, we're trying to do our best to minimize those spot discounted sales that will happen. So I feel pretty confident we've done a pretty good job with that.

Operator

Our next question will come from Ken Zaslów of Bank of Montréal.

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

So just going back to the LCFS credits, how much did you benefit this quarter versus, again, you rolling off from last quarter? And then how much do you expect to gain momentum throughout the year? Can you just give some sort of qualitative, if not quantitative, way of thinking about it?

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

Yes. Ken, this is John Bullock. It needs to be qualitative because, obviously, what we do with our customers and the specifics about our contracts is something that we've always kept as a nonpublic information, and kind of view that as very important from our customers' perspective. What I can say is that you've seen the LCFS -- it's interesting because remember, earlier this year, CARB redid the time line in which they implemented the LCFS volume increases. They originally were going to go to a 10% reduction target by 2020, and they evened that out towards 10% by 2022. And then they increased the target from 18% to 20% by 2030, and now have given us the timetable on the implementation of that increase of 23% to 2030. When they did that, CARB credits were at \$150 a ton. And then when they did -- when they made that evening of that curve, CARB credits dropped to \$115 a ton. Well, as we said here today, I believe CARB credits are \$154 a ton. And so it tells you that the demand that comes out of California is driving the LCFS prices up. And I can tell you that every time we redo our contracts to the LCFS markets, Diamond Green Diesel is receiving an increasing percentage of that LCFS credit. And those numbers are fairly dramatic when you look at them on a time-over-time basis of every 6 months or every year. And so that's one of the reasons we feel real positive about what we're seeing in California. But it's not just California. We have increasing LCFS demand that comes out of Canada, that comes out of Europe. The U.K. just announced that they're going to be increasing their targets. And if Brexit really happens, and they leave the EU, that means the barrier from a tariff perspective of being able to move renewable diesel into the U.K. will not be there. So we see demand coming from all corners. And as that happens, we are increasing both the base price of the carbon, and we are negotiating better and better contracts with our customers, simply because our demand -- our supply is still valued by those customers.

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

My second question, just to go in -- Randy, look, you have a better corn environment, a little bit weaker yellow grease prices. And kind of on the Food and Fuel -- Food and Feed side, is your outlook similar to what it was last quarter? Has it changed markedly? Can you kind of just put some parameters to that, just so we could just kind of -- because there seems to be a lot of moving parts between the trade and the corn prices and yellow grease prices, how it's all playing out and what you're thinking in terms of the outlook relative to last quarter?

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

Well, first off, you did a good job of last -- after the last earnings call of calling the quarter. You had the feeling that we were under a little pressure. We're given a little more positive outlook that is very -- I don't know that we're changed in the year. We're just going to build momentum into it



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just like we said. We feel a little better right now after we came out of March and April here, and have seen what the business is doing from there. Like I said, it's just -- it's going to come down to final size of the South American crops. And what we actually get planted up here, corn seems to be wanting to hang around that \$4 mark. I don't know that I would have felt that going into the year. You've got to always look back at cash prices in the Midwest. They're a little depressed. But at the end of the day, it feels pretty good, Ken. And I guess, I'm not ready to move the full year expectation of saying I think we'll be -- have an improved year over last year. But it's feeling like we're gaining momentum on it right now.

Operator

Our next question will come from Garrett Wubben of Gates Capital.

Jeffrey Linn Gates - *Gates Capital Management, Inc. - President, Managing Partner, and Portfolio Manager*

Randy, it's Jeff. So a couple of things. One is, can you give me the -- what the revenues would be, pro forma third quarter -- the first quarter of 2017 for pro forma for the accounting change, and also the restatement or the deconsolidation of the hive facility? That's the first thing. And then the second thing is, the revenues on the accounting restatement, it looks like they all came from the Feed segment. Can you confirm that? And then, third, can you tell me, on Diamond Green Diesel, the CapEx for the first quarter and the remaining amount to spend on the expansion to \$275 million?

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

Tim, this is Brad. On the -- Jeff, I'm sorry. On the first item, on net sales, the freight revenue adjustment was \$46.2 million. So that would have been \$921.5 million. I can't remember your second question.

Jeffrey Linn Gates - *Gates Capital Management, Inc. - President, Managing Partner, and Portfolio Manager*

Well, now what was the -- what would the revenues have been last year if I take it out?

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

That was -- there was \$38.2 million adjust -- would have been adjustment to last year for that. \$38.2 million.

Jeffrey Linn Gates - *Gates Capital Management, Inc. - President, Managing Partner, and Portfolio Manager*

And does that all come out of the Feed segment revenue?

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

The freight revenue, most of it comes out of Feed.

Jeffrey Linn Gates - *Gates Capital Management, Inc. - President, Managing Partner, and Portfolio Manager*

Okay. And what about the deconsolidation of the hive subsidiary? What effect did that have on revenues and EBITDA?



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

That was a \$2.8 million sale going from 60% down to 40%. And there was a \$0.9 million -- just under \$1 million loss from that.

Jeffrey Linn Gates - *Gates Capital Management, Inc. - President, Managing Partner, and Portfolio Manager*

How much comes out of revenues for the first quarter of '17, and how much for the first quarter of '18?

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

I have to get -- I'll get back to you with that number.

Jeffrey Linn Gates - *Gates Capital Management, Inc. - President, Managing Partner, and Portfolio Manager*

It sounds like it was a very big number, though.

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

It's not small, just not a large number.

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

It's not a large number. That hive business was a joint venture with our large supplier in Europe. As part of the renegotiation and extension of those contracts, they wanted a little bigger skin in the game on the hive business. And so we -- that's the reason we sold the -- backed down to a minority position there. Really not material to us.

Jeffrey Linn Gates - *Gates Capital Management, Inc. - President, Managing Partner, and Portfolio Manager*

And then what was the CapEx of Diamond Green Diesel in the first quarter? And how much left is there to spend on the \$275 million expansion? Do you understand what I'm getting on?

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

Yes. Nominally, Jeff, I think after we paid off the debt. We had about \$41 million cash, and then we got the \$160 million receivable, and then the balance of the year of production of about, whatever, 150 million gallons at \$1.25. And I want to say that I think the CapEx for the balance of the year was around \$100 million, if I remember right. And then we were also saying that we're going to have a pretty significant creep in working capital for the new supply chain that could be anywhere from \$35 million to \$45 million by the end of the year won't all hit day 1. So that's kind of the numbers that you run with in there. I mean, what it says is you're going to have a very significant cash build at these margins without the blenders tax credit as we approach year-end. And that's the reason we're given the dividend expectations.

Jeffrey Linn Gates - *Gates Capital Management, Inc. - President, Managing Partner, and Portfolio Manager*

So I wasn't on the earlier part of the call. So the \$100 million is for the -- is just for the \$275 million expansion?



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

Yes.

Jeffrey Linn Gates - *Gates Capital Management, Inc. - President, Managing Partner, and Portfolio Manager*

Okay. That would not include anything for additional expansion?

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

No. That's years out, yes.

Operator

Our next question will come from Bill Baldwin with Baldwin Anthony Securities.

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

A clarification, just one item. Randy, did you indicate that you felt like that Darling would receive a dividend in the area of \$75 million to \$100 million from Diamond Green or that would be the total dividend to the joint venture partners?

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

No. We're -- Bill, it's a timing deal right now. But right now, what we're showing is somewhere between the \$75 million and \$100 million to each partner.

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

To each partner? Okay.

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

So yes. And so we're starting to -- that was part of paying off the debt in Q1 here, was to flush the debt. So now as the cash balances build, we can pull out, balance it for the working capital needs. And just that says somewhere between a \$25 million and a \$30 million, \$35 million dividend per quarter going forward here.

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

Okay. Secondly, a little housekeeping here. On the plant expansions or new plants, did you have a new rendering or a plant expansion in Los Angeles come online here in the first quarter?

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

Yes. We had a complete rebuild of a 1954 plant come online out there. I get to see it tonight, so I'm looking forward to it. That's phase 1. And then we're also in construction of building a new poultry plant in L.A. on the same site to day 2. And that will come on later this year. So yes, new capacity...



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

So the plants that you had expanded was a beef plant or rebuild a beef conversion?

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

It was a -- yes, it was a mixed BC plant, and now we're breaking it out. We're going to run beef on one side, and then poultry on the other side. And that poultry plant is under construction right now, too.

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

Okay. And secondly, did you have a beef rendering plant come online in Nebraska here in the first quarter also?

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

We had the rebuild of our Wahoo -- our antique plant in Wahoo, Nebraska. That has been fully rebuilt and online. Yes, that's been commissioned. Both of those are replacement factories. You're going to get some modestly lower operating costs, lower repairs and maintenance and a chance to go out and gain some additional volume over time. But as far as materiality of moving the needle here, they're really just replacement investments at this time.

Operator

Ladies and gentlemen, this will conclude our question-and-answer session. I would like to turn the conference back over to Mr. Stuewe for any closing remarks.

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

All right. Thanks, Allison. Thanks, again, everybody, for joining us. I look forward to reporting on the second quarter performance in August. As you see on our website, we'll be presenting the Darling strategy and outlook at the BMO conference here mid next week, and look forward to seeing any of you there that show up. Thanks again. I appreciate it.

Operator

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

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