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DAR - Q1 2019 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 the company's first quarter 2019 financial results. On the call today are Mr. Randall C. Stuewe, Chairman and Chief Executive Officer; Mr. Brad Phillips, Executive Vice President and Chief Financial Officer; Mr. John Bullock, Executive Vice President and Chief Strategy Officer; and Ms. Melissa Gaither, Vice President of Investor Relations and Global Communications. (Operator Instructions)

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

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

Thank you, Denise. Good morning, everyone, and thank you for joining us to discuss Darling Ingredients' earnings results for the first quarter ended March 30, 2019. To augment management's formal presentation, please refer to the presentation section of our IR website for the earnings slide deck. Randy Stuewe, our Chairman and CEO, will begin today's call with an overview of our first quarter operational and financial results, focusing on year-over-year comparisons, followed by a discussion about some of the trends impacting our business.

Brad Phillips, Executive Vice President and Chief Financial Officer, will then provide additional details about our financial results.

Finally, Randy will conclude the prepared portions of the call with some general remarks, after which we'll be happy to answer your questions. Please see the disclosures and 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 Form 10-K for the year ended December 30, 2018, and our recent press release announced yesterday and our filings with the SEC. Forward-looking statements 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.

Now I'll turn the call over to Randy.

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

Thanks, Melissa. Good morning, everyone, thanks for joining us. Let me begin by providing some brief macro comments about our global performance.

We had a solid start to 2019 with a very challenging global environment. Overall, adjusted EBITDA of $103.4 million improved versus last year when adjusting the prior year for the $12.6 million blenders tax credit benefit recorded in the quarter and a much stronger U.S. dollar. Sequentially, the Feed segment was flat and the Food segment was up sharply. The Fuel segment reflected difficult biodiesel economics. Tough winter conditions in North America, flooding in the Midwest and the growing disruption of African Swine Fever provided headwinds and was reflected in the sequential performance. The shining star in the quarter was our Food segment that is beginning to reflect the investments we have made to diversify our product mix in Rousselot.

In the Feed segment, earnings were impacted by higher winter energy costs, lower pet-grade protein margins, a destroyed pet food blending facility in the Midwest and stagnant fat and protein pricing. Global raw material volumes remain strong, growing by 2.7% year-over-year to a new record.

In the Fuel segment, adjusting for the lack of the BC -- BTC, we had a consistent performance as our green energy operations returned to normal capacity in Europe.

Diamond Green Diesel met our expectations for the quarter and delivered $59.7 million in EBITDA or $0.85 a gallon on 71.1 million gallons of renewable diesel sales. On an operating basis with no hedge loss, we are earned $1.22 per gallon. Since our latest expansion to 275 million gallons, DGD is tracking well against our guidance of $1.25 per gallon when averaging fourth quarter 2018 and first quarter 2019 EBITDA for a net run rate of $1.25 per gallon. For full year 2019, we believe we remain on track to achieve full production of 275 million gallons and an average EBITDA contribution of $1.25 to $1.40 a gallon during the full year of 2019.

Our Phase 3 Super Diamond expansion project is underway to increase production to 675 million gallons of renewable diesel plus 60 million gallons of renewable gasoline. We are on schedule and on budget and look for completion by the end of 2021. With this significant expansion, we will be well positioned to supply the growing global mandates for low-carbon biofuels, which are reaching far beyond California and the U.S. and we are very excited about this game-changer for Darling's future.

Now we continue to be optimistic that the blenders tax credit will be implemented and made retroactive for 2018 and prospective for 2019. At this moment, we are being told that vehicle Congress may use to attach the extender it is a bipartisan supported by -- retirement security act. We are hopeful this advances in both houses within the next 45 days.

With the tax credit, there's potential for an additional $157.4 million into the EBITDA for 2018 and another $275 million for 2019.

And finally, as reported in the media this week, DGD is in very preliminary discussions with Preem, the largest petroleum refinery in Sweden to analyze the construction and operations of a 265 million-gallon renewable diesel unit. Preem is a valuable partner and customer of Darling's feedstocks in Europe. We plan to make a final investment decision once engineering is completed in late 2020.

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

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

Okay. Thanks, Randy. Before we review our financial highlights for the quarter, I'd like to point out that effective December 30, 2018, we adopted the new lease accounting rules of ASU #2016-02 commonly referred to as Topic 842 for leases, utilizing the modified metrospective (sic) [retrospective] method of transition. Our balance sheet now includes both operating lease assets and operating lease liabilities, previous consolidated financial statements were not restated under the modified retrospective method. The key takeaway is that ASC 842 is an accounting change with no impact to our business or total cash flows.

Now on to the financial highlights. For the first quarter 2019, we reported consolidated net sales of $835.1 million compared to $875.4 million for the comparable period in 2018. Several factors impacted by year-over-year sales shortfall including the 2017 retroactive BTC of $12.6 million recorded in Q1 2018, lower pet-grade protein pricing, a stronger U.S. dollar, the closure of the company's Argentina collagen facility and the sale of our Terra Renewal Services subsidiary in the second quarter of 2018.

We posted first quarter net income of $18 million or $0.11 per diluted share compared to net income of $97.3 million or $0.58 per diluted share for the first quarter of 2018. The decline in net income was primarily driven by the inclusion of the 2017 retrospective blenders tax credit in the prior year period results. The credit has not yet been reinstated for 2018 or 2019.

Additionally, lower protein product pricing, higher energy cost, FX variance and costs due to Midwest flooding negatively have impact earnings for the quarter.

SG&A was $85 million for the first quarter of 2019 compared to $86.9 million for the 2018 first quarter. The decrease was primarily due to the decline in several areas that more than offset an increase in performance-based compensation expense.

Interest expense was $19.9 million for the period compared to $23.1 million in the first quarter of 2018. The decrease was primarily due to refinancing the EUR 515 million senior notes in May 2018 from 4 3/4% to 3 5/8%.

I want to briefly mention taxes. The company reported income tax expense of $5.3 million for the 3 months ended March 30, 2019. The effective tax rate is 21.2%, which differs slightly from the statutory rate of 21% due primarily to the relatively mix of earnings amongst jurisdictions with different tax rates on discrete items including the favorable settlement of an audit. The company also paid $2.9 million of income taxes in the first quarter.

As you know, there's been little movement with respect to the biofuel tax incentive. With that said, we are hopeful that the biofuel tax incentive, which has bipartisan support, will ultimately be reenacted during the year. For 2019, we are projecting an effective tax rate of 30% excluding the biofuel tax incentive. If the biofuel tax incentive is reenacted retroactively for 2018 and 2019, the effective tax rate is projected to be 15%.

Finally, we're projecting cash taxes of approximately $30 million for fiscal 2019.

The company reported equity and net income of unconsolidated subsidiaries of $23.8 million for the 2019 first quarter compared to $97.2 million for the same period in 2018. The variance is related to Diamond Green Diesel and the lack of blenders tax credit made retroactive for 2017 recorded in Q1 last year.

Now turning to the balance sheet. Working capital is $325 million for the first quarter of 2019 compared to $357.9 million in 2018. CapEx for the first quarter of 2019 totaled $84.3 million compared to $56.6 million for the first quarter of 2018. Our liquidity remains strong with unrestricted cash of $95.7 million and funds available under the revolving credit facility of $901.5 million. Our covenant leverage ratio was 3.25 at the end of the first quarter.

We launched and priced or refinanced of our 5 3/8% $500 million U.S. senior notes to a new 8-year term at 5 1/4% rate and closed on the transaction here in early Q2. In April, we received a $17.7 million cash dividend from Diamond Green Diesel JV and forecast additional cash dividends as we move through the remainder of 2019.

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

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

Hey, thanks, Brad. We're off to a good start given the global headwinds. We are pleased with our progress and we see tremendous opportunities to leverage our unique global position to capitalize on the feed, food and low-carbon renewable fuel markets. Our capital growth projects and strategic acquisitions are scaling our global reach even further, setting us up to feed and fuel the world.

For Q2, we carry solid momentum. The world remains challenged with trade tariffs and barriers along with the growing outfall from African Swine Fever. However, the diversity of our model will once again prove itself.

Diamond Green Diesel is rolling this quarter and operating margins continue to support our guidance. I'm proud of the business we've built and continue to build as Darling continues to have a positive impact on the world and provide long-term value to all of our shareholders.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question will come from Heather Jones of Vertical Group.

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

So just quick detail-ish question. You say for Q2 that you're carrying solid momentum into the quarter and we have started to see fat pricing pick up. So I was wondering, should -- but there obviously are still some headwinds, so are you expecting the core Darling business to be able to exceed year-ago levels? Or could you frame it for us?

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

Yes, I can frame it. And I think the first thing you got to start out with is, is to kind of -- I'll give you a little more color on the first quarter. I mean, within that, I tried to do that at the macro level. But logistically, we've had a real challenge up in the Midwest with all the flooding. So you've got collection costs of the trucking operations, bridges out, roads out. In U.S.A., you had an extreme winter up there with lots of ice and snow. We had a levee break on one of our protein blending facilities in Nishnabotna, Missouri and put the facility 16 feet underwater. That facility supports 5 or 6 locations.

So when I said we're going to carry solid momentum, it meant operationally, we're going to see energy costs, they have come down. All of our formulaic pricing in North America has recovery for both natural gas and electricity, so you'll see that uptick. You're seeing some pretty solid fat demand out there as the weather warms up here a little bit.

Protein demand. If you look at a year ago, the pet-grade, feed-grade premium on protein, chicken proteins was out at about $100 -- or it narrowed by about $100, it's widened back out by about $25 to $30. And so we'll see that flow through the U.S.A. operations.

The European operations as we look around the world are continuing, they've very -- they've seen a recovery in their fat prices here for Q2 after a pretty weak Q1. Protein demand is stable over there, same with Canada as we've seen a little bit of an uptick there. And then when you move to our Food segment, the gelatin business had a record quarter underneath the Food segment there that includes edible fats and casings in there. Excellent demand out of China even after the Chinese New Year, solid demand out of South America through the quarter. We're seeing -- we've installed our new technology into making a new product mix, a product we call Peptan. We're starting to see the payback from those projects, and we think we'll carry a pretty solid performance there into Q2. You know, I'm always -- I sit in the chair of optimism, but I'm also realistic about it. We talk about African Swine Fever, Heather. I think collectively as a management team in our 30 and 40 years of global ag experience in our room here, we've never seen anything like that. We're starting to see a little bit of raw material trickle away and be frozen to be sent to China. That would be true if you're going to talk hogs head in Canada, some low-cut grade material here in the U.S.A. and in Europe and then you're seeing the scale-back of slaughtering in China right now, which is causing, if you will, pigskin prices to move up pretty rapidly here in Europe and in China today, and that's one of our gelatin product lines is based on that. That would cause some margin pressure, but I don't see anything there in the near term that can't be recovered. As I've said, it's a diverse model, it is spread-managed, it's got a little bit of lag in timing. But right now from our seat, in Q2 we see pretty solid momentum and don't see anything wheels off right now that's going to take us one way or another.

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

So you think it could be higher than last year for the core?

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

Gee, I didn't think you were going to make me answer that question.

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

I was -- you talked a lot and I think you hoped I would -- you would lose me, but.

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

I think we're probably today if you looked at -- I think we're going to do better than we did in Q1. And I see Q2 -- I think we're in the range. I don't -- I can't predict this thing down to $4 million or $5 million EBITDA.

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

Okay. And actually I was going to ask about the gelatin side. So I mean, to your point, so you're losing, let's just for round numbers, 1/3 of the herd in China. That's a ton of pigskins that are gone. And from what I understand, pigskins are the predominant feedstock for gelatin. So I was hoping you could help us understand how quickly you can pass through those -- that higher pricing?

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

Well, first off, you have to look at the 10 button plant system that -- we only have 1 pigskin plant in China. We've dealt with this before. So that to me, that doesn't worry me much. We're seeing -- what you do see is then the -- what the unintended consequence of a shrinking herd is that there are a portion of the population in China eat premium proteins, chicken and high-end pork cuts and then there's the other portion of the population that just eat meat, if you will. And meat can include pigskin. So they're coming back to Europe now to buy pigskin to -- as you would think in North America, your chicharons or fried pork rinds and the sense. But at the end of the day, we're watching pigskin move up rapidly in Spain and Poland. I think we're covered for Q2. The pricing pressure would come in Q3, and you just got to be careful in that business not to go out and take long-term positions where you don't own the raw material, and I think we're doing a pretty good job there. So really at the end of the day, you've got the plant in China, a couple of plants in Europe and then 1 plant in the U.S. on pigskin that's going to have to make some margin.

The other side of the trade-off is if pigskin gelatin prices move up, then that should help pull up the other prices of both the hide and the more bone gelatin plants around the world, and so there's a little bit of an offset there. Overall, what we've done and I think the more important thing in the Food segment is this has been the capital investments we've done into our new technologies to produce Peptan. We had a second -- one of these units come online down in Amparo, Brazil at the end of March. So we're diversifying away from commodity gelatin more into the specialty side and we're starting to see the benefits of that. And as we've said we've got another plant coming online in Angoulême, France and another one in Ghent, Belgium and then another one down in Brazil over the next 1.5 years that will once again help us move away and manage those margins and put up some better returns.

Operator

The next question will be from Ben Kallo of Baird.

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

So I just wanted to touch on -- and congratulations on the potential opportunity in Europe. I wanted to touch on the funding for the next expansion down at Diamond Green Diesel. And your wording just changed slightly, it might be just timing, but how you are going to fund the plant. So would you just talk through that? And is it a change because of the opportunity in Europe? Or what's driving that change? And how will you fund it outside of cash?

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

No, this is Randy, and I'll let John Bullock help me here if I don't answer it right. What we're looking out there is, number one, our goal is to get Super Diamond online as quick as we can. The land has been cleared, it's been filled, it's been wicked. We're driving piles here in about the next month and long-lead-time equipment has been ordered. And so at the end of the day, we're trying to do the best we can to accelerate and bring that plant to market. As any big project of this scale, if you remember back, that we built Diamond Green one in about 28 months from conception to commissioning. This one's got a little longer lead time on it right now in the original construction plan. So all said, when we added the word substantially to that, I was very much aware of that and I'm proud that you've picked that up. For us, it's just the timing issue. And at the end of the day, right now, Washington, D.C. is a mess, we -- you know, if you -- the last 2 conference calls I've used the word optimistic on the blenders tax credit, I kept that word, I still am. So at the end of the day, it's -- we're just trying to be very open with people that we don't know if the BTC if coming in, when or where, it can be attached now or could it be attached on an appropriations bill. And it's just a timing deal at the end of the day. If you look at it, we're going to run 275 million gallons this year and next year and then in 2021, we're telling you that 5-year historical margin at about $1.26 a gallon down there, we don't see any -- we're not wavering off of that, and then $1.1 billion on the construction. So you can kind of run your own model and say, given timing, given outflows, there may be or have to be a small funding that happens sometime in '20 or '21 and it's just the timing and we can either loan into it or put equity into it. And then immediately in '22, it would be pulled back out. So that's answer 1 to you.

The European opportunity, I think we have to a degree telegraphed to people that we're looking for a solution for our fats that we produce in Europe today both cat 1, cat 2, cat 3. And we obviously Preem is one of our large and very valuable customers today, we had worked with them for years. We're just in the early, early, early stages of discovering whether that makes sense and what it's going to cost and construction time frames. I think what it does to the marketplace in general is once again, it signals our confidence that the low-carbon fuel demand in the world is real and it's just not a California, an Oregon, a Washington, a British Columbia or Ontario market, it is a global market. We're going to start to consider shareholder capital into those markets to value add the fats that we have in Europe today.

All said, things take longer in Europe to construct and at the end of the day, the final investment decision there would be made in 2020, sometime mid- to late there. And so by then, the capital spend and the funding out of Diamond Green Diesel to fund that would probably coincide, if we do this project, like I said, very preliminary with the start-up and the commissioning of the bigger unit.

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

Got it. And then just two more. As far as the dividend goes from the JV, is that really a decision with the partner, I assume, because you could give keep cash there and fund the expansion with the cash flow rather than giving it up?

And then on a separate note, just the step up in the Food margin. Is that really driven by Peptan? And then can you talk about how sustainable that is going forward?

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

Yes. Brad, you want to talk about the dividend?

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

On the dividend, the partners have a formula for that, okay? So that is kind of an automated thing now as we start into the construction on Super Diamond. So that's why we say we do expect some further dividends through the remainder of this year.

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

And then on the Peptan side. Yes, Ben, I mean, our hope is that is a very sustainable margin as we diversify our product mix away from some of the low-end commodity gelatins that we were selling out there. So like I said, we've got the second finishing unit, spray-dryer done in Amparo, Brazil, came up end March and we start bringing on capacity over the next 6 months. And the margins continue to be attractive into the health, nutrition and biomedical markets that we're serving with those products.

Operator

And our next question will be from Ken Zaslow of Bank of Montreal.

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

One quick one. How much did you guys incur in weather cost in the quarter? I'm assuming you don't expect that to happen again. So how much was that?

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

I'm going to take a shot, Ken. I don't know that we can calculate that. I know that the flooding of the Nishnabotna, we had I don't know, 3,000, 4,000 tons of really expensive protein sitting on the ground there that went underwater. This is covered by both liability and the product insurance and then also business interruption. But to the income statement, we booked about $1 million in Q1 on that. The excess trucking cost, we had to drive around bridges in there, hard to calculate. But raw material, because we're picking up extra raw material that had perished during the flooding out there. And then the energy costs were probably somewhere -- in North America, somewhere between $500,000 and another $1 million and that gets all recovered in Q2 as we adjust the formula. So $1 million, $1.5 million in Q1 related direct cash cost that flew through the P&L is kind of the best we can guess at this time.

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

Okay. And then going back to the Food business, I think your highest margin since 2016. Can you talk about were there capital projects, were there -- was it just the Peptan business? Can you get a little bit more into detail of what the drivers were to make that margin? Is that the margin we should expect going forward? Just how do I think about that a little bit more clearly?

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

I think, number one, you've got -- we've been adjusting our product mix here for about the last 100 days. And we shut down our Hurlingham, Argentina facility that -- in, I believe, what Q1 or Q2 of last year, moved some of that capacity around, moved out some low-price sales, moved some higher-priced sales up, the expansion of our Peptan product line coming on, our fish Peptan, our hide Peptan products. And really at the end of the day, we're rebalancing our portfolio. It allowed us also in China to rebalance. We've also seen a rebound of our bone gelatin business from really the doldrums back to black margins, and really it's the rebalancing of the business around the world. We've always said to you that the cheapest gelatin in the world is the South American gelatin that's driven off of animal hides. And by us diverting a significant portion of that production now into our Peptan product line, we've taken some pressure off the market. So a long way of answering, margins are clearly going to improve. I always hate to say I can maintain a record pace after a record quarter. So I'm going to temper that a little bit but yes, they are improved going forward.

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

Great. And then can you talk about if the U.S.-China -- again obviously it clearly is not known, but if U.S. and China do actually have a resolution, which parts of your business and how do we frame that for thinking about how it would change the outlook for your business? And I'll leave it there.

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

Wow. I think the overall discussion, I've read a lot of comments of our different companies out there from ADM to Bunge to the different folks out there, the Smithfield or WH Group. We've never experienced anything like we're seeing right now. The initial impacts to Darling were twofold as ASF broke out. And really at the end of the day, about a year ago today was when we realized that ASF potentially could be bigger than most people could get their minds around because of our 5 blood drying plants in China. Our volumes were large as they rapidly slaughtered animals before they died. And then at the end of the day, the Chinese government came out with their ASF programs to -- and declared that you couldn't feed plasma back to baby pigs. And so we took the write down in Q2 or Q3 last year of our plasma back to basically hemoglobin. That maintains today, we're selling all the hemoglobin that you can want to sell to aquaculture but we lost a couple of thousand renminbi per ton of value into the plasma business.

The second thing that hit was China was a big importer of chicken meal or low ash chicken products for aquaculture. And what the Trump tariffs, those trades have ceased right now. And so that backs up some of that product back into the U.S., which kind of that narrowed the spread, if you will, of the premiums over the pet grade or over the feed grade. So, those are 2 direct impacts. Obviously, we can rationalize some of the impact of not exporting soybeans, the crushing industry was running crush margins in the U.S. of $1.30, $1.50 last year now running at $1, which is still pretty awesome, but it's the backdrop of the -- related to not exporting out of here. So that overall impacts the protein values that we get. There's ample protein in this country and there should be different products moving to China that aren't.

So if the tariffs go away, I think there will be a reopening of a lot of those products, I suspect it will take a little bit of time. At some point in time, you have to get your mind around, and I don't mean to be on my soapbox here, of how long it takes China to replenish the hog herd. Whether they've lost 10%, 20%, 30%, who the hell knows, at the end of the day, it's essentially equivalent to the entire U.S. hog herd that they have to breed and bring back. And that will just take some time, but it will create some incredible demand.

It will also shift meat production, I believe, personally, in different places around the world back to the U.S.A., back to Canada, back to Europe, back to Brazil, Argentina to feed that population. And so you're going to say different demand drivers along with some short-term demand destruction in China but you're going to say demand creation that hasn't been in other parts of the world as you grow more animals quicker and put more weight on them, which ultimately should be pretty positive to our business. But right now it's a little disruptive. Clearly, the direct impact into the Feed segment, into the P&L is the loss of value of the plasma business in China and then kind of the narrowing of the pet grade spread.

And then in the Food segment underneath the Rousselot business, you have the edible fat business. We're now watching slaughterhouses in Europe instead of sending us edible fat to mill, they're sending it in frozen containers, if you will, to China, which is one of those -- part of the Chinese tariff issues that exist today is, we can't export, if you will, packaged edible fat to China, it can go as raw material. So it's kind of an unfair situation but that's what's happening today. So overall, I think if we get the tariffs down, we'll see a pretty nice little rebound back into the global S&D for all of our products as we go forward.

Operator

And the next question will be from DeForest Hinman of Walthausen & Co.

DeForest R. Hinman - *Walthausen & Co., LLC - Research Analyst*

Can you just spend a little bit more time talking about the opportunity with Preem? How did that come about? Why does it make sense, I guess, on paper to do a project like this? And why are they the right person to partner with?

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

This is John Bullock. The -- first of all, we've known the Preem guys for a very long period of time. Wonderful, wonderful people, fabulous to do business with. They are the largest refinery in Sweden, have a lot of distribution into Sweden, and not only Sweden but also Norway. Those are excellent countries because they have extremely strong low CI mandates, which are exactly the type of markets that we're seeking to be able to move our low-carbon intensity product to. So they're an excellent partner from that standpoint. They have been looking at the renewable diesel now for some period of time. Obviously, we had a relationship with them that went back several years. And it was logical for us to get together and talk with them about the potential opportunity given the strength of the low carbon mandates that occur in the Nordic countries.

As far as why does that make sense for us in Europe? Well, in Europe, we have an oilfield just like we do in the United States. We have a lot of fat raw material that we produce in Europe, we're one of the largest European rendering operations. So it's a -- really we think it's just a natural, natural type of a fit.

Having said all that, I think as Randy emphasized, this is an early discussion that we are having with them to evaluate this opportunity and to make sure that it's the right opportunity for us. So we very much appreciate the opportunity to work with Preem on this through our Diamond Green Diesel joint venture. And we are in the process of analysis on it, a lot of macro considerations here make a ton of sense. But we are still working through whether this is the right investment decision for Darling.

DeForest R. Hinman - *Walthausen & Co., LLC - Research Analyst*

Okay. Just so I understand the wording, it would be a JV with the Diamond Green, so it would be a JV in the JV? So hypothetically, the economics would be a 25% ownership Darling would have? Is that the right way to think about it?

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

That's the right way to think about it.

DeForest R. Hinman - *Walthausen & Co., LLC - Research Analyst*

Okay. That's helpful. And then just can you give as an update on the legislative area in Sweden as it relates to renewable fuels, renewable biodiesel? And is there any protections either from imports, and anything that would protect that type of investment from palm oil-derived production?

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

This is John again. Again, the Swedish -- the Norwegian mandates for low carbon fuels are as aggressive as any place in the world. They are in the process now of modifying their pathways and what's allowed as far as a low carbon fuel into those marketplaces. And while it's unlikely that they will totally eliminate palm oil or palm fatty acid distillates, certainly the direction of both of those countries is that where that was primarily the renewable diesel feedstock that was used in those countries, we think there will probably less of that going forward, which is going to create opportunity for us, we believe, to help supply that market with the type of renewable diesel we produce out of our facility.

DeForest R. Hinman - *Walthausen & Co., LLC - Research Analyst*

Okay. And then shifting to the Food side, very impressive results there, see the margins come up after a number of years of lower levels. But when you talk about the opportunity and what's happening on the collagens, I think you call out collagen and Peptan. Can you just give us more color on the demand drivers? And what is really helping us get to that tailwind if that's in fact was occurring? And then just help us understand some of the investments that have been made and what the return thresholds were for those investments? And how they are performing versus those targets?

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

Sure. So if you think about it from just, and I'll talk really macro here, you've got a pharmaceutical demand for gelatin today and you get into hard caps and soft caps, that's a -- the hard caps are where your bone gelatin and then we operate plants in Massachusetts and in France and 2 of them in China today that predominantly serve the pharmaceutical market. You then move over to the confectionery at which time you will have both pigskin and hide gelatin move to confectionery and food, basically emulsification and gelatinization into the confectionery business.

And now you've got an emerging category that is rapidly developing out there in the health and nutrition and joint supplement markets both in drinks and in bars. And that's where as we've worked on this, this has not been a 1-year phenomena, we've been at this for, I don't know, 4 or 5 years developing a product line to meet the health and nutrition demand that we see coming for collagen and collagen peptides and hydrolysates going forward. So at the end of the today, how we're going to manage that, time will tell the here. We have committed to putting in finishing units, we've had 1 unit down in Brazil today, we started up a second unit there. We've got a third unit under construction at another plant in Brazil. We're looking at a unit in China today that's been board approved. We're looking at a construction of a unit in Ghent, Belgium. And then 2 units in Angoulême, France today to meet the growing demand around the world for health, nutrition and beauty aids of the product. So we see a very positive outlook going forward, it's a relatively new market that's rapidly developing. Return standards for this is obviously we think that we don't put capital in play or new capital in play that can earn between 15% and 20% margins on it. And so that's kind of where I'd leave it today, I don't want to educate the world too much on what we're doing but we're very positive on it.

Operator

And our next question will be from Benjamin Hogan of Inherent Group.

Benjamin Hogan

I've got 2 on Diamond Green and then 1 ESG. On DGD, can you provide a little bit more color on what exactly you're hedging there? There's obviously a loss in the quarter, I think it may have been a reversal from last quarter, but just some more color there.

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

Yes, this is John. Obviously, we have to buy our fat forward to be able to move it logistically in position to Diamond Green Diesel. And as we're buying that fat, we sell the base product, as we've discussed in the past, on our sales of renewable diesel, there's always the diesel fuel price. And so typically, we will hedge when we buy fat, we'll sell the diesel NYMEX market. And then as we turn around and load the vessels out, we will buy those hedges back. So the hedge result is primarily associated with NYMEX. Occasionally, we'll also hedge in soybean oil, but it's primarily in the NYMEX heating oil.

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

But Ben, you're spot on. I mean, as we referenced, we try not to get out there and tell people hedge gain, hedge loss. I mean, you got to average the $1.67 that was in Q4 with the $0.85 here and then you come to it. And as -- it was just a reversal of Q4 here on the pipeline.

Benjamin Hogan

Okay perfect. And then the Preem announcements obviously exciting, obviously early days there. How much renewable diesel are you guys shipping to Europe today from DGD?

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

This is John. We've talked about this in the past. We think it's inappropriate for us to talk about specific customers or product flows that we deal with. Just because of the confidential nature of our relationship with our customers and we feel it would be disrespectful to them to talk about that type of information. So I wish I could tell you that but it's not appropriate for us to do so.

Benjamin Hogan

Okay. But reading between the lines it sounds like it's not 0. You guys are able to access those markets today.

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

Yes. And I think different a way of framing the answer is if you go look at the Neste for last year, I think it's a very positive and it's once again I'm just reiterating to the family and the shareholders here that Neste made around, I don't know, 800 million gallons or whatever the number was, and I think about 140 million or 150 million came into the U.S. There's a very large low carbon fuel, renewable diesel market out there that they shipped around 700 million gallons to last year. And so we have access to that and we make the decision between shipping California, Canada, it's a global arbitrage decision as demand comes up for us.

Benjamin Hogan

Last question. On the last call, you brought up your corporate social responsibility disclosures, that you were planning to increase. And you just give some more color on which ones and kind of the timing for that?

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

Yes. And we're working with your help, Ben, we do appreciate that. This is something that is evolving very nicely for us. As you know, with a couple hundred facilities around the world and trying to make sure that while we all speak English, sometimes the numbers don't translate back to English. And so we're trying to make sure whatever we put out there is accurate. And so we started down the path with the clean air, clean water, safe food, safe feed and then into the social side down there. We are going to be updating those. I suspect you're going to see that we're going to put out both targets, benchmarks and improvements against them. We're going to include -- right now we're in the final stages of ramping up workplace safety such that we can report that and go forward from there. So it's in the early stages, I'm expecting by this summer for some real updated positions by us that will be meaningful, measurable and something that I think people can get their minds around. Brad, Melissa, you want to add anything to that.

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

No. I think you're...

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

Okay.

Operator

Next question will be follow-up from Heather Jones, Vertical Group.

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

So I just had a question on the LCFS. So it dipped into net credit generation in Q4. And John, I was just hoping you could help us how to think about it this year because you have, obviously, an accelerating compliance curve, but you also have accelerating production. So what is your thinking about '19 and to '20, does Q4 seem like a fluke and you would expect other quarters to be deficit-generating? Or how do you think about that?

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

Yes. I think the way to think about that is, first of all, in 2018 we worked at a 5% mandate. We're now at a 6.25% or 6.3% mandate. We also have to remember that in 2018 for a substantial period of the year due to the pull-out litigation, we got the diesel fuel pool portion of the thing, of the mandate, capped at 3.5%. That litigation has subsequently been lifted and I can't remember if that was third quarter or fourth quarter of last year, but it's been lifted now. So now the entire pool is at 6.25%. That's going to substantially increase the deficit generation that's occurring in California. And we should see a large increase in the amount of deficits that are demanded.

I think what you're seeing though that we view as extremely healthy on how the LCFS is developing is that as the market demand for credits increases, we see the amount of credits increasing into the marketplace. We see the market at $185, $186 a ton today, that's excellent from our perspective. The one thing we do not want to see is we do not want to see the LCFS credit spike well above the $200 number. As you know, CARB has talked about more hardening of that cap at the $200 a ton number, which is really not $200 a ton because there's $200 a ton plus inflation, which now puts it at $210 and or $212 a ton. And over time, that will go up by the middle of 2025 to $225 a ton. But the fact that this market is developing in such a healthy fashion and the fact that it continues to demand more and more product, renewable diesel, which is the primary product going in to satisfy those LCFS credits. We really like the way that, that marketplace is developing. It's developing in an extremely healthy fashion. As you know those mandates go all the way up to 20% by 2030. So they continue to move higher each and every year requiring more credits be produced. And obviously, California is a key market for us as we ramp-up production of Super Diamond. So, it -- very, very positive is how we see it.

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

Awesome. And my final question is, just wondering, why did China lift the ban on feeding blood plasma? I read, I think it was in Q, but I must've read it somewhere else that they lifted that ban. Did they determine that when it's dried, it's no longer harmful? Or?

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

Exactly. You've answered your own question. We worked hard ourselves and a couple other, APC, to show the science behind the kill step of the pathogen within the spray-drying units over there, and that they've deemed the product safe to be fed. Now that all said, we're not selling 1 kilo of plasma to the pig industry yet. So it's kind of -- they know that they have a herd replenishment issue coming on. You can take your mind around this thing and say, remember, from a demand destruction side, it really aren't a lot of the commercial feeding units that have biosecurity, it was the backyard family farms that lost all the pigs. Those aren't the guys that are feeding soybean meal or plasma. So they're just trying to get ready positioned with the right regulation in order to replenish a herd here over the next 1 to 5 years.

Operator

Ladies and gentlemen, that will conclude our question-and-answer session. I would like to hand the conference back to Randall Stuewe for his closing remarks.

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

Thanks, Denise. Appreciate everybody's questions today. As you know, we'll be presenting at the Citibank conference aside from Valero on Tuesday at about 8 or 8:30 in the morning, and then will be at the Ken Zaslow's conference on Wednesday coming up this week once again to tell the story and drive value for you.

So with that, we'll talk to you again here in August. Thanks so much.

Operator

Thank you, sir. Ladies and gentlemen, the conference has concluded. Thank you for attending today's presentation. At this time, we ask that you disconnect your line.