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Darling Ingredients, Inc. (DAR)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Darling Ingredients Inc. Conference Call to Discuss the Company's Third Quarter 2021 Results. After the speakers' prepared remarks, there will be a question-and-answer period and instructions to ask a question will be given at that time. Today's call is being recorded.

I would now like to turn the conference over to Mr. Jim Stark. Please go ahead.

James E. Stark

Vice President-Investor Relations, Darling Ingredients, Inc.

Thanks, Grant. Welcome to the Darling Ingredients third quarter's earnings call this morning. Participants on the call are Mr. Randall C. Stuewe, Chairman and Chief Executive Officer; Mr. Brad Phillips, Chief Financial Officer; Mr. John Bullock, Chief Strategy Officer; and Ms. Sandra Dudley, Executive Vice President of Renewables and US Specialty Operations. There's a slide presentation available, and you can find that presentation on the Investor page under the Events and Presentations link on our corporate website.

During this call, we will be making forward-looking statements, which are predictions, projections, and other statements about future events. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could materially differ because of factors discussed in yesterday's press release and the comments made during this conference call and in the Risk Factors section of our Form 10-K, 10-Q, and other reported filings with the Securities and Exchange Commission. We do not undertake any duty to update any forward-looking statement.

Now, I'd like to hand the call over to Randy.

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

Hey. Thanks, Jim. Good morning, everybody, and thanks for joining us this morning. Our core business continues to perform very well. For the third quarter, we reported combined adjusted EBITDA of approximately $290 million, of which $230 million was directly from our global ingredients business.

Like many companies around the world, we continue to face the challenges others are facing when it comes to labor, transportation and higher cost of operations. Our team continues to execute our business strategy and operate our facilities with great efficiency, while improving our gross margin year-over-year and sequentially from the second quarter of this year. I want to thank all of our employees who continue to dedicate their efforts in navigating the challenges we face in our daily responsibilities.

As it has been well stated, Hurricane Ida took a big bite out of DGD's performance in Q3. For the first time in eight-plus years of operating, DGD was shut down to protect the employees and the assets of the facility from this significant storm. The great news is there was little damage to the facility, which it took a direct hit from Ida. With the days of shut down and the restart process, we lost approximately 17 days of renewable diesel production.

Also on the great news front, the DGD Norco expansion is running well and is closing in on reaching its production capacity, putting DGD on track to sell 365 gallons (sic) [365 million gallons] (00:14:27) or more in

2021. We also believe DGD could sell over 700 million gallons of renewable diesel in 2022 as the engineering team continues to fine-tune the performance of this expansion.

The achievement at Diamond Green Diesel is only possible because of the hardworking employees, contractors and service providers at the facility. While many of these fine people suffered damage to their personal property and disruption to their daily lives from the hurricane, their resiliency to return to work and get the plant back into operation and finish the construction of DGD II was extremely important and exceptional. We truly appreciate their tenacity for getting the job done.

Also, during the quarter, Darling repurchased approximately $22 million of common stock. And for year-to-date, we have purchased approximately $98 million worth of stock. On a year-to-date basis, our global ingredients business has earned approximately $628 million of EBITDA, putting us at an annualized run rate of approximately $850 million for 2021.

With that, now I'd like to hand it over to Brad to take us through the financials. And I'll come back and discuss a little bit of our outlook and how things are going to finish up for 2021. Brad?

Brad Phillips

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

Okay. Thanks, Randy. Net income for the third quarter of 2021 totaled $146.8 million or $0.88 per diluted share, compared to net income of $101.1 million or $0.61 per diluted share for the 2020 third quarter. Net sales increased 39.4% to $1.2 billion for the third quarter of 2021, as compared to $850.6 million for the third quarter of 2020.

Operating income increased 61.4% to $205.7 million for the third quarter of 2021, compared to $127.5 million for the third quarter of 2020. The increase in operating income was primarily due to the $114.1 million increase in gross margin, which was a 53.8% increase in gross margin over the same quarter in 2020. Our operating income improvement was impacted by the lower contribution of our 50% share of Diamond Green Diesel's net income, which was $54 million in the third quarter of 2021 as compared to $91.1 million for the same quarter of 2020.

As Randy mentioned earlier, Hurricane Ida impacted gallons sold in Q3, resulting in lower earnings for DGD during the quarter. Our gross margin percentage continues to improve year-over-year and sequentially. Q3 2021 gross margin was 27.5%, which is the best result we have had in the last 10 years. For the first nine months of this year, our gross margin percentage was 26.8%, compared to 24.9% for the same period a year ago or a 7.6% improvement year-over-year. As you can see on pages four and five of our IR deck, gross margins have continued on a positive trend for the last four years, as our management team across the business has worked to increase the profitability of their operations.

Depreciation and amortization declined $7.9 million in the third quarter of 2021 when compared to the third quarter of 2020. SG&A increased $7.3 million in the quarter as compared to the prior year and declined $1.9 million from the previous quarter. The main causes for the higher cost in the quarter compared to a year ago are related to labor, travel and other. Interest expense declined $3.4 million for the third quarter 2021 as compared to the 2020 third quarter.

Now turning to income taxes, the company recorded income tax expense of $42.6 million for the three months ended October 2, 2021. Our effective tax rate is 22.3%, which differs from the federal statutory rate of 21% due primarily to biofuel tax incentives, the relative mix of earnings among jurisdictions with different tax rates and certain taxable income inclusion items in the US based on foreign earnings. For the nine months ended October

2, 2021, the company recorded income tax expense of $126.3 million and an effective tax rate of 20.2%. The company also has paid $36.9 million of income taxes year-to-date as of the end of the third quarter. For 2021, we are projecting an effective tax rate of 22% and cash taxes of approximately $10 million for the remainder of the year.

Our balance sheet remained strong with our total debt outstanding as of October 2 at $1.38 billion and the bank covenant leverage ratio ended the third quarter at 1.6 times. Capital expenditures were $65.6 million for Q3 2021 and totaled $191.7 million for the first nine months of 2021. As a reminder, this CapEx spend does not include our share of the capital spend at Diamond Green Diesel, which continues to be substantially funded by internal resources at DGD.

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

Randall C. Stuewe

Chairman & Chief Executive Officer, Darling Ingredients, Inc.

Hey, thanks, Brad. As our global ingredients business and Diamond Green Diesel continue to perform well, and as we indicated in our press release yesterday, we are maintaining our guidance for 2021 of combined adjusted EBITDA of $1.275 billion. There is strong momentum for our global platform as we finish out our best year in our history and look to build on that energy going into 2022.

I want to spend a few minutes on capital allocation. Over the last couple years, we have discussed our best use of cash at Darling through five points, and those really have not changed. Those five points are investing in DGD, growing our core business, reaching the investment-grade debt rating, meaningful share repurchases and potentially starting a dividend policy for our shareholders. It is our belief, and most everyone who is on this call knows, that our future cash generation will be large enough to address all of these points in our capital allocation plan. And we continue to work on the execution of this plan as our free cash flow generation continues to grow.

I do not need to point out that we did make the decision earlier to accelerate the construction of DGD Port Arthur, Texas, which puts a bigger capital spend on DGD in 2022. That does push out the potential size of distributions from the venture in 2022, but increases the potential for 2023. I do also want to add that our M&A funnel of opportunities to grow our low CI feedstock footprint around the world and grow our green bioenergy production capabilities is rising. This may adjust priorities in our capital allocation plan, but not limit our ability to execute on all of the points I already mentioned.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question today comes from Adam Samuelson with Goldman Sachs. Please go ahead.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Thank you. Good morning.

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

A

Morning.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

Morning.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

So I guess my first question is around policy and just thinking about some of the new incentives that are working their way through Congress in the Build Back Better Act, specifically the sustainable aviation fuel tax credit and then that clean fuel production credit post – for 2026 and beyond. Randy, I'd just be interested to hear how you see the opportunities for DGD around both of those and what the longer-term kind of potential contribution of those would be to the DGD entity?

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

A

Okay. Adam, I'll let Sandy take a shot at this for us.

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.

A

Hey. Good morning, Adam. First of all, I think we think it's very supportive of the biofuels industry. It is really a long-term commitment and one that says that biofuels are an important way to reduce emissions, which we've all known for a long time, but sometimes we don't seem like we get recognition for that.

In terms of the BTC extension, there are actually two things that I think that are positive with regards to Darling. First, there's the BTC extension as well as the SAF credit. So, first, on the BTC extension, that's a four-year extension at $1 per gallon. It's treated in the same manner as it is today, which is very positive. Then after – and that would go from 2023 to 2026. After that then, you have the clean fuel production credit that would go from 2027 to 2031, and the way we read it, possibly to 2034.

What we're seeing is that then becomes a production credit. That's $1 per gallon that's adjusted annually for inflation and then subject to a CI adjuster as well before there's a step down in credit value. And that step down in credit value is based upon whether or not a certain emissions reduction has happened or we've gotten to the year

2031. So, gosh, that's just enormous support in terms of what we've been doing today and what we expect to do going forward.

In terms of the SAF, you also have a credit there for four years. It's what we are reading $1.25 per gallon up to another $0.50 per gallon, depending on the CI. Under that, you'll have to have a life-cycle reduction of at least 50%, as determined by [ph] ITO (00:13:31) or a similar methodology. After 2026 then, you have the clean fuel production credit that kicks in and that would go again from 2027 to 2031, and again, possibly to 2034, depending on whether or not there's been a step down. Again, it becomes a production credit. Then the credit goes from $1.25 to $1.75. Again, that would be adjusted annually for inflation and then subject to a CI adjuster as well as the step down.

All of that is just so supportive of reducing emissions and supportive of the direction that Darling is going and DGD.

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

A

Yeah. Adam, I think – this is Randy. I mean, I think Sandy did a really detailed, nice job there of explaining. I mean, overall, the legislation that's out there and, if you will, the Build Back Better or social spending plan that, I think, has a pretty high probability of moving forward is probably the single most bullish thing that we've seen in many years here that gives certainty of our participation in the climate change discussion. I think Sandy was very subtle and hopeful you picked it up, but I'll make sure you pick it up. She said the word producers or production credit. And so, that's a very key principle in here that gives extreme favorability to US assets.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

That's really helpful color, Sandy and Randy. And I guess, as a follow-up, just as you look at DGD kind of with the Norco expansion just about done, Port Arthur coming in 18 months or so, how are you thinking about both scope for opportunities to reduce the CI scores of your own production, and then incrementally just thinking about SAF and what it would take to actually start making that fuel?

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.

A

Yeah. So I think we're constantly looking at trying to reduce our CI scores. There are a number of ways that we're doing that. I think that we can start with our feedstocks too. So we're looking at ways with our feedstocks of helping reduce the CI scores. But then, internally, we look at that all the time and try to make adjustments to our processes that allow us to do that. And so it's just a constant thing on our mind.

In terms of SAF, where we're headed, I think we've constantly said that we're really excited about SAF, but we need the right economics. And to that end, we've reviewed the capital required, we've studied the yield profiles, we've talked to the logical markets, we've done the preliminary engineering and we've evaluated the economics. I will say, just as we were talking about, the Build Back Better bill appears to be really serious about trying to grow the SAF industry, and we're really excited to see that. But yet, unfortunately, the legislation is not yet finalized. So we have to see it before we can make any decisions. Assuming that the final economics are supportive, we look forward to expanding our role in terms of low carbon solutions.

And I think what you've seen from Diamond in the past is that when we make an announcement, it's well contemplated and we're serious about it. It's not just an announcement that we want to get something out in the press or have an ESG story; it's because we plan to do it. And so, at the end of the day, we've done our homework, and once things are finalized, we should be able to let you know relatively quickly where things stand. I'm hoping that's in Q1 of next year. That said, I hope that we can become a part of the SAF movement soon.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

All right. I appreciate all that color. I'll pass it on. Thank you.

Operator: Our next question comes from Prashant Rao with Citigroup. Please go ahead.

Prashant Rao
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Good morning. Thanks for taking the question. I wanted to...

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

A

Morning.

Prashant Rao
Analyst, Citigroup Global Markets, Inc.

Q

...pick up on – good morning. I wanted to pick up on something you said there, Sandy, about an ESG narrative and then also with sort of the legislative environment, what the push is here broadly with this administration and globally. Darling has a very compelling ESG and sustainability story. And Randy, [indiscernible] (00:18:00) before that there's a – 2022 might be the year that there could be some clarity around the messaging, so that the market gets that.

I was wondering if you could help us maybe think about that just beyond just decarbonization, other – land use, water use, other factors, and the highlight in the Darling story that you think sort of this might be the time to really emphasize those. I was wondering if you could help us to think about how you think about messaging that and sort of leveraging [indiscernible] (00:18:28)?

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

Yeah. This is John. It's an interesting point. We have long viewed ourselves as an ESG company because, quite frankly, almost everything that Darling does is a carbon capture story, which in a world that needs to reduce carbon emissions is a great thing. I think what's more interesting than that, though, than just the fact that historically we happen to be standing in the right place at the right time, is I don't think there's another company out there that has actually moved as aggressively to help the world reduce carbon emissions as Darling has, not only with our Diamond Green Diesel, but also the actions that we're taking internally to help reduce water usage. The fact of the matter is we recapture much water associated with our rendering operations.

We have a really broad-based ESG story. We have – as this story has evolved and part of this is ESG is a developing concept, and there's been a lot of moving pieces on how people view and how people judge that. We're working hard internally to trying to clarify our messaging around this issue because, at the end of the day, once you pull all the curtains back, the reality is there's no company out there that's doing more in relationship to the ESG story and the ESG movement than Darling is and has been doing for several years now in preparation for it. So I think it's a matter of getting the messaging out there because the story is absolutely rock star. Randy?

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

A

No, absolutely, John. And Prashant, as we did during your conference, I mean clearly, 2022, we will be spending a lot more time talking about the initiatives that we have around the world from water intensity reductions. We're looking at different technologies in the gelatin business, which is a huge water consumer; water recapture for crop production; energy intensity. Clearly, when energy is cheap, no one really spends a lot of time thinking about this stuff. And all of a sudden and over the last year, we've seen energy move up 40% to 100% different parts of the world. And so, once again, it's going to get more and more attention. And then clearly, in the labor world, we've got to get smarter there as the world is at full employment. So, I think it's a great time for us. I appreciate you bringing it out. I'd tell you to stay tuned and we'll bring you more here in 2022.

Prashant Rao
Analyst, Citigroup Global Markets, Inc.

Q

Appreciate that, John and Randy. And just one quick follow-up, I just wanted to touch on capital allocation for next year. Randy, you – great to hear the reconfirmation of how you think about these things. I just wanted to check, when you think about 2022 specifically, given the acceleration of Port Arthur and the distribution up to the partners might be have to wait until we see DGD III up.

How much – when you think about inorganic growth in 2022, I just wanted to sense check where your appetite is and what room there might be on the balance sheet should you need to go there on the debt side to source capital for a potential inorganic growth, bolt-on or something like that? I'll leave it there.

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

A

Wow. That's a great question. And I'm getting lots of stares in the room here. Now the fun part is we're clearly, as we're trying to decode and telegraph, we're seeing more M&A opportunities multi-continent than we've seen in the last three to four years. Can't really address them yet, can't tell you if they're going to be fair priced and if we're going to get them home. Clearly, our – as we think of our business today, we want to continue to build the moat around the machine, and the machine is this giant ESG story. And how do we do that? By procuring and securing additional low carbon feedstocks around the world.

So, we're looking hard. Obviously, the acceleration of DGD III, it's both kind of a blessing and to the degree not a curse, because what it means is, is it'll be online in early 2023 we hope. And once again, a source of – it'll be completely funded and de-levered, and it will give Darling unlimited cash generation capacity at that time, a high-class problem. Between now and then, we've got plenty of availability within our credit agreement, within – maybe some modifications to it if we need to here. Clearly, as Brad said, we're down to a 1.6 leverage time ratio, if not headed lower even yet this year. And so we have plenty of room to do what we want to do in 2022 and then pretty much a high-class problem as we say in 2023 here.

Prashant Rao
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thanks, Randy. Appreciate the time, guys. I'll turn it over.

Operator: Our next question comes from Tom Palmer with JPMorgan. Please go ahead.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Good morning and thanks for the question.

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

A

Good morning.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

Morning.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

We've seen animal fat prices move a bit higher. Used cooking oil, corn oil haven't really followed to the same extent. Curious what your view is on that. Do you expect the price gap for UCO and corn oil to converge with tallow over time? Or are there constraints to consider when it comes to the pricing of these other feedstocks?

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

Yeah. This is John. Yeah, I think, in general, what you're seeing is this trend that waste fats are a valuable fat when we're trying to reduce carbon emissions in our fuel supply. And so, you've generally seen those move higher. I wouldn't take too much note in any type of short-term movements on the relative price of UCO and corn oil and animal fats. They all carry slightly different carbon intensity scores. But essentially they're all substantially better than vegetable oils are in relationship to their value and the low carbon intensity fuel cycle. So, I think this market – it's a big market and it's an evolving market. I wouldn't get too excited about short-term type of differences between the fat prices.

The general concept that waste fats are valued in low carbon fuel markets is a fundamental truth now and is going to be a fundamental truth for a very long period of time to come. And that's essentially the oil fuel that Darling sits on top of is a low carbon source of fuel for low carbon fuels.

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

A

Yeah. And I would say, Tom, this is Randy, I think John said it very, very well. As Sandy pointed out, SAF is going to give preferential treatment to low carbon feedstocks. Once again, that's us. When you look at the low carbon pool of feedstocks both in North America and around the world, We're now trading well above the chloric value of corn, which has always been kind of the baseline of where it could go. And so, at the end of the day, DGD II, we kept telling you, keep in mind, it's buying 40% of North America's feedstock today. And so it is clearly firmed prices for us, but it's also – there's plenty of feedstock out there for us to accomplish what we want to at number two and number three.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

Great. Thanks for that. And last quarter, you laid out an EBITDA outlook for 2022 of $1.6 billion to $1.7 billion, and I think it was kind of $850 million from the ingredients business, $800 million from DGD. Is this still the outlook?

You did increase your production, I think, at least by a little bit at DGD. Does that affect the outlook at this point or kind of still the prior one?

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

A

No. I think we're kind of still – there's been a lot of fluctuations clearly in margins with the disruption of Ida, RINs moving up, LCFS moving around, heating oil moving around. I mean, we're still going to – we came into the year telling you that we would operate around $2.25 a gallon, maybe a little more in DGD. Clearly, 17 days offline didn't help us there.

But as we go forward to next year, I think we're pretty much where we said we would be at this time. So I feel good what I see right now. If you think, as we said, the base business this year should finish up around $850 million, plus or minus a few dollars there. And then you sit there and say, okay, $750 million then coming out or $700 million coming out of DGD next year, which would be $2 a gallon at 700 million gallons. I mean, that's the simple math we're doing today. I don't see any real change in that forecast at that time.

Thomas Palmer
Analyst, JPMorgan Securities LLC

Q

Great. Thank you.

Operator: Our next question comes from Manav Gupta with Credit Suisse. Please go ahead.

Manav Gupta
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey, guys. I want to ask a policy-based question. You do talk to a lot of people at CARB and you talk to the high-level people in CARB. And again, there are some estimates out there which are saying; A, number of projects are coming on, which we don't think all of them are coming on, but there's a bare thesis floating around saying that LCFS price could drop to $80, which would not be good for the entire program of LCFS, investments will be curtailed back.

In your opinion and discussions with CARB, do you think they will be supportive of a decent carbon price? I'm not saying high or low, but would they try and at least set the expectations where people who are investing in these lower carbon projects would get some good returns? And so, will they try and support the price of carbon? That's what I'm trying to ask.

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

A

Go ahead, Sandy.

Sam Margolin
Analyst, Wolfe Research LLC

A

Yeah. So, Manav, this is Sandy. So I realize everyone's very focused on LCF as credit prices these days and the direction they've taken lately. I think, in Q2, we saw LCFS credit exceed deficits. And over the last few months, we've seen a general decline in LCFS prices. Within the market, we've seen things going on. We've seen weakness in California, gasoline and diesel demand versus historical levels. And we saw the same thing really over in Europe as well. And that may be even more pronounced.

That resulted in more renewable diesel volumes being shifted from the European market to the California market, which we saw in terms of increased imports, not further weighed on the market, I believe. We also saw increased credit generation within a number of categories recently. And we've heard about a number of projects that are planned to take place.

But keep in mind, we also have seen credits exceed deficits off and on over time, and there's been a general decline in the credit bank since 2017, 2018. We also recently saw Governor Newsom calling CARB and the CUPC (sic) [CPUC] (00:29:52) to achieve carbon neutrality by 2035, and that's a whole 10 years earlier than was originally planned. That's a huge task, and it's going to require significant carbon reductions.

We've been hearing that CARB is contemplating ramping up its carbon reduction targets, in answer to your question, and we've recently seen too that the 2020 average credit [ph] crude (00:30:15) intensity exceeded the baseline, and that's going to be added to the regulated party's obligations for 2022 unless something changes during the comment period.

And we've also seen, don't forget, that some projects have been delayed or scrapped. We've seen Washington State passing LCFS, although granted there's still some work to do in terms of implementing the transportation package. We also know that Canada will be implementing LCFS in the not too distant future. And we know other states are looking at implementing LCFS-type programs, like New York and New Mexico. And then finally, we've seen Europe propose some significant mandates within its Fit for 55 suite of programs. And all of these carbon reduction programs will be competing for low carbon credits going forward.

So, sometimes I think when we look at events or trends over the short period of time, we get focused on those temporary trends, and John kind of spoke to that earlier. And so we don't necessarily always see the broader picture. So I'm not entirely sure that we're seeing an inflection point here with the LCFS, because there's a number of things coming down the road that I think should be bullish on credit prices. But we like everybody else are going to continue to monitor that.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

And if I could just add on top of that, Manav. We're actually extremely pleased to see that the LCF credit market has not challenged the maximum ceiling pricing. I think what we've established now, and this is really going to help the long-term low carbon fuel programs in other jurisdictions move forward and help California increase its mandates, is these things are successful. The market brings new low carbon alternatives into the marketplace, and we have a vast array of other government entities that are thinking about implementing low carbon fuel standards.

Quite frankly, the success in California and the fact that the market has responded with low carbon alternatives, not only renewable diesel, but other, is extremely positive for expansion in these programs. And the expansion in these programs provides a much more stable base and long-term viability base for what Diamond Green Diesel is and for what Darling is as a supplier of low carbon feedstock.

So, we very much like how this is working and we think this is good news. And I know everybody obsesses about the bad news and what's the impact going to be on per gallon this quarter and all that good stuff. The fact of the matter is it's indisputable. The pattern that's being laid out here is extremely positive for what we have at Diamond and what we have at Darling.

Manav Gupta
Analyst, Credit Suisse Securities (USA) LLC

Q

Perfect, sir. I'll stick again to a little bit of policy again. And I know Reuters came out with some numbers and there was a knee-jerk reaction that the Biden administration is probably going against biofuels. But when we dig deeper, it's very clear that they may not be fully supportive on the ethanol side, but when we look at the advanced biofuel, renewable diesel, biodiesel, there's almost a 2 billion gallon increase that they're proposing.

So I understand it's a leaked document, but wanted your views as to do you generally feel when you're interacting with Biden EPA, they may only talk electrical at the top, but down under do you think there is support for biofuels within the Biden EPA administration?

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

A

Go ahead, Sandy.

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.

A

Yeah. I do think that there is support within the biofuels – or for biofuels within the Biden administration. I think you see that within the SAF credit that we saw. Yesterday, there was a new report that was released, the 2021 Aviation Climate Action Plan, that's very supportive of SAF going forward. And it's a whole host of programs that support SAF. In addition to that, I think what you've recently seen too is you've seen a potential long-term extension of the BTC. So, I do think that that's very supportive for us as well. So, I do, I think there's...

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

Let me just add on. And this is John. In relationship to the RVO question, the fact of the matter is you can't just look at what Biden administration is doing with RVOs. I think your point, Manav, is right on. It's quite clear that they are going to be ramping up the mandates for the biomass-based diesel part of the program and for the advanced categories. That's extremely positive for us. The other thing that I think that you've got to take into consideration here, it's just not the RVOs, it's what do they do with the SREs. And as we saw, they just denied an SRE. I think the general noises we hear is that there's not going to be the level of grounding of SREs. That's very important to the S&D and RINs.

And then finally, there's this historical question, there are some folks that are obligated parties that are behind on the RINs compliance. What's the administration going to do and the courts going to do in relationship to those issues? So there are a number of balls bouncing. We see nothing that tells us that the Biden administration has anything less than totally positive and committed to reducing carbon emissions in fuel. And the answer today for reducing carbon emissions in fuel are biofuels, specifically biomass-based diesel is the primary driver of that.

So we think the support is there, absolutely. We know that there's going to be some confusion when these RVOs come out, because when you think about it, the EPA had to address the issue that gasoline consumption had reduced dramatically during COVID and that the standards had been established on a pre-COVID basis. They have to figure out how to adjust that S&D. As they come out with the new rules, that's going to create some controversy, it's going to create some sparks. But we think where we are positioned in relationship to biomass-based diesel is on extremely firm ground and we should see excellent support for RINs moving forward.

Manav Gupta
Analyst, Credit Suisse Securities (USA) LLC
Q

Thank you for taking my question. And I'll just say that you took a bad hit from Ida, but you maintained your annual guidance and that is very commendable. Thank you for taking my questions.

Operator: Our next question comes from Ben Bienvenu with Stephens. Please go ahead.

Ben Bienvenu
Analyst, Stephens, Inc.
Q

Hey. Thanks. Good morning, everybody.

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

Morning, Ben.

Ben Bienvenu
Analyst, Stephens, Inc.
Q

I want to follow-up on Adam's question that was around SAF. And I don't want to put the cart ahead of the horse because I know we're still ramping DGD II, we've got DGD III. Sandy, you talked about wanting to get a little bit more clarity around the policy to support the production economics with SAF, but noted the merit of the fuel in reducing greenhouse gas emissions. John, I think you talked about having all of the feedstock availability you need to ramp DGD II and DGD III. In addition to production economics, how does the feedstock component of the equation figure into your decision around what to do with potential involvement in SAF?

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

Go ahead, John.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.
A

Yeah. Are you asking – I'm not sure quite what you're asking us. Are you asking...

Ben Bienvenu
Analyst, Stephens, Inc.
Q

Is there going to be enough feedstock available to pursue both the build out of SAF and renewable diesel? Because it seems like renewable diesel alone is going to suck up most of the fat oils, greases available to make low carbon fuel?

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.
A

Yeah. Yeah. So we have kind of two paths we can go down here. One is we can convert some of our current, or in process of being expanded or built, renewable diesel capacity for the road. We can make some of that SAF if we want. So we have the alternative of essentially diverting some of that road fuel to SAF if we want to do that. That clearly is possible. We also have the possibility of building Diamond Green Diesel IV at some point in time in the future and making it part of that products from that unit being SAF as well.

Both of those roads are open to us in the future. I think it's more likely than not that if we were wanting to move rapidly into the SAF marketplace, and I'm probably jumping a little bit ahead, but we would probably want to take some of our existing capacity and create optionality around SAF on it. We can get there a little quicker than we can with the new unit. But we'll see what all that leads to. We don't have to pre-judge any of those conclusions yet.

The fundamental thing is we have our homework done, right? So, once we see how these policies finalize, and they're not finalized yet, and there's a lot of very important details that go into these tax credit bills that you've got to take into consideration as to whether – how valuable they are in terms of your production economics. We'll see how they finalize. We've got the rest of the homework largely done. And then we'll sit down with our partners, then have a discussion about what we want to do. But the most rapid method would be to divert some of our current renewable diesel production to SAF if we wanted to get there pretty quickly. The decision on Diamond Green Diesel IV, we'll just have to evaluate as we go forward.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Yeah. Okay. Thanks, John, and understood. Appreciate the thoughts. Shifting gears a little bit and thinking about the food ingredients business, you guys continue to expand margins there. That business has been – food ingredients has been kind of the unsung hero, I think, over the last year, given the focus on DGD and understandably the enthusiasm there is warranted on DGD. Where are we on the curve of continuing to expand margins there? Any thoughts you could offer on the food ingredients business would be helpful.

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

A

Yeah. Ben, this is Randy. I mean, clearly, there's been a parallel strategy. While seems like 80% of the calls are DGD and rightly so, quietly we've been transforming the Rousselot business from basically a gelatin supplier to a collagen company. And it's a two- or three-pronged strategy there with the Peptan being the collagen peptide that's out there now on the shelves around the world, predominantly in North America, being launched in Europe today and Asia with extreme growth potential, double-digit growth potential, driven by basically its solubility and solution here for different product applications.

And so, we worked long and hard. We always talk a little bit, and I have to give a little pitch, Darling is an innovation company. We've been working on collagen peptides for, I don't know, almost nine years and we got it right. And we're building – we've got our four plants running, contemplating another one. That's Phase 1, Phase 2. You heard us roll out our discussion on biomedical. That would be our X-Pure. And then we're also starting to work on different tissue regeneration and organ development off out of the biomedical area.

So, long story short, we're in a three- to five-year window of margin expansion and growth in that business unit as we go forward. We've taken little headwinds with COVID against the collagen peptide business as the world shut down and the supply chains got screwed up. And then now we're – and then we're struggling a little bit, to be honest, in South America today. The different raw materials that the products are produced from are very tight and the raw material prices have escalated 200%, 300% from where they were a couple years ago, as the number of cattle being processed in South America has declined, both due to availability and labor and COVID and all of the above.

So, long story short, it's got a great trajectory. Stay tuned over the next three years. We keep throwing the breadcrumbs out there. It should accelerate nicely again next year and I think that's why Jim Stark's been very comfortable to talk about earnings growth next year is, is that business expands.

Ben Bienvenu
Analyst, Stephens, Inc.

Q

Okay. Thanks, everybody. And good luck with the rest of the year.

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

A

Thank you.

Operator: Thank you. Our next question comes from Sam Margolin with Wolfe Research. Please go ahead.

Sam Margolin
Analyst, Wolfe Research LLC

Q

Hey. Good morning.

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

A

Good morning.

Sam Margolin
Analyst, Wolfe Research LLC

Q

Wanted to just follow up on this ingredients M&A question, and I recognize that there's some competitive elements at play and you might not be able to reveal too many details. But, in the past, you've talked about how valuations in the private universe of this industry were just sort of prohibitive relative to where Darling was trading and it was undervalued, and so you're awaiting for that to bridge.

And I just wanted to ask about how that was playing out. Is the ask for private acquisition targets coming down because they're not capitalizing today's prices? Or are there new sort of synergies and value creation tools that Darling has to pull that unlock more value? Just anything on what is kind of opening this window on M&A that's new relative to the past, call it, three to five years?

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

Yeah. This is John. I'm not sure there's a lot that's new out there. I mean, I think what we've said in the past is when valuations get too high, we always have the opportunity of building, and we've done a lot of that with Diamond as well as in our core business. I mean, the fact is that the last four or five years, typically every year, we've had anywhere from four to six plants under major expansion or greenfields going in under our non-Diamond Green Diesel business around the world. So, we've always had that alternative.

Having said that, I think we're an aggressive player in terms of acquisitions out there, and you're going to see us be aggressive in this round of companies that come up for sale. And I think, we'll – we always maintain price discipline. We see sometimes prices go in on businesses that are just simply ridiculous and non-sustainable going forward. We won't do that. But at the same point in time, I would anticipate you will see us being an aggressive participant in this round of acquisitions. I don't think you can count us out in these deals.

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

A

No, and I think that's well said, John. I think the thing – as we get a chance at looking at lots of different businesses around the world, remember, other than since last December, there's been some pretty strong headwinds in these businesses around the world. And so, they're having a little better year this year. We're having a great year. Families make decisions at certain times and especially when the business turns, it might be time to sell. We're seeing a little bit of that around the world.

Also you've seen the platform that John referred to is we have the ability to take many of the products streams that come out of the slaughterhouses and the slaughtered animal byproducts business to their highest and best use. And I know that's kind of an over-clichéd term. But whether we're making organic fertilizers, whether we're making pet foods, whether we're making heparin, there's all kinds of things now that as we have the platform built, we can bolt-on these companies and turn them into something a little different than they were.

So, we do have a little different proposition than we had. But as John said, price is price and we stayed on the sidelines when things got up into the big double digits here four, five years ago, and we will maintain that discipline as we go forward.

Sam Margolin
Analyst, Wolfe Research LLC

Q

Okay. Thanks for that color. Appreciate it. And then just one more follow-up on ingredients and margins. And I'll revert questions that investors have asked me, which is that, as rendered fats maybe take another leg higher because, to your point, CI becomes an input factor in their value to a greater extent and that manifests, there's been some questions that your suppliers, the slaughterhouses will notice that and margin expansion might see some friction as a result. And I just want to know what your thoughts on that are. If that's something that you see as a risk that, in other words, your margins won't participate with pricing in the next leg?

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

A

No. I think we've been clear for about 18 years that a significant amount of our raw material procurement is on a shared commodity basis. And so they're getting the benefit of those higher CIs and those values. So, end of the day, that's being passed on already. Where we're getting our margin expansion is really in a lot of the different specialty products that we make out there and are able to transform. That's the capital we put in play over the last five-plus years. So I don't really see any pressure there.

I mean, from time-to-time, if you said what is the pressure you have around the world? It's energy prices, it's labor prices. The sales price of our products today have basically nothing to do with the inflationary issues that are happening around the world. Those are the challenges we're facing on margin here is, can we expand out our processing fees, our collection fees, our service models to recover those higher operating costs.

So – but the CI side or the feedstock or protein price, remember the meat companies for the most part are all making a lot of money too. And part of it's coming from us as we're able to glean and give them more money.

Sam Margolin
Analyst, Wolfe Research LLC

Q

Got it. Thank you so much. Have a great day.

Operator: Our next question comes from Craig Irwin with ROTH Capital Partners. Please go ahead.

Craig Irwin
Analyst, ROTH Capital Partners LLC

Q

Good morning, and thanks for taking my questions.

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

A

Hello.

Craig Irwin
Analyst, ROTH Capital Partners LLC

Q

Randy, $95 million higher feed segment margins is a beautiful thing, right? It looks like roughly two-thirds of that came off at some used cooking oil. You're driving part of that with DGD II, right, taking 40% of the feedstock off the market. But can you maybe talk us through what you see as the primary drivers of that margin expansion? And has this commissioning of DGD2 had full impact on the market yet for fats and oils? I know the biodiesel guys benefited last quarter from the backup with Ida, right, in the supply chain. But how does this play out in core operations in the fourth quarter?

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

A

Yeah. And I'll tag team this with John a little bit. End of the day, on a macro basis both North America and globally, strong fat prices. I mean, there's just solid demand for low CI feedstocks. Clearly, we learned how fragile that business is again with Hurricane Ida when it becomes basically a mono-customer business, meaning Diamond Green Diesel and all of a sudden Diamond Green Diesel goes offline for 17 days. And when we were offline, what needs to be understood, offline means we could run, we just didn't have electricity. And if you don't have electricity, you can't unload railcars. And so, then you get this screwed up logistical pipeline. And so, we had to defer stuff to fourth quarter here. We had to pay people to not ship and all of the above. And so – but they were still having to move product to the market. So, that's your biodiesel guys.

So, I guess, my shorter answer on the fat side, you start – you've seen prices rebound as the supply chain gets back into Diamond Green and we start to truly operate at these new levels. The protein side is really one, specialty proteins remained very strong. Pet food demand is robust. The challenge is really logistics around the world, nothing that you haven't seen on the news channels every day of container freight. It isn't even really about pricing, it's availability. And so what we've seen on proteins both here and in Europe is the challenge has been to get it out of their primary market to the consumer has been really impacted. Thus, you got to sell it to somebody, and how do you do it, that's the word commodity, you've got to price it back in to somebody else's use.

So, as we go to 2022, we see fat prices where they're at today, firm. And protein prices should be pretty steady, maybe improve a little bit. It will depend on the soy crush around the world, but as we've all seen, we've got robust crops all around the world. And so – but remember, meat demand and meat production is really solid out there today. So, from our business model, raw material volume should be solid next year, fat price is good, protein price is steady.

Craig Irwin
Analyst, ROTH Capital Partners LLC

Q

Excellent. Thank you. And my follow-up question. So, roughly dozen renewable diesel plants out there that want to come online. Maybe we get half of those that actually work and do produce, right? But many of those companies are approaching feedstock suppliers, either soy crushers or others, for long-term commitments for feedstock. There's even conversations about processing agreements because they don't want to put out the CapEx to process for their own facility. Can you talk about whether or not you're in conversation with any of these let's just call them spec plants? Is there a possibility we see a long-term offtake with any of these third parties?

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

A

I don't know, John, do you want to take that?

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

So, are you asking if Darling would contract with somebody who is building a renewable diesel plant that will compete against Diamond Green Diesel? If that's the question, I can answer that in one word, no, we would not do that, of course. I think the answer is this, yes, there's a lot of conversation and there's a lot of folks running around trying to figure out, quite frankly, how to recreate what we've got at Diamond Green Diesel. The fact of the matter is we've positioned Diamond Green Diesel, we said this time and time again, on the right location with the right capabilities with the right logistics to be able to hit the right markets. That means that Diamond is always going to be the best place for fat to go in the North American marketplace. Now, people can talk all they want about cutting deals to do something else, but basic economics are basic economics.

And I think the other thing that's important to consider here, and this question was kind of alluded to earlier in this, at the end of the day, our fat suppliers going to get a part of the margin of the renewable diesel business. The fact of the matter is they do because the renewable diesel business is creating a higher price for fat. However, I have – no business in the world that invests a capital and then turns around and gives away its margin to somebody who hasn't put any capital in it. And there seems to be a lot of conversation around that particular concept. That hasn't worked in American capitalism for 200 years. I doubt it's going to work in the next 10 years that way.

So, at the end of the day, this is great for fat suppliers. We're well-positioned. We're going to buy the fat because we're in the right location with the right capabilities. And that's how the economics are going to work going forward. People can have all sorts of conversations about all sorts of stuff. But at the end of the day, economics are economics.

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

A

And keep in mind, Craig, I mean the thing that we feel so strongly about is it's the ultimate real estate play, location, location, location. And the ability for Diamond Green Diesel to originate raw material from around the world is just unheard of. No one else has that ability to unload ships directly at their dock, whether it's Port Arthur, whether it's Norco, with fat from Brazil, fat from China, fat from Australia, fat from Europe, wherever it works. So, as we look at this deal, as some of the petroleum guys are out there making deals with soybean crushers, good luck. I mean, at the end of the day, the CI is terrible; and B, the economics rule here and will give us a very strong margin going forward.

Craig Irwin
Analyst, ROTH Capital Partners LLC

Q

That's a forceful answer. I like it. Thank you, guys.

Operator: Our next question comes from Matthew Blair with Tudor, Pickering, Holt. Please go ahead.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

Hey. Good morning. Congrats on the strong results. Randy, you had some comments on [ph] exploring spendings (00:55:34) in 2022 and I'm just hoping to clarify what the spend at DGD will be next year. At one point, we were thinking $350 million, but sounds like it might be more. And then also, could you lay out any numbers for what the Darling stand-alone CapEx would be in 2022?

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.

A

Okay. So I think that that one's for me.

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

A

Yeah. I'm going to let you to answer that, Sandy.

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.

A

But I'll be honest, I struggled – we struggled, all of us here, with hearing that one. So, I apologize. Can you help me go through that a little bit further?

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

A

Capital spend for DGD for 2023.

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.

A

So, capital spend for DGD for 2023 should be around $800 million.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Q

2022.

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

A

2022, I'm sorry.

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.
A

I'm sorry, 2022. So, that's what I meant. Yeah.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.
Q

Around $800 million.

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.
A

Around $800 million.

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

And then our base business, what, we're at $275 million to $300 million?

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.
A

$275 million to $300 million. Yes.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.
Q

Okay. So, $800 million for DGD and $275 million to $300 million for Darling stand-alone. Okay. Sounds good. And then, Randy, you reiterated the overall EBITDA guidance for 2021, but do you have any updates for the segment-level guidance? If we take the previous numbers, it would imply that the feed would be coming off quite a bit quarter-over-quarter in Q4, whereas food would be moving up. Is that the right conclusion?

James E. Stark
Vice President-Investor Relations, Darling Ingredients, Inc.
A

Yeah, I – Matthew, this is Jim. I think the best way to think about is the upside is going to be in the feed segment for us, that the food would still be on track to be what we had had out there at around $200 million for the year, the fuel segment lining up about where we are. So, really just the higher results are going to be in the feed segment.

Matthew Blair
Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.
Q

Great. Thank you.

Operator: Our next question comes from Ken Zaslow with Bank of Montreal. Please go ahead.

Kenneth B. Zaslow
Analyst, BMO Capital Markets Corp.
Q

Hey. Good morning, guys.

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

A

Morning, Ken.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

Morning.

Kenneth B. Zaslow
Analyst, BMO Capital Markets Corp.

Q

Hey. Just a couple of follow-ups, real easy. What was the decision in terms of share repurchases and where do you stand with that going forward, particularly as your stock has kind of been picking a little bit of a backseat now?

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

A

Yeah. The board has authorized, and I think the number is $200 million, right, John? Yeah. So, $200 million, of which we've used $98 million. Clearly, we have a strategy around here to opportunistically purchase from time-to-time as we see fit, and I think you'll see that behavior continue as we go forward here. Clearly, we're under some pressure again this morning.

And we reflected on this in the board meeting the last couple of days. We've got a lot of great shareholders and owners in this company, and some of them have bases as low as $14. And so, still the challenge within the stock here is that major position to unload can put some pretty significant pressure on it as people exit. So, end of the day, the forward look is quite bullish. But if you're wanting to move a big block, it can be a bit challenging. And thus, we're there – yes, I'd use the word defend it if someone wants to pressure too hard opportunistically going forward.

Kenneth B. Zaslow
Analyst, BMO Capital Markets Corp.

Q

Great. And then you alluded to the point of – you talked a lot about the feed on a couple of the questions. Are you fully capturing the full amount of the rise in the prices or is there more to capture as contracts keep on being reviewed? And how does that work? I just didn't fully understand that. Or is it just a margin shift based on your increased product offerings? I just didn't understand the full opportunity there.

James E. Stark
Vice President-Investor Relations, Darling Ingredients, Inc.

A

The question is, in the past, we've talked about working on increasing our fees and services, and are we still in that round of updating those.

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

A

Absolutely, Ken. And I think as we look, there's two or three different in, if you will, the supply chain feedstock business around the world, whether it's Europe, those are time-to-time contracts. Every couple, two, three months, you renegotiate. We've had some really nice margin expansion there as capacity is relatively full. Canada, we've seen a nice return to historical levels there.

And then, in the US, we have focused on, if you will, the non-fully-integrated large slaughterhouses to widening the margins. And it's been a two- or three-year process and program for us. I mean, the challenge there for us is now to recapture the exponential rise in labor costs and energy as we move forward. So, is it fully baked in? Yeah, for the most part, yeah, I think. But from time-to-time, we'll be able to do a little better.

Kenneth B. Zaslow
Analyst, BMO Capital Markets Corp.

Q

Great. I appreciate it. Thank you, guys.

Operator: Our last question today will come from Ben Kallo with Robert W. Baird. Please go ahead.

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

Q

Hey, everyone. Good morning. Randy, I like...

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

A

Good morning.

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

Q

...how you pin the guidance on John. My first question, the carbon intensity, how does that make a difference in pricing and in costs? Could you explain that to us? And then, you mentioned South America a couple times, I think, too and just we get the question all the time about the feedstock, and I think you've been way ahead of the curve on this and everyone is trying to catch up now. How do you maintain that lead?

And I guess just the third one part of that is, you do a lot of – you've done a lot of acquisitions with family-owned businesses. You've mentioned that – I think you've said in the past that COVID gets in the way of that because you can't go meet them and do that. But where are we with that right now and has that picked up on the activity? Thanks.

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

A

Sandy, you want to take the CI?

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.

A

Yeah. So, in terms of the CI, I think if you look at the market, what you see is the lower CI feedstocks generally priced higher, but those lower CI feedstocks also give you the greatest margins. And so, that's what we're seeing there. I mean, they may cost more on the front end right now, but they're returning a much greater value.

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

A

But specifically, Sandy, into the pricing of the finished product, if someone can buy a gallon of renewable diesel made out of soybean oil or a gallon out of UCO...

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.

A

Right.

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

A

...how does that work?

Sandra Dudley
Executive Vice President-Renewables & US Specialty Operations, Darling Ingredients, Inc.

A

Yeah. So, again, if I look at UCO or corn oil or animal fat, those typically have traded higher, sometimes in soybean oil, not RBD soybean oil. But because we have the pre-treatment capabilities, we're able to convert that and turn that into a higher margin finished product price in terms of renewable diesel because we're able to capture more value in terms of LCFS credits and things like that.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

So, just to add on to that. Essentially the way this works is the lower the carbon intensity of the fuel that you sell, the more valuable it is because the green premium associated with it is better. And the fact of the matter is, the waste fats, which is what we produce in our company, those fats have a lower carbon intensive. Fuels made from those fats have a lower carbon intensity score. And therefore, when they price into the marketplace, when we include the compliance element of the price, which is the green premium, part of that being the LCFS, it gives you the higher value and therefore better margin for the company.

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

Q

Yeah. And so, just so I have it clear, I might need 2 gallons if I use soy as a feedstock versus 1 gallon of – just very rough.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

So, let me answer it this way. If I buy – if I'm a consumer of renewable fuels and I buy 1 gallon of renewable diesel based off of vegetable oils versus 1 gallon of renewable diesels made from waste fats, UCO, animal fat, distillers' corn oil, or whatever it may be, the fact of the matter is the credit that I have is worth more on the gallon that I had bought from the waste fats because it has a lower carbon intensity score and therefore it has more value to the purchaser of the fuel or the buyer of the credit than the alternative of the higher CI fat.

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

A

So, John, a different way of saying that is we're selling 1 gallon of compliance.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.

A

That's right.

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

And it has more value to the obligated party...

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.
A

Correct.

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

...when it's made out of waste fats than vegetable oil, if you will. And so, therefore, they're able to meet their obligations and they're willing to pay us more for that.

John Bullock
Executive Vice President-North American Specialty Businesses & Chief Strategy Officer, Darling Ingredients, Inc.
A

Yeah. Well said.

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

Thank you. And then, just on the feedstock front and acquisition front, maybe help there. Thanks, guys.

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

There's no help there, Ben. Not going to answer that. But, no, we're working hard on it around the world. I think the thing is – and it won't – the secrets out there don't last very long until the government data is published. But clearly DGD is and will be an importer from around the world. So, I mean, clearly, we've got a supply chain system set up because we operate on the five continents today. That's always been the secret sauce of why we didn't have fear on feedstock. And so, that'll come clear.

The rest of the stuff, it just takes time. We're seeing a lot of businesses for sale, potentially for sale, if you will, in Europe, Asia, South America, US, and we'll just see if we can get any of them home. Some are being driven by potential changes in tax policy, some are succession planning, some are just time to sell, just one out. But what I can always say to everybody is we buy good businesses with great management teams that can or do share our values. And so, we're just – we've got the ability like we've never had before to grow and we will when the time is right to the fair value, continue to expand the moat around the machine.

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

Sounds good. Thank you, guys.

Operator: Ladies and gentlemen, this will conclude our question-and-answer session. I'd like to turn the conference back over to Randy Stuewe for any closing remarks.

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

Thanks, Grant. Appreciate everyone's time today and hope everyone continues to stay safe and have a wonderful holiday season. There's a list of upcoming events that Jim Stark's got in the IR deck that we'll be putting on out there and we look forward to talking to you again soon.

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