Good morning, and welcome to the Darling Ingredients, Inc. Conference Call to discuss the Company's Second Quarter 2022 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 call over to Ms. Suann Guthrie. Please go ahead.

Suann Guthrie

Thank you for joining the Darling Ingredients' second quarter 2022 earnings call. Here with me today 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 is a slide presentation available on the Investor Relations page under the Events and Presentations on our corporate website.

During this call, we will be making forward-looking statements, which are predictions, projections or 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 will hand the call over to Randy.

Randall C. Stuewe

Hey. Thanks, Suann, and good morning, everybody. And thanks for joining us for our second quarter 2022 call. Our 2022 second quarter financial results yielded another record quarter illustrating the tremendous growth and diversity of Darling Ingredients. This quarter's combined adjusted EBITDA of $402.6 million is nearly equivalent to our entire fiscal year combined adjusted EBITDA just five short years ago in 2017.

As I reflect on where we have come as a company, I am tremendously proud of the work our teams across the world have done repurposing animal and food by-products into the specialty food and feed ingredients to support the growing population and converting waste fats and oils into low-carbon fuel to power a growing world.

Going into the quarter in brief here, our global ingredients business had a record quarter of $312 million and EBITDA. The feed ingredients segment had a record quarter at $242.1 million, and our Specialty food ingredients segment also
had a record quarter posting $65.4 million in EBITDA. Our fuel segment ended the quarter with $110.8 million with $90.6 million in EBITDA attributed to our joint venture at Diamond Green Diesel.

Starting with our feed ingredients segment, globally, raw material volumes were up 23% quarter-over-quarter or 13% year-to-date. Fat prices continued to climb rapidly, illustrating the high demand for low-carbon waste feedstocks for renewable diesel. Protein prices were also strong throughout the quarter with some challenges remaining in container tightness for protein export sale. Rapidly escalating global energy costs and lower gross margins from the Valley acquisition contributed to a reduction in gross margins for the feed segment.

As we have discussed in the past, our procurement performance formulas will ultimately recover many of the cost increases in the following quarter. Since we closed on the Valley Proteins acquisition on May 2, the team has been working hard on the integration efforts with a laser focus on margin improvements. I'm encouraged by our efforts today and continue to believe Valley Proteins will contribute $150 million of EBITDA in 2023 as we continue to address operational challenges and synergies.

Turning to our specialty food ingredients segment, we continue to see uplift from gelatin to higher-margin collagen peptides. Hydrolyzed collagen demand continues to rapidly grow as consumers turn to these specialty products for joint, ligament, hair and skin health. More resistant to commodity fluctuations, we anticipate to grow this business line in the high-single digits in the next three to five years. We have pioneered and led the way in this space and we are excited about its potential for the future. In our Fuel segment, our green energy investments in Europe continued to deliver as predicted, with higher sales prices and volumes.

Now let's turn to Diamond Green Diesel. DGD2 is running at full capacity, which resulted in record volumes of 209 million gallons in the second quarter and 375 million gallons produced year-to-date. In Q3, Diamond Green Diesel recorded $0.91 per gallon EBITDA lower than Q1 2022 and our full year estimate. However, higher feedstocks while benefiting our specialty feed ingredient business impacted DGD's margins this quarter along with some lower LCFS.

Second quarter, LCFS prices averaged a 100 per metric ton compared to about 130 per metric ton in the first quarter of 2022. On August 5, Diamond Green Diesel delivered a dividend of approximately $181 million, of which $90.5 million was distributed to Darling. This should once again provide confidence in the strong cash potential for the joint venture as we start up DGD3.

As we head into Q3, DGD margins are improving. Feedstock prices have moderated. Additionally, DGD in Port Arthur, Texas should be operational in the fourth quarter of 2022, bringing our total renewable diesel production going forward to 1.2 billion gallons annually. Our strategy to procure and process waste, fats and oils as feedstocks and not food-based oils will continue to position DGD as advantaged over other renewable diesel producers in the market. Our global supply chain, augmented by our two recent acquisitions Positions are vertical integrations, second to none in the world. Additionally, we continue to see growing public policy that supports low carbon energy solutions beyond California. We're excited about Canada's Clean Fuel regulations passed last month and encouraged by the rulemaking currently underway in Washington State and Oregon. The proposed Inflation Reduction Act, if passed, will represent the most robust piece of climate legislation in US history and bring sustainable aviation fuel closer to reality. These programs give a boost not only to DGD, but to Darling's global specialty feed ingredients business. As we proved, we are the premier provider of low carbon feedstock. With access to inbound water, truck and rail for feedstocks and outbound water, and options for either pipeline and rail to both coast. DGD is well-positioned logistically to serve markets well beyond California.

Now, before I turn the call over to Brad for details on the financials, I mentioned last week, we closed on the purchase of FASA Group, the largest independent rendering company in Brazil, for approximately BRL 2.9 billion or approximately $562 million at the current exchange rate. This acquisition adds 14 rendering plants with an additional two plants under construction to our portfolio, and it processes more than 1.3 million metric tons of beef, pork and chicken annually. Currently, the EBITDA run rate is around BRL 500 million per year.

With that, I'd like to turn the call over to Brad and then I'll come back and give you a little outlook for the balance of 2022. Brad?

Brad Phillips

Okay. Thanks, Randy. All right. Net income for the second quarter, 2022 totaled $202 million or $1.23 per diluted share compared to net income of $196.6 million or $1.17 per diluted share for the 2021 second quarter.

Net sales were $1.65 billion. Net sales were $1.65 billion for the second quarter of 2022 as compared to $1.2 billion for the second quarter of 2021, or a 37.7% increase in net sales. Operating income increased 3.8% to $278.6 million for the second quarter of 2022 compared to $268.3 million for the second quarter of 2021 primarily due to a $98.1 million increase in the gross margin from our global ingredients business, which more than offset a $52.1 million decline in our share of the earnings from Diamond Green Diesel, as well as an increase in SG&A and depreciation and amortization primarily due to the addition of Valley Proteins.
The second quarter of 2022 also included an $8.6 million impairment charge. Additionally, we incurred $5.4 million of acquisition and integration costs primarily related to our acquisitions of 00:08:52 Valley Proteins and FASA. Interest expense increased $8.7 million in the second quarter of 2022 as compared to the second quarter of 2021 due to an increase in debt related to the closing of the Valley Proteins acquisition.

Now, turning to income taxes. The company recorded income tax expense of $47.3 million for the three months ended July 2, 2022. The effective tax rate is 18.8%, 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 excess tax benefits from stock-based compensation.

For the six months ended July 2, 2022, Darling recorded income tax expense of $73.4 million and an effective tax rate of 15.7%. The company also has paid $72.4 million of income taxes year-to-date as of the end of the second quarter. For 2022, we are projecting an effective tax rate of 19% and and cash taxes of approximately $30 million for the remainder of this year.

Total debt outstanding at the end of the second quarter 2022 was $2.9 billion as compared to $1.5 billion at year end 2021, and the bank leverage ratio ended the quarter at 2.59 times. The increase in debt was primarily a result of the acquisition of Valley Proteins, which included a $750 million issuance of unsecured senior notes due year 2030.

We continue to maintain strong liquidity with $1.45 billion available on our revolving credit facility as of quarter end July 2nd. Capital expenditures totaled $79.9 million in the second quarter and $151.5 million year-to-date. The company repurchased approximately 700,000 shares of its common stock for $48.7 million during the second quarter, which brought the year-to-date total shares repurchased to 971,000 for $65.9 million. Subsequent to the July 2nd quarter end date, the company also repurchased an additional 29.3 million in shares.

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

Randall C. Stuewe

Okay. Thanks, Brad Fred. I am very optimistic about the rest of the year as the market environment remains favorable to Darling. We operate a diverse business platform across multiple sectors that allows us to take advantage of our scale, integration and technical expertise to deliver shareholder value. We produce what the world needs, food and energy. We maintain our strategy to deliver a positive impact on our planet and society while also providing superior returns. There is no singular solution to environmental challenges we face, nor is there one priority to focus on. Darling Ingredients is committed to helping the world avoid carbon emissions by turning discard and animal waste into valuable specialty feed ingredients, specialty food ingredients, and low carbon energy. You'll hear more about our efforts in this space in our upcoming ESG report, which will be published next month. Our vertically integrated supply chain allows us to fully leverage the strength of Darling's platform. With superior access to waste fats and oils, coupled with our technical expertise pretreatment technology and superior logistics, DGD will continue to be a leader in the North American Renewable Diesel Market for years to come.

While I recognize DGD's EBITDA this quarter was less than our full-year forecast, we expect the back half of 2022 to improve. DGD should be able to deliver $1.10 to $1.25 a gallon EBITDA and is still a great return and we remain advantage over other producers relying on non-waste fats and oils for feedstocks.

Looking forward to the back half of the year, our global specialty ingredients business is currently running at a rate well over $1 billion in EBITDA, including the new FASA group. We believe margins will improve at DGD. Therefore, we are reaffirming our forecast to $1.55 billion to $1.6 billion in combined adjusted EBITDA for 2022.

So with that, 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. At this time, we will pause momentarily to assemble our roster. And our first question will come from Adam Samuelson of Goldman Sachs. Please go ahead.

Analyst:Adam Samuelson

Question – Adam Samuelson: Yes, thanks. Good morning, everyone.

Answer – Unidentified speaker: Good morning, Adam.

Answer – Unidentified speaker: Hi.

Question – Adam Samuelson: Good morning.
So, I guess the first question, Randy, is thinking about some of those forward comments that you just made. So, one, a clarification on DGD to $1.10 to $1.25 per gallon of EBITDA, is that your expectation from margins in the second half or the margins for the full year average, because I mean we've look at spot margins today and even with lower LCFS prices, they would seem to be well above that level. And I guess the corollary to that is thinking about the second quarter, was the impact — it seems like the impact was much more around hedges on diesel and the backwardation in diesel curves than the declines that you saw in the LCFS and increases in feedstocks. I'm just trying to clarify kind of how you were framing the DGD performance.

Answer – Unidentified speaker: Yeah. I'll take a stab and let Sandy build on it. Clearly, in Q2 — clearly, we don't want to dive into derivative hedges and impacts, but clearly the volatility and the inverses that were there with how you procure feedstock, you put on a hedge and then you lift the hedge clearly had a significant impact on Q2. That curve has clearly flattened in Q3. That will be beneficial. Feedstock prices have leveled off. But remember, we own feedstock anywhere 60 to 90 days in advance. And so, as it flows through, you should see improvement of margins. I think $1.25 is still very doable for the full year as an average at this time.

Sandy, do you want to add anything?

Answer – Unidentified speaker: No. I think, Randy, you hit it on the head. We had really high feedstock prices that outpaced diesel prices throughout the quarter. LCFS prices did contribute to the decline versus Q1. We saw that RINs continue to work really hard during the quarter, but the LCFS prices were just off.

Unidentified speaker

Question – Unidentified speaker: Okay. And then, if I take a step back to the whole company, I mean, you talked about the ingredients business running at well over $1 billion EBITDA rate. The full-year guidance at the whole company level was unchanged. FASA closed four or five months earlier than you thought. And I think 00:16:04 of $35 million to $40 million or so based on the run rate you talked about of incrementally EBITDA that wasn't in the prior outlook. So, can you talk about some of the moving pieces and what you're thinking for feed and food and fuel and the parent for the full year and how that has changed relative to May?

Answer – Unidentified speaker: Yeah. I mean, clearly, as Suann read my name as Randall Stuewe, the C stands for conservative. And we look at this thing right now with a lot of moving parts, as you said. I mean, feedstock prices, number one, have come down a little bit. But oh, by the way, DGD 3 hasn't really started buying yet. That's a secret out there, right? So, the market knows that we've got to go to market and start buying another 4 billion pounds of waste taps and grease in the back quarter of the year here. So, we become pretty friendly on where the feedstock prices will either stabilize or rebound a little bit as we start to ramp up that facility. Protein demand remains pretty darn good around the world. So, Feed segment should have a pretty solid quarter in Q3 here. Valley is delivering as we expected it. I mean, there's some operational challenges there, and we're still moving tonnage around from and getting the synergies from moving used cooking oil accounts, moving different raw material streams to different plants, trying to make pet grade at one plant, etcetera. That should pick up momentum in the back half of the year here. And then the FASA Group, it's currently at the current reais rate running, $90 million to $100 million EBITDA. So, we'll have it here for the quarter as we go forward or two months of Valley for 3.5 or 2.

So I mean, overall, if DGD puts on 750 million gallons for the year and then that doesn't have any gallons in there for DGD3 start-up, that's where the C for conservative comes from. So we feel pretty darn good even though there's a lot of moving parts here. You know, Adam, we always — as you've been around the business a long time, quality is hot all over the world and quality of animal fats gets challenged in the summertime. We always have to deal with that, but now we've got the machine that can convert those. And so it's a little different kind of set of circumstances than we've had in the past. John Bullock, anything want to add that you're thinking?

Answer – Unidentified speaker: No, I think that's exactly right. If you look at it overall, what you see is Diamond Green Diesel as a result of the expansion of Diamond Green Diesel has gone from a 300 and 800 million gallon and we're set to go to 1.2 billion gallons. Whether we're making $1 or $1.25, that's a lot of money on that number of gallons. And at the end of the day, the impact of the low carbon fuels in the world has increased fat prices from $0.20 or $0.30 to $0.60 to $0.75. All that's not bad especially when we've increased massive scale to our low carbon, vertically integrated supply with the Valley and FASA acquisitions.

Unidentified speaker

Question – Unidentified speaker: Okay. It's all very helpful color. I'll pass it on. Thank you.

Operator

The next question comes from Manav Gupta of Credit Suisse. Please go ahead.
**Analyst:** Manav Gupta

**Question – Manav Gupta:** So hey, guys. A little bit of follow up kind of on Adam’s question here. I mean, we can sit here and debate why the EBITDA was $1 a gallon and not $1.25. Fact of the matter is that you are the best in the renewable diesel business. We just saw somebody start up a 200 million gallon facility to end up with an EBITDA of minus $25 million in the quarter. So, you guys are a class of act 00:19:45. And what I'm trying to get to is why is the best in the business – what will it take for the best in the business to announce an entry into the sustainable aviation fuel market now that you could actually get like $1.75 BTC on your sustainable aviation fuel? So, I know you and your partner had been working very hard on commercializing sustainable aviation fuel, but I'm just trying to understand with this Inflation Reduction Act how close are we for DAR and 00:20:12 together think about announcing something on sustainable aviation fuel?

**Answer – Randall C. Stuewe:** Yeah. Thanks, Manav. This is Randy. I'm going to have Sandy comment on. I think we want to comment on a couple of different pieces that I'll have Sandy cover up. I mean, clearly the Inflation Reduction Act is very positive to Darling globally. And then the SAF wording in there is very positive also, and it moves us a step closer. But, Sandy, why don't you fill in the blanks here?

**Answer – Sandra Dudley:** Yeah. So thanks, Manav. This is Sandy. So, I think that the Inflation Reduction Act, it's probably one of the most important pieces of US environmental legislation that we've seen in a long, long time. It's very supportive not only of our road fuel business, but I think it makes a significant inroad into enabling us to be able to produce SAF. What we saw when we were looking at it, there are a number of positives. The first thing is we're excited about the opportunity to have the programs in place for five years. That shows significant support for biofuels.

Also, as the US biofuels producer, we were really excited to see the change to the producer’s tax credits starting here in 2025. And then as a renewable diesel producer that focuses on waste feedstocks. We're really excited to see the new focus on emissions reduction. And I think that that's really important for Darling too, and John and Randy had hit on this earlier. From a Darling perspective, From a Darling perspective, that focus on emissions reduction is also very positive give that we're a low CI 00:21:44 feedstock producer. And then, you know, through – on top of that, the FASA and the Valley acquisitions, those couldn't have been more timely in support of that. So all of that is great stuff.

And so, what we think of when we think of the incentives and SAF is it gets us a whole lot closer to being able to justify SAF production. And we're hopeful that the airlines feel that the incentives greatly reduced their burden since I know that they so want to be able to use SAF. You know what? We're still doing is we're still reviewing the legislation, the economics, and obviously we have to talk to our partner. But what I can say is that the airlines commitment is they're enclosing any potential gaps that might exist. You know, we look forward to supplying them with SAF.

**Question – Unidentified speaker:** Perfect. My quick follow up here is. And we saw the volumes in Tokyo, they were extremely high, meeting our expectations. So first, can you talk a little bit about how Valley contributed to the overall volumes? And then what I'm trying to get to is, well, while 2Q had Valley, 3Q will have Valley and FASA. So help us understand how the volumes in the feed segment will trend in the back half of this year?

**Answer – Unidentified speaker:** Valley by volume relative to the US rendering size is about half the size. We've given that optic out there. So that should grow us. So that should grow us. I think, overall, Valley net-net is about 2.5 million tons and FASA is 1.3 million tons. So, let's round up to for simple math for me. And then there's, what, about five months left here in the year? So I mean, they should add, you know, what, there are five-twelfths of that 4 million tons going forward to the back half of the year, Manav.

**Analyst:** Manav Gupta

**Question – Manav Gupta:** Thank you so much. Thank you so much for your comments.

**Operator**

The next question comes from Ben Bienvenu of Stephens. Please go ahead.

**Analyst:** Ben Bienvenu

**Question – Ben Bienvenu:** Hey. Thanks. Good morning.

**Answer – Unidentified speaker:** Good morning, Ben.

**Question – Ben Bienvenu:** So I want to ask – you got FASA. You've got Valley. I'm sure you're going through an integration process, but those are in full swing here. You've started to buy back a little bit of stock, but there's going to
be a pretty meaningful cash build on the balance sheet in the absence of either continued M&A or distributions or share repurchase. And I know we keep asking this each quarter, but the anticipation keeps building around, what are you going to do with all the cash? And is what we saw in the quarter from a buyback perspective indicative of the sort of support that you'd like to allocate to that use of cash?

Answer – Unidentified speaker: Yeah. I mean and I'll – then I'll have Brad help me out here. I mean, clearly, the dividend that we pulled out of DGD, out of the venture here is symbolic of where we're at and like even as the dollar $10, $25 margin and getting larger, shows the cash generation ability. So, it's the kind of like hello, it's pretty obvious now.

The second thing is the share repurchases that you saw in Q2 are indicative of the authority that Brad and I have to opportunistically continue to buy back as it makes sense. And, clearly, we came under some pressure here post Q2, so we'll just leave it at that.

The third thing is, prioritizing is really de-levering back to 2.5 over time here, which will happen very quickly. You know, we're always looking for opportunistic M&A that may happen out there and then, we'll decide with it from there. Brad, anything you want to add to that?

add to that?

Answer – Brad Phillips: Yeah. Just to reiterate, Ben, and you know this. I think everyone recalls 00:25:39. But we closed FASA and we 2.59 00:25:44. So, immediately after the FASA, we're a little higher than that below 3, but with the dividends and with number three coming on paid for the JV debt-free, you know going into, let's call it, going into 2023, the distributions are expected to be material in 202. So, to Randy's point of de-levering, not to mention just the base business and where it's – where it's running with free cash flow going into 2023.

Question – Ben Bienvenu: Yeah. Okay, great. And then my second question is a follow-up on Randy, your comments on the DGD margins $1.10 to $1.25. What consideration is there around the start-up of DGD 3 and that as a potential kind of margin detriment as you initially ramp it? And, I know you guys get better each time you do these ramps, would you expect the impact of that spool up to be less than we've seen over the last couple of iterations?

Answer – Unidentified speaker: Yeah. I'll take a front-end stab at it and then give it to Sandy here. I mean, clearly, we've affirmed 750 million gallons. You know, we ran 200 plus in the – in Q2. So, we're exceeding that already 00:26:59 25. So, that has no DGD 3 in it. Clearly, that's where we're trying to be conservative as always. Anytime you try to start one of these things up, you don't know what you don't know yet. Although we've got 10 years of experience in history. And Sandy, do you want to comment on the ramp-up of DGD 3 here?

Answer – Sandra Dudley: Yeah. So, you know, I think we learn a lot every time we do one of these. And it was a big step up for us for DGD 2. DGD 3 will be another big step up. And I think we'll see some flows move around on that side. I think we've also learned an awful lot from DGD II. We've expanded who we source fund both domestically and internationally and I think that will be advantageous to us.

Unidentified speaker


Operator
The next question will come from Tom Palmer of JPMorgan. Please go ahead.

Analyst: Thomas Palmer

Question – Thomas Palmer: Good morning and thank you for the question. Wanted to ask on the expectations on DGD. You paid down debt this quarter and paid distributions to the JV partners. So, I guess this seems like a signal that CapEx winding down, obviously Port Arthur just a few months from opening. What are your expectations for distributions for the remainder of this year or should we start expecting come later this quarter or fourth quarter for the distributions or is it more a 2023 event?

Answer – Brad Phillips: Yeah, Tom. I'll start. This is Brad. So, we do have a distribution policy obviously with our partner. So that's what allowed or created the recent distribution. So, I would say, and Sandy add on to this, really it will depend on the remaining cadence of the spend, as well as really the ramp-up in the feedstock here for DGD III because that's all taken into account along with the anticipated cash flow.

So, at the end of the day, could we receive another distribution? Yes, we could, but really the focus whether we do or don't, like I've said earlier, are going to – want to be significant distributions beginning in 2023.
**Answer – Sandra Dudley:** Yes. I agree with that, Brad. We've always said that we expect strong distribution starting in 2023 and we'll see what Q3 and Q4 hold for us.

**Unidentified speaker**

**Question – Unidentified speaker:** Okay. Thank you. And then, just in terms of the spread at DGD between what's been produced and shipped. It's been a little wider than we've seen in the past. I think you've actually under shipped about 20 million gallons in the first half. Should we be factoring in some catch up here as we look towards the second half? And in terms of that, that's just the timing?

**Answer – Unidentified speaker:** Yeah. You know, I think what you can count on is that we'll get to 750 by the end of the year. That's what we're projecting. And, you know, often, you know, between quarters and things like that, we may have shipments that carry from one quarter into the next and that can impact that, too. And I think that's kind of what you saw on some of those numbers.

**Unidentified speaker**

**Question – Unidentified speaker:** Okay. Thank you.

**Operator**

-The next question comes from Ben Kallo of Baird. Please go ahead.

**Analyst:** Benjamin Joseph Kallo

**Question – Benjamin Joseph Kallo:** Hey, good morning, guys.

**Answer – Unidentified speaker:** Good morning, Ben.

**Unidentified speaker**

**Question – Unidentified speaker:** Hey, thanks for taking my question. I guess maybe just can we talk about the fuel business, not DGD and then the feed business or the food business? So, the fuel and the food business. And I know last time you called out for fuel, just kind of rising energy prices in Europe. So, maybe how are we thinking about that going forward? And then on food, I think cost is still driving the boat there but just how do you think about that going forward in the mix and how long that sustainable or any incremental additions you have there and I'll follow up.

**Answer – Unidentified speaker:** Well, clearly, Ben. And I'm going

**Answer – Unidentified speaker:** Clearly, Ben, and I'm going to hand it off to John Bullock here. The management is very intimate in driving the strategy of both the business and our European green energy business. The things we like to point out to people is those are the de-commoditized businesses for the most part. I mean, they're just really just far more inelastic in a sense of exposure to the commodities in that feed segment. And so we love growing them.

And we think over the – last year, we did a board meeting, of course, yesterday, and we looked back at the at the growth of 00:31:37 business and our European green energy business. The things we like to point out to people is those are the de-commoditized businesses for the most part. I mean, they're just really just far more inelastic in a sense of exposure to the commodities in that feed segment. And so we love growing them.

And we think over the – last year, we did a board meeting, of course, yesterday, and we looked back at the at the growth of 00:32:08 since 2014, 2015. It's just been a tremendous story in that food segment. And we – we all have been very open 00:32:16 represents the biggest portion of that food segment, so no surprises there. The green energy side comes from not only putting the growth money into some of existing facilities for the client and new facilities and being able to arbitrage different feedstock streams around Europe for benefit, and then, making more money. So, John, you want to kind of talk where we're at and where we're going a little bit?

**Answer – John Bullock:** Yeah. So, I think just stepping back for a second, what you see with Darling is essentially a company that has been based on value adding the byproduct streams from the animal industry around the world. And what's made us so successful over the last 10 years is we have created rock star products and been on the leading edge of that. That uses low carbon feedstock to create renewable diesel, obviously, in the transportation low carbon fuel segment. And we've also been the world leader in terms of hydrolyzed collagen and the peptide revolution which has continued and looks like it's continuing going forward.

So, both the European strategy of decarbonized low-CI, energy products for power generation as well as the improvement because of the investments we made in 00:33:28 in relationship because of the investments we made in 00:33:28 in relationship to the collagen peptide. Fit into that basic theme, we have rock star products that we are the leading edge producers in the world, and we are continuing to extend our advantage on those critical – two critical trends that we see as moving positively forward.
Unidentified speaker

**Question – Unidentified speaker:** Thank you. My follow-up and we get this question quite a bit, as whether it's from your rendering or from the used cooking oil as you know your products become more valuable. Does that change your – the protein plants and how they look at it and they want to take value from you? Or how does that negotiation go going forward just because now this new big, huge end market and they must realize that there is value there. Thank you.

**Answer – Unidentified speaker:** Yeah. Ben, we get – this is Randy, we get that question all the time. And it's a fair question to ask. The model that we built into this thing 20 years ago was a sharing model. We needed to de-commoditized or take some of the risk out so that we could put fair credit lines underneath it to build and grow the company. And so, with our very large suppliers, these are very transparent agreements that share the upside and protect us on the downside with a – basically a fixed margin processing fee. So we're here in no pushback, in a joking sense, if you want, then we get that question where we'd like to have a little more of a – some of that benefit out of Diamond Green Diesel. That's when John Bullock asked him for $1 billion so they can be part.

But end of the day, the formula is both protect us. They share with these guys. And from a – just a pure philanthropic standpoint, we are obligated to – in my sense and my responsibility to give back to the raw material guys much money as we can to help grow because if they grow, we grow. And so, this thing is a very dynamic thing. We're under no pressure in the world to deliver anything. We continue to be very opportunistic and very aggressive in the used cooking oil business around the world and I think we're in good shape. John, anything you want to add that I'm missing there?

**Answer – John Bullock:** No. I think you hit it exactly.

Unidentified speaker

**Question – Unidentified speaker:** Thanks, guys.

**Operator**

The next question comes from Ken Zaslow of Bank of Montreal. Please go ahead.

**Analyst:** Kenneth B. Zaslow

**Question – Kenneth B. Zaslow:** Hey. Good morning, guys.

**Answer – Unidentified speaker:** Good morning, Ken.

**Answer – Unidentified speaker:** Good morning, Ken.

**Answer – Unidentified speaker:** Morning.

**Question – Kenneth B. Zaslow:** Did you say that you have yet to buy for the Port Arthur facility yet? And does that mean that the feed business is still not fully enjoying all the profitability that could come with the higher rendering values? I just didn't understand that exactly.

**Answer – Unidentified speaker:** Yeah. No. What I'm trying to say is we're nearing mechanical completion down there. We're not there yet. Logistics will start. We got a fourth quarter startup. So, with the fourth quarter startup, you'll start buying towards the end of third quarter. While you may own some on paper, until the logistics start to flow, then the market doesn't see it.

I mean, this is where we're trying to remind people. On or about the start of Q4, we will be procuring 70% of North America's waste, fats and greases. We're not there yet. We're just starting. So, I think it will end up, it will move some whether it's going to non-traditional markets and other markets. Clearly, DGD II is an importer from around the world. Clearly, part of our FASA acquisition was already a supplier into DGD II.

So, I think, at the end of the day, it's we've seen palm oil prices come down around the world, we've seen soy in a bit of sympathy through that. Our prices are really holding firm. We're working through summertime issues right now, but I'm fairly friendly and, at least, supportive through that going back into the feed segment. John Bullock, any you want to add to that?

**Answer – John Bullock:** No. I think that's right. I mean, obviously, and this question was asked earlier, as we bring each of these diamonds on, these are huge businesses that we're starting up and we go to a zero to a 100 really...
quickly as we’re operating those businesses. That’s going to have an impact in relationship with the feedstock markets and as the supply chain has to adjust to be able to feed us the product, but it will happen.

We’ve seen this happen time and time again. We started at a 126 million gallon run rate and we always wondered where was the fat going to come from. We wondered that when we went to 160 million. We wondered if we went to 275 million. We wondered went to 400 million gallons. We wondered when we went 800 million gallons and now we’re going to go to 1.2 billion or 1.3 billion gallons. The faster it’s going to come because we have the best machine in the world by the fact.

Unidentified speaker

**Question – Unidentified speaker:** Okay. My second question is, is there any reason that you don’t generate the industry renewable diesel margin and that there is not a parallel between what we see in the market and what you generate and saying, ex-hedging? It just seems like – I understand that you said there’s some hedging issues, but it seems a little bit more dramatic, the differential and I’m not sure if maybe we’re miscalculating? I’m just trying to figure out if there’s any other disconnect that we don’t know about and just trying to figure that out. That would be very helpful.

**Answer – Sandra Dudley:** So, Ken, this is Sandy. And so, I think that other folks in the industry, they often talk about capture rates. And capture rates, in my mind, are really looking at the spot market, and that’s really not what we do at DGD. If you think about our supply chain, we’re buying our feedstocks months in advance. And what we can choose to do is we can choose to let that, you know, ride and not hedge it. And when we hedge, what we do is we lock in the feedstock price and we would sell a heating oil contract to kind of lock in the margin between the two. So, we can either let it ride or we can hedge it. We choose to hedge it. And what that hedge does is it protects us from downside adjustments in terms of diesel prices.

And so, what I think you see is that, you know, our margins don’t necessarily look like the capture rates because we can never look like the capture rates because we’re not operating in the spot market by virtue of, you know, our supply chain and the feedstocks having to be purchased ahead of time. And so, I think really, that’s what you’re seeing. And I think what you saw during Q2 is you saw that, you know, prices throughout the quarter, diesel prices generally increase. And so, what that means is when you unwind your hedge, you’re always buying back generally at a higher price. That’s okay, because you’re on the other side of things. When you’re selling out your renewable diesel, you’re also getting a higher price in terms of your revenue. Those two things kind of offset each other, and so you end up with your hedge price. And so the hedge is not a bad thing. It doesn’t look as great during a time when you have high rising prices. But now as we’re moving into Q3, what you’re seeing is you’re seeing prices, the diesel prices decrease. And so, you should see the opposite effect when that happens. So, I think that there’s a little bit of a disconnect between capture rates and how we actually look at our business.

Unidentified speaker

**Question – Unidentified speaker:** So right now, you would actually be in third and maybe fourth quarter. You’ll be actually higher than the 170-ish that we’re seeing. Is that kind of what you’re seeing? It depends on how the hedges are going. But is that...

**Answer – Unidentified speaker:** That – it will – all the trend on where diesel prices end up.

**Answer – Unidentified speaker:** Yeah. Clearly. Ken 00:41:28, that, you know, the heating oil curve has flattened from where it was. And that, you know, the inverses that we saw in all commodities were as steep as anything ever seen in history. So, trying to hedge in that environment was incredibly difficult. And it looks like, from what I see now on paper, that’s leveled off and spot margins will be tend to be closer long term if it stays that way than they’ve been in the past.

Unidentified speaker

**Question – Unidentified speaker:** Great. I appreciate it, guys. Thank you.

Operator

The next question comes from Matthew Blair of TPH. Please go ahead.

**Analyst:** Matthew Blair

**Question – Matthew Blair:** Hey, good morning. Could you talk about the expected feedstock mix for DGD3 and how much of this will be sourced internally from Darling and how much will you have to pick up from external third party...
suppliers?

**Answer – Unidentified speaker:** So, I think you had kind of see that our feedstock mix would be about the same. You know, we're probably going to be a little bit heavier in terms of your Yellow Greases, your Tallow. Just by virtue of that, there's more of those available. And so, I think you expect that. In terms of internally sourcing, you know, as DGD we don't necessarily rely on Darling or Valero to provide corn oil. And so, I don't think that there's a set percentage. It's going to be whatever price is the best price in the market and who DGD is going to buy from. Yeah. I don't know what that percentage will be.

**Answer – Unidentified speaker:** No. I mean, clearly – Matt, this is Randy. And at the end of the day, as John was reflecting back, a small portion or a third of Darling went to, basically 1% and 2% and moved up to a little over 0.5% now. And with Valley and FASA, it's probably going to move up more. Clearly, the numbers to love are big here. So, it has to go there. It'll be the best market. Now, keep in mind it's an arm's length relationship and the procurement teams are obligated to maximize profits and profits are defined as both output price and quality. And so end of the day, there's always going to be arbitrage opportunities. That's what we love about the business for some of our products. And many of the Valley production was being exported. That's now being redirected into there.

They weren't set up to load railcars. So when I made my comments about operational challenges and efficiencies, that's what I'm talking about. And it's easy to send a truck to a tank terminal in Norfolk, and now you've got to load a railcar. That will all happen over time, and that'll put more and more of Darling's product in here.

I mean, we're not fearful at all of originating to support number 3 here. The team's been traveling the world. And as John's always said, the moat around the business is that we can procure domestically and internationally with the ease. And so at the end of the day, you will see probably a lot more come in on the water to us than in the past and that'll help regulate the right product mix for both quality and price into the unit that no one else will have. I mean, you're not going to originate Chinese. You go and move it to Artesia, New Mexico. That doesn't make sense. So, it's an amazing advantage that the facility is going to have.

**Unidentified speaker**

**Question – Unidentified speaker:** Sounds good. And then on the current feedstock mix for DGD, it looks like at least on paper RD 00:45:06 from soybean oil actually looks pretty good here. And I know you have your advantages on the on the low CI feeds, but just curious have you been switching to any soybean oil feedstocks currently at DGD?

**Answer – Unidentified speaker:** Yeah. So, I don't think that we're really going to talk about our current feedstock mix. What we do is we focus on great stocks. And if opportunistically, it makes sense to occasionally do soybean oil, we would consider doing soybean oil.

**Answer – Unidentified speaker:** Yeah. I think that's fair, Matt. I mean, at the end of the day, the focus is a super high percentage of waste fats and oils. People always have to remember that 40% of the soybean oil production in the US ends up in energy anyway. So, from time to time, we may arbitrage a few trucks or a few railcars in. But at the end of the day, our focus is waste fats and greases driven because of CI content.

**Unidentified speaker**

**Question – Unidentified speaker:** Great. Thank you very much.

**Operator**

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

Okay. Thanks, again, everybody. Appreciate your time, and hope everybody stays safe and has a great summer and gets the kids back to school. I look forward to seeing you at some of our upcoming events listed in the earnings presentation and look forward to talking to all of you soon. Thanks again.

**Operator**

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