Darling Ingredients Inc.
3rd Quarter 2016 Earnings Conference Call
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Company Representatives
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Randall Stuewe; Chairman and CEO
John Muse; EVP and CFO

Analysts:
Adam Samuelson; Goldman Sachs
Tom Palmer; JPMorgan Chase & Co.
Chip Moore; Canaccord Genuity
Dan Mannes; Avondale Partners
Craig Irwin; Roth Capital Partners
Jeff Gates; Gates Capital Management
Ken Zaslow; Bank of Montreal
William Baldwin; Baldwin Anthony Securities

Presentation

Operator: Good morning, everyone, and welcome to the Darling Ingredients, Inc. conference call to discuss the Company's third quarter 2016 financial results. With us today are Mr. Randall Stuewe, Chairman and Chief Executive Officer of Darling Ingredients; and Mr. John Muse, Executive Vice President and Chief Financial Officer. (Operator Instructions). Today's call is being recorded.

I would now like to turn the call over to Melissa Gaither, Vice President, Investor Relations and Global Communications for Darling Ingredients. Please go ahead.

Melissa Gaither: Thank you, Amy. Good morning, everyone, and thank you for joining us to discuss Darling's earning results for the third quarter 2016 ended October 1, 2016. To augment management's formal presentation, please refer to the presentation section of our IR website for the earnings slide deck.

Randal Stuewe, our Chairman and CEO, will begin today's call with an overview of our third quarter operational and financial performance and discuss some of the trends impacting our business. John Muse, Executive Vice President and Chief Financial Officer, will then provide additional details about our financial results. Please see the full disclosure of our non-US GAAP measures in both our earnings release and at the end of the earnings slide presentation. Finally, Randy will conclude the prepared portion of the call with some general remarks about the business and the rest of the year, after which we will be happy to answer your questions.

Now for the Safe Harbor statement -- this conference call will contain forward-looking statements regarding Darling Ingredients' business opportunities and anticipated results of operations. Please bear in mind that forward-looking information is subject to many risks and uncertainties, and actual results may differ materially from what is projected. Many of these risks and uncertainties are described in Darling's Annual Report on Form 10-K for the year ending January 2, 2016; our recent press release announced yesterday, and our filings with the SEC.

Forward-looking statements in this conference call are based on our current expectations and beliefs, and we do not undertake any duty to update any of the forward-looking statements made in this conference call or otherwise.

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

Randall Stuewe: Thanks, Melissa. Good morning, everyone, and thank you for joining us today.

As we discussed in our last call, we anticipated some seasonal tempering of core business earnings after a strong Q2. Seasonal softening, alongside production and market adjustments within our gelatin business, account for the majority of this decline.

Our DGD investment performed exceptionally well once again, providing the counter-hedge to lower prices of fats and greases. All in all, we are carrying good momentum into fourth quarter and into the coming year.

Now, let's look at the segments. In the food segment, on a sequential basis, our performance dropped sharply, attributable primarily to Rousselot, our gelatin business. During the quarter, China and USA plants took major annual turnarounds for maintenance. We had a temporary production interruption at our Angouleme, France plant and demand declines for low bloom gelatin in China drove an inventory write-down charge.

Interestingly enough, I must point out that year over year we are only down modestly in the quarter. And this is predominantly related to the inventory write-down charge.

In the feed segment, results sequentially softened but held up nicely considering volatile and sharply declining fat prices. European and Canadian rendering margins held solidly, while the USA chased the declining values of fats and greases in their formulas. Fat prices continue to be resilient, supported by world demand, as India and China consume more along with growing global bio demand.

Protein prices for the quarter were steady. But late in September, the pressures of the largest harvest on record began to weigh on values. Raw material volumes were strong around the globe, and this continues to put abundant protein supplies on the market.

Our global blood business came in slightly lower but remain strong in China, as demand for plasma for piglet feed continues to be robust, along with strong hemoglobin demand in the aquaculture sector.

Our restaurant services business in the USA continues to enjoy tonnage growth. Our improved go-to-market strategy for this unit continues to show promise and should pay nice dividends in our fuels business, as this is the preferred feedstock from a carbon intensity standpoint.

The US bakery feeds business tonnage is up year over year. And through prudent and smart risk management, earnings have improved in light of lower corn prices. Additionally, our premium proteins group, which includes pet food blending, wet pet food and fertilizer, all delivered consistent results. Our new wet pet food plants turned the corner and should be contributing at expected rates by the end of the year.

And finally, our fuels segment turned in a steady performance during a normally light seasonality. Tonnage shipped to Rendac, our European-based waste energy business; and Ecoson, our Euro-based digesting and refining business, were sequentially lower. Thus, third quarter earnings declined slightly. However, improved volumes and solid operating performance contributed to year-over-year increases.

Our Canadian biodiesel profitability came in slightly less sequentially but delivered on target and ahead of last year.

Operating at capacity, Diamond Green Diesel demonstrated outstanding earnings power and reported its strongest earnings contribution to date, improving EBITDA by 23% from the previous quarter, our model once again proved viable by capitalizing on lower fat prices in the quarter, arbitraged into higher earnings at Diamond Green Diesel.

We also loaded a [renless] vessel shipment on the last day of the month. [Rens] are marked to zero until they are sold. Therefore, we anticipate roughly $9 million of earnings will shift into Q4. As I mentioned earlier, most of our products are now moving to the LCFS markets, and we expect a strong Q4. Building on this momentum, we expect solid margins heading into 2017.

On the DGD expansion front, final engineering is complete, which, at full capacity, will increase our annual production from 160 million gallons to 275 million gallons. We made modifications to allow for additional flexibility on raw materials and product shipping that creep the scope and the cost of the facility. Our final cost estimate is $190 million, and construction is now scheduled to be completed and started up in early 2nd quarter 2018.

We remain net debt free in the joint venture, and our obligation to our partner is to retain the cash necessary to fund the extension. All said, no matter what your view is on the tax credit extension, we will be debt free in early 2018, and we will then have the freedom and opportunity to issue dividends as prudent.

Looking ahead, we expect the fourth quarter to deliver another strong DGD performance. Rousselot should also rebound, and the rendering business will continue to make adjustments to manage the volatile pricing environment due to the globally ample crops and continuing strong animal slaughter. All of our new assets are up and performing nicely, and we've commenced construction of two additional plants, one in Mering, Germany for blood, and new digester in Denderleeuw, Belgium.

As John will outline further, we continue to strengthen our balance sheet and are well on our way to our $150 million debt-reduction target for 2016. Our leverage ratio has now broken the 4.0 market. And additionally, we continue to improve working capital usage while deploying capital to grow and maintain our world-class infrastructure.

So with that, I'll let John take you through some financial highlights, and I'll come back with a few closing comments. John?

John Muse: Thanks, Randy.

Through the first nine months of 2016, we continue our focus on debt reduction, reducing working capital, cost reductions in both operating and SG&A expenses, and monitoring CapEx deployment. During the third quarter, 2016, this is kind of how we performed.

We continued our focus on debt repayment and paid down $60 million in debt in third quarter. Year to date, we have paid debt down by $105 million, and our debt-reduction target for 2016, as Randy indicated, remains at $150 million.

We remain committed to reducing working capital in our business in 2016 over 2015 levels. We're focused on lowering inventories and managing payables and receivables. For 2016, we remain on target

for a $20 million improvement in working capital. At the end of the third quarter, working capital over 2015 has improved by $13 million.

For the quarter of 2016, SG&A expenses were $76.5 million. SG&A was lower in the third quarter due to gains in currency hedges and capitalized expenses. We expect SG&A to run in the range of $80 million to $81 million in the fourth quarter of 2016.

Our CapEx target for 2016 is $225 million, and our third quarter CapEx spend was $58.8 million. In regard to significant CapEx deployments, we have completed construction and are running raw material into two new US rendering plants. We will see the impact of these facilities in the fourth quarter.

Now, on to our financial results for the third quarter ended October 1, 2016. For the third quarter of 2016, the Company reported net sales of $853.9 million, compared to net sales of $853.7 million for the third quarter of 2015. Net sales were basically flat year over year. Finished product sales were mixed year over year, with raw material volumes up. Overall, global raw material volumes in the feed ingredients segment were stronger year over year. The food ingredients segment raw material volumes were significantly flat -- essentially flat, I'm sorry.

Net income for the third quarter 2016 was $28.7 million or $0.17 per diluted share, compared to a net loss of $9.1 million or a loss of $0.06 per diluted share in the third quarter of 2015. The increase is primarily attributable to higher earnings from Diamond Green Diesel due to the inclusion of the blenders tax credit, which was not available as of the end of the third quarter of 2015.

Adjusted EBITDA for Darling in the third quarter was $106.2 million, compared to adjusted EBITDA of $106.1 million for the third quarter of 2015. The third quarter adjusted EBITDA of $106.2 million was down $17.8 million from the second quarter of 2016 adjusted EBITDA of $124 million.

The decrease in the third quarter compared to the second quarter was primarily attributable to lower earnings in the food ingredients segment. This was the result of limited availability of pigskins in China, reduced low bloom gelatin demand in the China food market, which created an inventory write-down; and the annual maintenance turnarounds at plants in both China and the USA.

As we move on to the operating segments, a sequential quarter result breakdown of each is included in the slide deck that we have provided. Feed segment operating income in the third quarter was $35.3 million, a decrease of $0.4 million compared to the third quarter of 2015. Our earnings for the segment were lower due to a decrease in fats and used cooking oil finished product prices, which did offset increased production volumes due to higher raw material supply.

On a sequential basis, third quarter operating income decreased by $6.1 million over the second quarter of 2016. This was due to lower fat protein and bakery finished product prices.

Food segment operating income for the third quarter of 2016 was $7.9 million, a decrease of $3.6 million compared to the third quarter of 2015, which were down sequentially from the $19.7 million in the second quarter of 2016. The sequential decrease in earnings is mainly attributable to the reduced low bloom gelatin demand in China, which drove inventory write-downs.

The fuel segment, exclusive of Diamond Green Diesel joint venture, generated third quarter operating income of $6 million, a decrease of $0.6 million as compared to the second quarter of 2016. The decrease is due to slightly lower earnings at Ecoson and Rendac, which offset improved Canadian biodiesel earnings.

Darling's share of Diamond Green Diesel's joint venture third quarter EBITDA was $22.5 million. Lower fat prices, stable heating oil prices and rising [ren] value supported improved earnings.

At the conclusion of the third quarter, Darling's total debt to EBITDA ratio was 3.97, compared to our covenant requirement of 5.50. Our secured debt ratio was 1.64, compared to a covenant requirement of 3.25.

Now, let's take a look at our effective tax rate, cash taxes and depreciation. The income tax expense for the nine months ended October 1, 2016 was $9.1 million, compared to $9.8 million for the income tax expense for the six months ended July 2nd. Accordingly, the Company reported an income tax benefit of $0.7 million for the third quarter, three months ended.

The effective tax rate for the first nine months ended October 1, 2016 is 12.2%, which is lower than the US statutory tax rate of 35%, primarily due to biofuel tax incentive. The quarterly income tax expense is based upon the Company's estimate of its expected tax rate for the full year and discrete items recognized during the period. We expect our effective tax rate for 2016 to be about the same as last year, which was around 14%.

I want to briefly mention our cash taxes. For the first nine months, the Company paid net of refunds $14 million to the taxing authorities. We anticipate tax payments of $5 million to $7 million for the next quarter, bringing our cash taxes for 2016 to around $20 million. Depreciation and amortization remains in the 70 to 71 range on a quarterly basis for the remainder of 2016.

I will now turn the call back over to Randy.

Randall Stuewe: Thanks, John.

All in all, Darling Ingredients delivered the performance we expected in the third quarter. We remain laser-focused on executing against our 2016 strategy to delever, grow, manage costs and widen margins.

Our growth strategy is on pace with four new plans currently online, two more under construction; and our pipeline of long-term growth opportunities remains robust. We remain committed to maintaining a strong balance sheet. And once again, we are carrying good momentum into 2017.

So with that, let's open it up to questions, Amy.

Questions and Answers

Operator: (Operator Instructions) Adam Samuelson, Goldman Sachs.

Adam Samuelson: So maybe first on the food segment -- you gave a lot of detail for reasons why the results did tick down sequentially and year over year. And they were closer to flat year over year ex the inventory write-down. Would it then be fair to assume that, if seasonality kind of turned back more normally, that fourth quarter ends up looking more like last year, which would end up being pretty similar to the run rate you were at in the first half of the year? Or are some of the market issues in China something that you expect to persist, that that's going to weigh on the performance for a couple more quarters?

Randall Stuewe: I mean, clearly, they're going to improve over Q3 for seasonality, inventory write-down, and several other operating issues that were out there. I suspect they'll be a little softer than fourth quarter last year. We were carrying some really strong momentum in Q4 last year with Chinese demand.

The China situation -- and not to spend a whole lot of time and give color on it, because it's fairly complicated -- the China plants -- we run multiple plants in China, one in [ephone] -- a couple of [vphone] and one on pigskin. The pig or pork availability in China continues to tighten because of the reduction in the herd. And what we've seen, Adam, is a run-up in pigskin prices. Remember, pigskin can either be eaten as food, you know, fried; or it can go in to make gelatin. Prices of pigskin rose rapidly in the third quarter as the amount of hogs that came to market went less and less.

And so as you try to move your gelatin spread margins up, you temper demand a little bit there. And then you force the switchover to an alternative way to make gelatin out of hides. And so you had a little bit of consternation in the switchover of plants that could do it, plants that couldn't; some different values as you convince customers to take a little different product. While most of it's homogenous, it is a little different in application.

So like I said, fairly complicated way of saying I think the Chinese issue will continue to move a little bit more into fourth quarter for us. It won't come back as strongly as it was a year ago. But we are moving margins up in China again to reflect the higher raw material costs. So overall, I think we'll pick up good momentum into Q4, or towards the end of Q4 and then into Q1.

And as I think we look forward to next year, we see a pretty similar performance in that business unit next year. So just really, a third quarter interruption with a whole bunch of moving parts, back to normal in fourth quarter, picking up momentum into Q1.

Adam Samuelson: That's some really helpful color.

And then, maybe switching gears over to the feed segment -- just wonder your thoughts on the fat markets right now. Because I think it's interesting how, frankly, healthy the global vegetable oil complex has been, with [flavone] oil prices up near $0.35. Palm oil's been pretty tight recently, making some multiyear highs. And the yellow grease market domestically has been pretty stagnant. And I'd love to hear your thoughts on drivers there, especially against an RFS mandate that's still pretty ambitious on the advanced biofuel and biodiesel side.

Randall Stuewe: John, you want to comment on that?

John Muse: Yes. This is John. I mean, you're exactly right. You hit the drivers dead-on.

We see really good palm prices. And, quite frankly, it doesn't look like that's going to stop anytime soon. I think you can expect that market's going to remain pretty tight. We have a really large supply of soybean oil, but the demand is just excellent is the only way to describe it.

But you also have to remember, on the animal fats, we have a lot of production. I think we've shown that our volumes are up substantially. And as those animals get slaughtered, that means that there's a lot of fat on the marketplace. But that fat's being absorbed extremely well by the biofuel sector at this point in time.

And I think the final component we have is obviously a lot of our fat also goes into the feed channels. The corn market, despite the fact that we're going to produce over 15 billion bushels worth of corn in the United States, has remained extremely strong through this harvest, at the $3.50 range. And so fats really now are in a position where they can be well supported by the feed and the fuel segment.

So looks like we have pretty good demand here at this point in time. And quite frankly, while it has lagged a little bit behind, that's primarily been because corn's dropped down, and some of the feed demand we were too high for for a while. But right now, with the way the corn's holding through harvest, we've both got feed -- both feed demand and energy demand for our fats. So it looks pretty good position right now.

Adam Samuelson: Great, that's really helpful. I'll pass it on.

Operator: Tom Palmer, JPMorgan.

Tom Palmer: What are your thoughts on the extension of the blenders tax credit for next year? Do you think it gets passed in the lame-duck session? Or is it more likely to be addressed in 2017?

Finally, although not part of the proposal at this point, has there been any recent discussion about switching to a producers credit?

John Muse: Yes, this is John. Frankly, I hate guessing on what Congress is going to do, particularly in a lame-duck session of Congress. I know that there is a lot of discussion back in Washington, DC about both an extenders package in general and specifically about the biodiesel tax credit. It's going to be an issue that's certainly going to be brought up. I hesitate to really give you a guess on whether or not it's going to be prospective or retroactive.

What I've always continued to believe, and what I've always said, I think, to everyone, is that the farm community strongly supports the biodiesel tax credit. And so whether it comes in prospectively or retroactively, we believe that there's strong political momentum to eventually have it in place. But there is a lot of discussion. And there's a lot of discussion from changing it form a blenders to a producers tax credit as well.

Generally in Washington, DC, once you have something, particularly a tax program, in effect in a particular manner, it's hard to change it. And so, while I know that -- or I strongly believe -- nobody knows what Washington, DC will do, but I strongly believe that we will have a tax credit, either prospectively or retroactively for next year. The chances of it actually being converted to a producers tax credit are probably less solid than the fact that it does actually get implemented as a blenders, just because you're changing the format, and there's always resistance to change anytime you try to do something like that.

Tom Palmer: Okay. Thanks, John.

And just a quick follow-up -- could you provide any update on the CFO search? Have you been interviewing candidates? Can you discuss some of the traits you're looking for?

Randall Stuewe: Obviously, that's something we're working diligently on. John celebrated a birthday here this last week, and I promised him shortly that I'd have the new John Muse clone onboard. So, frankly, I don't really want to say any more than that. But John's shoes are very, very hard to fill. He's an exceptionally talented guy. And hopefully, we're getting close to moving forward there.

Tom Palmer: Thank you.

Operator: Chip Moore, Canaccord.

Chip Moore: Could you talk, kind of broad strokes, on CapEx for next year? The model here has demonstrated some good stability in a pretty volatile environment. Deleveraging is running ahead plan. Can you just remind us what's in the pipeline? And then, would you consider accelerating anything?

Randall Stuewe: Pretty much, Chip, we're looking at next year pretty much the same as we've got going on this year. Right now, we're in what we call our budgetary strategy and planning time of the year. We completed Canada a week ago, US rendering this week, specialty Monday; and then head to Europe Monday night.

All in all, the global CapEx plan is rolling up right now at about $225 million for next year. Course, that includes the maintenance CapEx piece, that includes the Mering blood plant and the Denderleeuw Ecoson plant. And then also, we're rebuilding a new plant in Wahoo, Nebraska and finishing up an expansion and modernization in Los Angeles. So that's all in there for next year.

Our approach into next year is once again to be cautious. We're optimistic of an improved situation for next year, because we have the new assets that we built this last year in the Pocahontas plant, the Weinsburg, Ohio plant; the two wet pet food plants. We've got an acquisition, the [Bosland] acquisition in Holland. They're all onboard, performing. The Dubuque gelatin expansion, the [Wensu] gelatin expansion.

So all of that stuff is lending towards what appears to be, right now on the onset, a more optimistic view of both margins and earnings. We're going to go at the CapEx side from a [225] side point. We're going to go low and slow in the first quarter and make sure, as we've got a new administration in DC, there aren't any surprises on anything. We don't foresee that. But we'll work from that perspective, with then a view of paying down additional debt next year and then continuing to delever it.

I'll comment a little bit, given my other comments on a robust pipeline. We continue to see an incredible amount of opportunities around the world to invest in. As we've said, we look for projects that can put us in a top-three market position within five years or bolt-ons that give us a 15% to 20% ROSI. We're starting to see those again. As the values and the agriculture markets moderated around the world, so have expectations.

So once again, I think by mid-2017, early 2017 here, we've got the balance sheet in a very stable place. Diamond Green Diesel is the big earner for us as we look into the future. And so as you start to model and think through the business -- and hopefully I'm answering some other questions here -- as you look through it, as Diamond Green comes on in early 2018 with both its shutdown and then its new capacity expansion, once you start to go to that 275 million-gallon rate, you look at the low-carbon fuel markets, you look at our ability to serve more and more of those versus what we're doing today, and you can clearly come up with cash dividends out of that unit on a completely delevered basis, anywhere from $100 million to $150 million a year, if the margin structures hold that we see today.

So then you've got the current operating run rate plus that. That then puts us into a position to once again either delever or really accelerate our growth again.

Chip Moore: Excellent. Understood.

And maybe just one more, on the collections business. Kind of jump again -- can you just sort of contrast that with some of the mix things we've seen in fast-food traffic and the outlook there? Thanks, guys.

John Muse: Yes, this is John.

Yes, we have continued to see our volume grow on the restaurant services side through the last year. I think part of it is the prices have been a little lower, so there's a little less theft out there than maybe there has been.

And the other part of it -- at least, I hope it's because we've got a more effective outreach strategy to the restaurants now and are doing a little better job connecting with them and getting our fair share of that product out of the back end of the facilities.

But we're optimistic, even with the restaurant business slowing down a little bit. We're optimistic that we're going to be able to continue to maintain volume growth on that segment.

Randall Stuewe: All right, Amy. Let's move to the next question.

Operator: Dan Mannes, Avondale Partners.

Dan Mannes: A couple questions here. Some will hopefully be quick.

Can you walk through a little bit more on the food inventory issue? Was this a situation where the product -- where either demand was low enough that there wasn't any value in the product, given the switchover in feedstock? Can you just maybe explain that a little bit more, the $3.5 million?

Randall Stuewe: I'll do my best, Dan. Like I said, it's fairly complicated. The reality is that when you operate a gelatin factory, you do three general extractions in our configuration, and you produce a high quality, a medium quality and a low quality, which is phrased high bloom, medium bloom, low bloom. The high bloom is the preferential product used in many applications of high-end pharmaceuticals, high-end confectionaries; the medium more so into the confectionary, and the low bloom into the dairy industry.

We moved prices up as we tried to maintain spreads into the Chinese market and maintain our margin structure. Like we said, it is a spread business. We moved our prices up, at the same time while some other manufacturers switched over to high gelatin. That high gelatin then hit the market. And as we went to move some of our low bloom inventory into the marketplace, where we had it valued versus where we could sell it became a significant difference. And via accounting policies, we wrote it down. If it comes back, we write it up. But at this time, we wrote it down.

Dan Mannes: Fair enough.

The other thing, just in terms of clarification -- in terms of the renless vessel, is this more of just -- I guess I'm just trying to understand, did you take credit for the sale of the diesel itself but not the ren, and the ren is only at the point of blending? If you could just walk me through the mechanics there as well? That was a little confusing.

John Muse: Yes, Dan, this is John.

We occasionally sell a vessel. Because we are a blender, and we ship everything out as a blended product, we're able to separate the [rens]. And occasionally, we have vessels, not very often, or markets in which we separate the rens out. We do take and recognize in the revenue associated with the sale of the fuel itself. But because of the income recognition rules from the accounting folks, we are unable to put the rens that we separated out, that are then attached to future sales within a few weeks -- we're unable to actually account for them to have any value at that point in time.

Dan Mannes: Got it. So [multiple speakers] --

John Muse: -- happens if we just carry it forward.

Dan Mannes: But that's not something you do frequently; this is kind of an infrequent occasion, where you would sell renless gallons?

John Muse: Fairly infrequently, I would say yes. In fact, it doesn't happen very often but does happen from time to time. And obviously, it usually doesn't matter (technical difficulty) load one of those on the last day of the month, and you're able to recognize the diesel fuel price, but you're not able to recognize the ren value.

Dan Mannes: Got it.

And then, this is for Randy or for John. In your goals to make the biodiesel -- or, I guess, in this place, the Green Diesel business great again, I was hoping you could prognosticate just a little bit for me on maybe how RFS2 may or may not change, given the incoming administration.

John Muse: Yes, this is John.

I don't know that we know. I mean, I think the Trump Administration has announced their top priorities. And energy activity was not amongst the top priorities. During the campaign, candidate Trump was extremely effusive on his support of RFS2. Whether or not that continues into his administration we will see.

However, I think there's always the question -- will RFS2 be repealed? Probably not, because you need 60 votes in the United States Senate, and this tends to be a geographic as well as along-party-lines type of an issue. How the EPA administers RFS2 going forward -- really not going to have any current impact on that until we see what they do this time next year, when they're actually doing the next round of setting of the obligations. But it's the current administration that's going to set the obligations that we're going to see for next year and for biomass-based diesel for 2018.

So to some degree, the category that we're in is really going to be handled in the next few weeks here, once the EPA comes out with their forward final rule on that subject. And then we'll just have to see how the Trump Administration handles RFS2 as they take the reins.

Dan Mannes: So conceivably in May, we could see a proposal for 2019 for biomass-based diesel?

John Muse: No, you'll see a -- that's correct, you'll see a proposal in May for the 2019 biomass-based diesel and the 2018 advanced and total renewable.

Dan Mannes: Got it. Thanks for the color.

Operator: Craig Irwin, Roth Capital Partners.

Craig Irwin: So there's been some pretty active discussion out there in the biofuels industry about the imports from Singapore, and obviously Argentina, of biodiesel, green diesel. And many people in the industry are advocating an FTC complaint, which sounds like it's gaining potential momentum. Have you discussed potential for an FTC complaint internally? And would you view this as a bullish thing for Diamond Green, if there was one that was filed maybe in the first quarter?

John Muse: Yes, this is John again.

The question -- this has been discussed by the industry for some period of time. I suspect that the industry will move forward. It probably targets more specifically Argentina than it does the renewable diesel coming in from Norway or from Asia.

The question here with this is it's a very long process. And it will take a long time for it to actually implement. So while I think it may ultimately catch some ground, I'm not so sure that it does anything for us in the short term. But if it does, and they do put [anti-dumping] tariffs on some of the stuff coming in, obviously that's going to be extremely supportive for the US industry.

Craig Irwin: Great.

Second question is about the US fats market. So from a macro perspective, it looks like we've got a lot more animals on feed in feedlots. Available supply seems to be very healthy versus where it was a couple years ago. Can you say whether or not this is likely to impact available pricing for you over the next number of quarters? Or do you feel that there are other factors that are helping support price and, obviously, profitability?

Randall Stuewe: Well, I think -- Craig, I think your read on it is the same as ours. I guess we get to see it every day. Our rendering plants across the country in the USA and in Europe are as full as they've ever been. We are near capacity or at capacity across the country, with several expansions underway now.

With that comes both protein and fat. The fat is supported and seems very resilient, being held up to a degree, if you will, by $0.35 bean oil and $750-a-ton palm oil -- all good news. I think, as John talked about it earlier, not only is feed demand good, consumer demand around the world for palm oil and soybean oil remains robust, predominantly really in India. India is leading the way this year. So you've got a pretty tight [S&D] of veg oils and fats and greases around the world.

And then, to accelerate that or support it even more, as we showed our board the list of biofuel programs around the world, the list continues to grow and grow, with people adding 1% or 2%. I mean, Malaysia added now a 7% demand. Takes another million tons out of the market next year. So all in all, that stuff continues to support.

Predominantly and specifically back to the US, we're going to have to -- the challenge we get into with animal fats is feed demand is fairly good when it gets cold. When it gets warm, it gets a little less. But offsetting that is the strong biofuel demand. There's some counter-seasonality there. We've got a lot of fat to move. The question will be, as we continue to slaughter both a lot of chicken right now, where does the poultry fat move? A lot of that doesn't move into biofuels today. And so we'll see.

There is a pretty -- that's kind of the reason you're seeing the discounts. I don't know, I would've probably bet you years ago that we would've never seen used cooking oil as a premium to animal fat, but it is. That probably will maintain its way because of the low-carbon fuel standard and the carbon intensity value. But I suspect this will all tighten up a little bit as expansions happen within Diamond Green Diesel and the fight for low-carbon feedstock intensifies over the coming year.

Craig Irwin: Great.

Then, my last question is subject of aviation fuels -- sounds like it's sort of creeping its way into the discussion around the next-generation RFS. Green diesel is a particularly good fit for blending into jet fuel, even moderate consumption rates per gallon. Can you comment about whether or not you have any

active programs working with any airlines, whether or not you deal with airlines frequently, often; introducing them to your capabilities and your longer-term plans; and whether or not addressing this market is something that you think credibly the industry can do over the next number of years?

John Muse: Yes, this is John.

Yes, we talk to the airlines quite often about the subject of renewable diesel. And clearly, we could convert some of the production from Diamond Green Diesel if we wanted. Take a little capital, but we could do it. But focus is on the renewable jet industry. I think it is going to be an extremely strong demand component.

However, the reality is in today's economics, we can make more money selling renewable diesel to the road than we can to the jet fuel industry, and there's a number of factors associated with that. But in today's economics, if I had the choice to have Diamond Green Diesel running as a road fuel producer or a jet fuel producer, I would just as soon that it be making road fuel.

Now, that may change as these programs and as some of these protocols become stronger on like flying into Europe, where a certain percentage of your fuel has to be renewable and so forth. That may change, and the economics may change. And we're going to be able to adapt to that change fairly quickly.

But certainly, there's a lot of talk about it, there's more focus on it. And it may be become the market to target.

For now, frankly, we have more demand at our current run rate or at our expanded run rate to hit the road fuel market. So we really don't have to drive into the jet fuel market. We're only going to go there if we can make more money doing it than we currently do with road fuel.

Craig Irwin: Great. Thanks again for taking my questions.

Randall Stuewe: Thanks, Craig.

Operator: [Garrett Luppin], Gates Capital.

Jeff Gates: This is Jeff. I have a couple questions.

You alluded to the oversupply of proteins hurting profitability. And I'm just wondering, did that materially hurt profitability? Because I thought most of that was formula. That's the first question.

The second one is if you didn't have a tax credit next year, what margin per gallon do you think Diamond Green Diesel could earn? And how long do you think it would take for the ren prices to transition higher?

And then, my third question is regard to bakery volume that you noted was strong. And I'm wondering, was the market that strong for bakery? Or are you gaining market share? Or what's happening in that business?

Randall Stuewe: Okay. Jeff, this is Randy. I'll try to answer all three of them and see if I can get some help here.

The protein situation is one that's evolving here with the large corn crop. But remember, the animal slaughter numbers are way up right now. We're running anywhere from 2% to 5% higher. The year-

over-year animal weights are still pretty heavy. And so the animal byproduct business finds its way into either pet foods or animal feeds. And that's whether it's domestic or exported.

So we saw a strong push of animal proteins here towards the end of September that are struggling to find markets. And you've got a couple things. I wouldn't say it impacted the Q3 a lot. But coming into October here, meat and bone meal fell off hard. It's come back a little bit. I think our team feels around the world that we probably -- we bounced. I don't know, I always hate calling bottoms on it, but we're starting to see a little more demand around the world for animal proteins. And it's coming from the export side.

Any time that you have historically large crops like we have, the world buyers tend to go to the sidelines and then try to pick a low. They've now seen -- as John Bullock said, we saw corn just really light, $350 a bushel. There were people thinking it was going lower. It's kind of held, so now people are coming back in and buying protein.

We've got soybeans meal holding in the low 300s, and meat and bone meal at a discount to it. Traditionally, it should be either a premium or equal. I think we'll see an improvement in that area.

The chicken proteins -- continue to be a lot of chicken protein out there. You're in the seasonality mix between aquaculture and pet food. Again, that should bounce.

So that's really the protein situation. I looked at it, we're still -- we're about where we were in fourth quarter last year. Fats are a lot better than they were in fourth quarter last year. But the protein situation is equal to or better, and especially on the feather meal area.

Okay, we'll try to take the second question, then, which was the dollar a gallon, what happens. I mean, if you look at the margin structure out there today, you're somewhere at -- and I'm not talking biodiesel, I'm talking Diamond Green -- Diamond Green's margins are anywhere from a dollar and a quarter to $1.45 a gallon. So if you took the dollar away, you would then say -- running next year, you would be $25 to $45. But traditionally or typically, when we've seen that dollar kind of disappear, rens will react a little bit to help the biodiesel guy. There'll be a view of whether the tax credit is going to be reinstated. So there's a little bit of view of run for fun there that happens. It's a better situation to have it known than known.

Now, what's different this next year is you have a defined low-carbon fuel standard market out in California that, if you can get there, will continue to pay you nice dividends to get there. So I mean, the challenge for us as we look forward -- and I know what you're thinking, Jeff, to a degree, and it is what is the cash position at Diamond Green? It's very ample, even if we get a prospective tax credit even funding the expansion, at which time then there can be discussion of pulling dividends out of Diamond Green in 2017. If it goes retro, then there's a little bit more. I don't think we'll have to put cash in, but I think -- I'm 99% sure pulling a dividend out would be challenging under a retroactive tax credit.

And bakery -- John, you want to comment a little on bakery? Volumes are just up this year.

John Muse: Yes. We just seem to have strong raw material volumes across the board. Typically, we've seen that surge for a period of time. And we keep thinking that if we're going to go back down to more normal levels -- but quite frankly, we've been thinking that now for five months in a row. And every months, the volumes keeps coming. So it's not really taking a lot of additional customers out there away from anybody else. It's more just the volume is up.

Randall Stuewe: Amy, let's go to the next question, please.

Operator: Ken Zaslow, Bank of Montreal.

Ken Zaslow: Just two quick housekeeping, just making sure -- their inventory write-down was $3.5 million. That does not continue any further?

John Muse: Well, we marked it down to the market value that we thought we could move the product for the coming period. If the market weakens more, then we would have to address it at that time. But we think we've got the value written down to what we can move the product at.

Ken Zaslow: Okay. And then, $9 million transfer from third quarter to fourth quarter -- what division was that in? I just didn't hear it, I'm sorry.

John Muse: Diamond Green Diesel.

Ken Zaslow: And is that 50% of that, or is that the full credit to you?

John Muse: Full credit to us. Yes.

Ken Zaslow: That's your share of it?

Randall Stuewe: No, that's the entity level.

John Muse: That's the entity level (multiple speakers) half it it.

Randall Stuewe: -- those rens will be sold out or attached in Q4. And so you'll just have $9 million of additional earnings in the Q4.

Ken Zaslow: Okay. And then, my big question is -- can you frame 2017 for us on what you see the puts and pulls are, and what type of earnings power are you looking to see? Just give us some sort of framework. There seems to be a lot of transitions going on. You got more CapEx projects, you got more stable maybe yellow grease prices -- just kind of how you're seeing 2017 relative to 2016, and just frame it for us?

Randall Stuewe: Yes. I'll try to articulate it real simple.

Fats and oils, pretty steady to maybe higher here, at least the front half of the year next year. So I think we're in pretty good shape there. The protein is abundant. We see slaughter being heavy around the globe here. We see a little bit of slaughter material leaving Canada and Europe for China as they just as short meat basically over there. But rendering volume is strong.

Protein has to find some export markets. And the majority of these animal proteins end up in the Southeast Asia Pac Rim countries. That's got to continue to help us.

It looks like soybean meal likes $300. So I think it's pretty simple that you can say meat and bone meal will trade in that $280 to $320 range next year.

As we look forward, then, a fairly consistent run rate from where we're at. But when I say consistent now, if you say what's our disappointments for this year -- our wet pet food plants did not contribute what we thought they would this year. And then, now we've got two brand new rendering plants coming on for

a full year next year. So you got to blend those in. Like I said, we're starting -- we haven't completed our annual planning process. That completes later this week or next week in Europe.

So we're looking for a slightly improved run rate from what we see right now in the world. Obviously, that can dramatically change. We see an outstanding year for Diamond Green Diesel. I think we'll probably budget it at a dollar a gallon. But right now, you could sit there and make a case for a dollar and a quarter out there. We'll just have to see what happens there.

CapEx, 2.25, Ken. That's pretty much what we're going to put out there for next year, and our interest payments are pretty similar to this year, and cash taxes are pretty similar. So at the end of the day, we set ourselves up to once again either delever or deploy capital, whichever makes sense.

Ken Zaslow: Okay. Just to make sure I understand it -- so the feed ingredients side -- this kind of run rate, this $35 million, is more than doable on a quarterly basis going forward. And then, the food ingredients side, you have more capital projects. So this $20 million is not a crazy run rate on a per-quarter basis. Again, there's seasonality to it and stuff like that. Is that the way to think about it, in that way?

John Muse: I think so, yes.

Ken Zaslow: Okay, great. I appreciate it, thank you.

Operator: William Baldwin, Baldwin Anthony Securities.

William Baldwin: Can you give us a feel for what the yields were like in your chicken and slaughter plants here in the third quarter, say, versus a year ago? I know seasonality there, they're hit with the warm weather. I just wondered how that compared with last year this time on the yield of the slaughter plants -- other rendering plants.

John Muse: The yields -- truthfully, the yields haven't changed that much. We did see the typical warm weather and the quality impact that did have on the fats, where you do discount the fat to move it into the marketplace on the rendering side. This year, as you're aware, it is a pretty warm summer. And we really have yet to see that break of the warm weather through most of the Midwest. We're now starting to see temps cool down a little bit.

But nothing unusual on the yields, about the same. We had a little more volume on poultry, which does take the overall yield down. Because poultry yields in more of the 33% range versus cattle in the 48% percent range. But from that perspective, pretty much a normal third quarter from a quality issue and a yield issue.

Randall Stuewe: Yes, Bill, we saw bird weights lighten up a little bit here, especially the big bird side. But overall, the poultry side is just rocking and rolling out there. And they remain very optimistic into 2017 here. And we're running full, like we said, everywhere around the country.

William Baldwin: In that same regard, then, or looking at that, is there good possibility that poultry fat could find its way to the feedstock, into Diamond Green Diesel? Like you say, there's a pretty heavy supply of poultry fat out there. I just wondered if that could be used more as a biodiesel feedstock than it has been in the past.

John Muse: We can use poultry fat at Diamond Green Diesel. So yes, we will be using more poultry fat, I believe, as we going forward. Particularly as we upside the facility, we're be using more poultry fat.

A lot of poultry fat, as you well know, is sold back, right, and is used for feed in the poultry industry. So there's not (inaudible) that as available as there might be from some of the other types of fats. But certainly, we'll use more poultry fat at Diamond as we move forward.

William Baldwin: Okay. So from a technical standpoint, there's no problem using that in your plant there?

John Muse: Correct, we can use poultry fat at Diamond.

William Baldwin: Very good. Thank you.

Randall Stuewe: All right.

Well, thanks, folks, for joining us. We'll continue to run out the year, and we carry good momentum into 2017. And we'll talk to you again in February. Thank you.

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