Darling Ingredients

Consumer Staples
NYSE: DAR
Market Outperform | Hold

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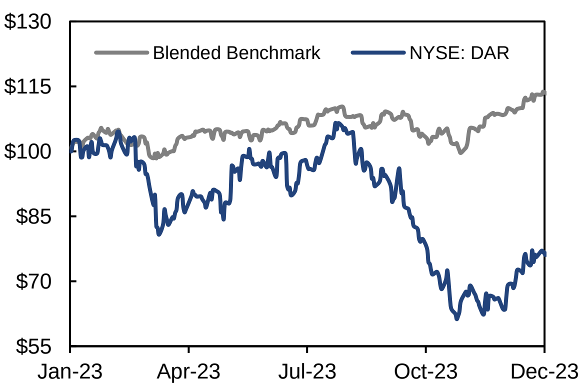
Return on Investment	
Current Share Price	$49.84
Target Price	$60.00
Dividend Yield	0.00%
Implied Return	20%
Conviction Rating	2

Market Profile	
52-Week Range	$38.97 - $71.60
Market Capitalization (US$mm)	$8,084
Net Debt (US$mm)	$4,288
Enterprise Value (US$mm)	$12,372
Beta (5-Year Monthly)	1.30

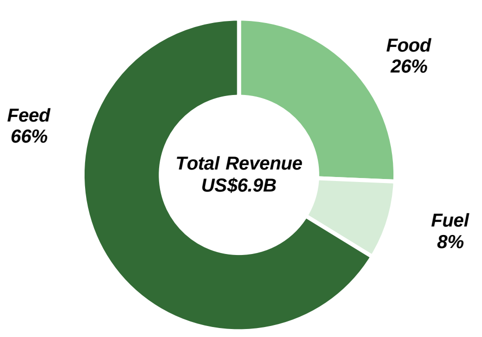
Metrics	2024E	2025E	2026E
Revenue (US$mm)	$6,870	$7,070	$7,277
EBITDA (US$mm)	$1,169	$1,203	$1,238
EPS	$4.31	$5.16	$5.51
EV/EBITDA	10.6x	10.3x	10.0x

Holding Period Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: LTM Segmented Revenue



Source: Company Filings

Business Description

Darling Ingredients (NYSE: DAR) is a global developer, marketer, and producer of specialty ingredients for both edible and inedible products. DAR operates a network of ~260 facilities across five continents, servicing pharmaceutical, feed, fuel, and fertilizer industries. The Company's core operations comprise the collection of recycled oils and conversion into feed ingredients. Additionally, DAR collects and transforms animal by-products into specialty ingredients, such as collagen, edible fats, fertilizers, and fuel feedstock. The Company reports under three main segments:

(1) Feed Ingredients: Consists of operations that convert animal by-products into non-food grade oil and proteins. This segment comprises ~70% of 2022 revenue.

(2) Food Ingredients: Includes the process of rendering collagen and gelatin from animal parts. Overall, the Food segment generates ~20% of 2022 revenue.

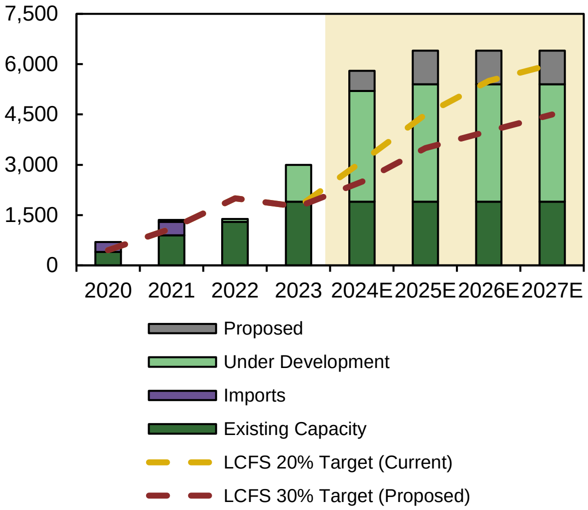
(3) Fuel Ingredients: Process of converting animal fats and recycled greases into biodiesel and other energy sources, accounting for ~10% of 2022 revenue. This segment comprises DAR's joint venture with Valero (NYSE: VLO) and its investment in Diamond Green Diesel (DGD).

Industry Overview

The agricultural product industry and associated renewable fuels businesses have had a challenging last 12 months from an investor sentiment perspective. The industry-wide sell-off was primarily driven by the sector's rate-sensitive balance sheet, declining renewable fuel performance seen in 2022, and year-end tax-loss selling. Fundamentally, Renewable Identification Numbers (RIN) and Low Carbon Fuel Standard (LCFS) markets are expected to remain oversupplied in 2024, resulting in continued pricing pressure. The RIN market is expected to be oversupplied by ~2.6B gallons in 2024, followed by extensive rebalancing via a combination of reduced imports and utilization. Previously, DAR benefited from the cellulosic waiver credit (CWC), which allowed renewable diesel (RD) producers who did not acquire sufficient RINs for their cellulosic biofuel renewable volumetric obligation to earn extra tax credits. This was at the greater value of $0.25 or $3.00 per gallon metric, less the wholesale price of gasoline. The retirement of the CWC has compressed producer margins, yet marginal capacity remains online.

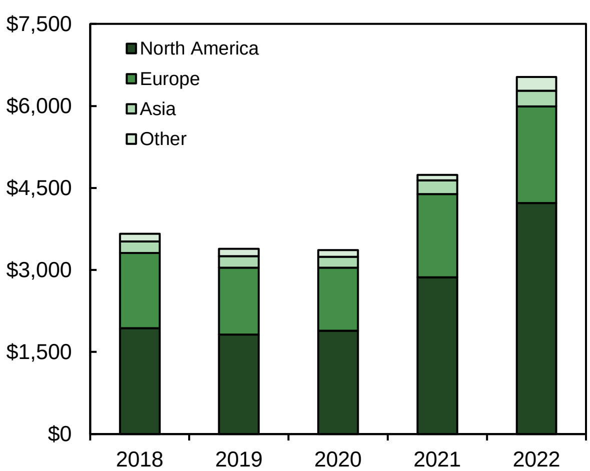
California's revised carbon intensity proposal for fuels is expected to tighten supply in 2025, following the oversupply of credits in 2024. The proposed amendments to the California LCFS are expected to support credit pricing of US$140/T in 2025 relative to the expected market clearing price of US$80/T in 2024 Despite negative short-term sentiment and oversupplied credit markets, DAR is positioned to benefit from tailwinds in 2025 and beyond.. Furthermore, the shift from the flat (US$1/gal) Blenders Tax Credit to the Inflation Reduction Act (IRA) Production Tax Credit (PTC), which is carbon-intensity weighted, will likely afford DGD the highest tax credit amongst its North American (NA) Peers. The IRA PTC requires RD to be produced domestically to qualify, which should eliminate any remaining imports serving as a conduit to more robust credit pricing.

Figure 3: NA RD Supply & Demand (mmGal/Year)



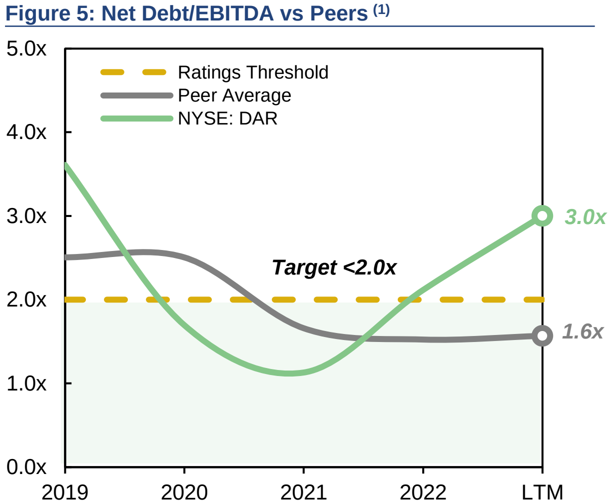
Source: Bloomberg

Figure 4: Geographical Segmentation Over Time



Source: Company Filings

Figure 5: Net Debt/EBITDA vs Peers (1)



Source: S&P Capital IQ

Mandate Fit

Quality Management: Randall Stuewe has served as DAR's CEO since 2003. Prior to entering this role, he served as the President of ConAgra Foods (NYSE: CAG). With over 25 years of experience in agricultural processing, Stuewe has enabled DAR to emerge as a leader in the sustainable ingredients space. Under Stuewe's leadership, the Company has seamlessly integrated over 20 acquisitions into its operating portfolio, solidifying DAR's position as an international operator. Furthermore, 82% of CEO salary and 66% of NEO salary is classified as at-risk pay, comprised of both short-term and long-term incentives.

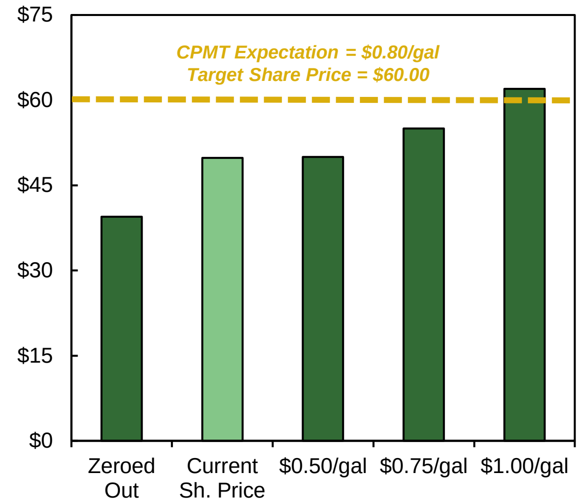
Competitive Advantage: DAR's competitive advantage stems from its position as a vertically integrated first-mover in all segments of animal by-product use cases. The Company focuses on inorganic growth through acquisitions within its Feed and Food segments to achieve economies of scale, further positioning itself as a low-cost producer in these unsubsidized markets. DAR boasts strong customer relationships exemplified by positioning operating facilities near customers, allowing the company to secure off-take contracts more efficiently. Additionally, DAR's M&A strategy provides a more diversified and predictable cash flow profile relative to regionally focused peers, such as Neste (HLSE: NESTE). This is achieved by limiting geographic dependence, increasing the diversity of end markets, and improving feedstock security. In the Fuels segment, the Company's scale presents a structural cost advantage in RIN generation ($0.20/gal advantage) and feedstock pricing ($0.30/gal advantage). Further supplementing the cost advantage is DAR'S CI score of ~23, the lowest among its peer group. With the introduction of the IRA, the new PTC is structured such that lower carbon intensity producers, on a per unit basis, will receive incrementally higher credit prices. The CPMT expects the margin advantages stemming from the PTC will allow DAR to capture additional market share in the Fuels segment moving forward.

Strong Balance Sheet: Historically, DAR has been acquisitive to fortify a dominant market position within NA rendering, which has forced the Company to take on incremental leverage. However, DAR has completed most of its large-scale M&A pipeline, and management will focus on bringing the Company's Net Debt/EBITDA ratio below 2.0x. Currently, DAR holds a LTM Net Debt/EBITDA ratio of 3.0x, compared to the peer average of 1.6x. Rating agencies have indicated that 2.0x leverage is the threshold for the Company to gain its investment-grade credit rating, which is currently a BB+ from both Fitch and S&P Global.

Growing Free Cash Flow: DAR boasts a three-year FCF CAGR of 8.0%, attributable to organic and inorganic growth, specifically within its Feed segment. The CPMT views the cash flow profile of the Food and Feed segments as a stable source of capital to fund the Fuel segment's growth. Within the Food segment, management is focused on shifting the weight of its production mix to higher-margin, non-commoditized collagen products to improve unit economics, improving FCF generation moving forward. However, higher input costs have slowed FCF generation in DAR's Feed segment. From a capex perspective, the completion of its DGD 2 facility turnaround is expected to lower DAR's capex into H2 2024. In the Fuels segment, DAR has received US$62.2mm in cash dividends from its DGD fuel joint venture YTD. In 2024, the CPMT expects improved distributions from DGD due to higher production volumes, lower capex guidance, and lower working capital requirements as the drag on current assets from the four previous quarters has abated.

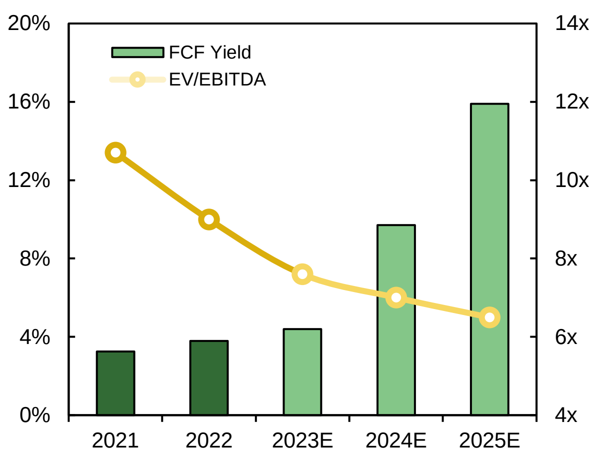
(1) Peer group includes NYSE: ADM, NYSE: BG, BVMS: JBSS3, HEL: NESTE, NYSE: TSN, NYSE: VLO

Figure 6: Valuation Sensitivity to DGD EBITDA



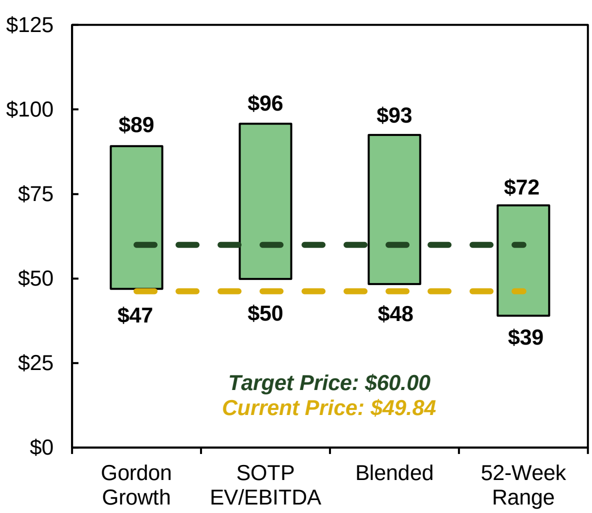
Source: Company Filings

Figure 7: LHS FCF Yield vs RHS EV/EBITDA



Source: FactSet

Figure 8: Valuation Football Field



Source: CPMT Estimates, FactSet

Risks

Acquisition Integration: DAR's recent acquisitions of Valley Protein (US$1.1B), FASA (US$542.6mm), and Gelnex (US$1.2B) provide a foundation for an acquisition-light 2024; this excludes its €110.0mm acquisition of a Polish rendering company that is expected to close in Q1 2024. Given the volume, frequency, and geographical spread brought on by acquisitions, the CPMT is cautious of management's ability to successfully integrate all new business lines simultaneously.

Maintenance of Competitive Advantage: A further risk for DAR is its ability to successfully build on current RD and rendering first-mover advantages to maintain market share. An inability to correct the operational difficulties in the future could potentially narrow the competitive advantage gap that DAR has established. The Company is also significantly exposed to evolving biofuel legislation, suggesting that unfavourable decisions at the federal and state levels will negatively impact margins.

Commodity Price Sensitivity: The business is exposed to potential compression in its Fuel segment margins as feedstock cost inflation remains persistent throughout 2023. Regarding business output, higher-for-longer fat prices and other commodity output prices can uniformly impact margins to the downside. However, DAR historically mitigates this through pricing premiums and lower turnaround times.

Investment Thesis and Valuation

Despite the current market sentiment and operational headwinds, DAR's legacy Feed and Food business lines provide advantages for the Company's growing RD business. This drives meaningful and underappreciated business line integration value over the long term while also representing a robust standalone business. The current valuation trough for DAR represents 7.0x EV/EBITDA, similar to traditional fuel refining businesses. DAR's valuation is materially below both its five-year average and YE 2022 multiple of 14.9x and 12.4x, respectively. The Fund believes this valuation is justified given regulatory headwinds, and further provides the foundation for mean reversion as the operating environment improves. However, the CPMT believes the valuation should reflect the legacy business lines more closely while simultaneously acknowledging the present value of growth opportunities within renewable fuel operations. RD and sustainable aviation fuel production represents a growth driver for DAR and its industry peers, all while the Company's upstream business lines provide strategic positioning in the longer term.

The derived target price is US$60, implying a return of 20% and 8.2x EV/EBITDA. The CPMT used a sum-of-the-parts (SOTP) analysis to value DAR, which separately analyzed the three main operating segments alongside its equity stake in DGD on a 2025E EV/EBITDA. The legacy Feed and Fuels segments are valued at 7.0x EV/EBITDA, which is a slight discount to similar agriculture product peers to reflect DAR's current capital requirements and operational difficulties over the past calendar year. The Food segment is valued at 9.0x EV/EBITDA, which is in-line with comparable companies based on operating margins. DAR's current stake in DGD is valued at 6.0x EV/EBITDA, a slight discount to comparable biofuels producers to reflect infantry of the infrastructure and un-proved execution to date.