DARLING INTERNATIONAL INC
Form 10-K
March 02, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

X ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended January 1, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number
001-13323

DARLING INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

Delaware	36-2495346
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
251 O'Connor Ridge Blvd., Suite 300 Irving, Texas	75038
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (972) 717-0300

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered

Common Stock $0.01 par value per share	New York Stock Exchange ("NYSE")

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes X No ____

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No X .

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes X No ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. X

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
X			

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes ____ No X

As of the last day of the Registrant's most recently completed second fiscal quarter, the aggregate market value of the shares of common stock held by nonaffiliates of the Registrant was approximately $587,955,000 based upon the closing price of the common stock as reported on the NYSE on that day. (In determining the market value of the Registrant’s common stock held by non-affiliates, shares of common stock beneficially owned by directors, officers and holders of more than 10% of the Registrant’s common stock have been excluded. This determination of affiliate status is not necessarily a conclusive determination for other purposes.)

There were 116,753,219 shares of common stock, $0.01 par value, outstanding at February 23, 2011.

DOCUMENTS INCORPORATED BY REFERENCE

Selected designated portions of the Registrant's definitive Proxy Statement in connection with the Registrant’s 2011 Annual Meeting of stockholders are incorporated by reference into Part III of this Annual Report.

DARLING INTERNATIONAL INC. AND SUBSIDIARIES
FORM 10-K FOR THE FISCAL YEAR ENDED JANUARY 1, 2011

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PART I

ITEM 1. BUSINESS

GENERAL

Founded by the Swift meat packing interests and the Darling family in 1882, Darling International Inc. ("Darling", and together with its subsidiaries, the "Company") was incorporated in Delaware in 1962 under the name "Darling-Delaware Company, Inc." On December 28, 1993, Darling changed its name from "Darling-Delaware Company, Inc." to "Darling International Inc." The address of Darling's principal executive office is 251 O'Connor Ridge Boulevard, Suite 300, Irving, Texas, 75038, and its telephone number at this address is (972) 717-0300.

The Company is a leading provider of rendering, cooking oil and bakery waste recycling and recovery solutions to the nation's food industry. The Company collects and recycles animal by-products, bakery waste and used cooking oil from poultry and meat processors, commercial bakeries, grocery stores, butcher shops, and food service establishments and provides grease trap cleaning services to many of the same establishments. On December 17, 2010, Darling completed its acquisition of Griffin Industries, Inc. and its subsidiaries ("Griffin") pursuant to the Agreement and Plan of Merger, dated as of November 9, 2010 (the "Merger Agreement"), by and among Darling, DG Acquisition Corp., a wholly-owned subsidiary of Darling ("Merger Sub"), Griffin and Robert A. Griffin, as the Griffin shareholders' representative. Merger Sub was merged with and into Griffin (the "Merger"), and Griffin survived the Merger as a wholly-owned subsidiary of Darling. The Company operates over 125 processing and transfer facilities located throughout the United States to process raw materials into finished products such as protein (primarily meat and bone meal ("MBM") and poultry meal ("PM")), tallow (primarily bleachable fancy tallow ("BFT")), poultry grease ("PG"), yellow grease ("YG"), bakery by-product ("BBP") and hides as well as a range of branded and value-added products. The Company sells these products nationally and internationally, primarily to producers of animal feed, pet food, fertilizer, bio-fuels and other consumer and industrial ingredients, including oleo-chemicals, soaps and leather goods for use as ingredients in their products or for further processing.

Prior to the Merger the Company's operations were organized into two segments: 1) Rendering, the core business of turning inedible food by-products from meat and poultry processors, butcher shops, grocery stores and food service establishments into high quality feed ingredients and fats for other industrial applications; and 2) Restaurant Services, a group focused on the grease collection business, grease collection equipment sales and grease trap servicing. Griffin historically operated in two segments, rendering (as described above) and bakery. The results of Griffin for the period December 17, 2010 (date of Merger) to January 1, 2011, are included in the rendering and bakery operating segments. For the financial results of the Company's business segments, see Note 18 of Notes to Consolidated Financial Statements.

The Company’s net external sales from continuing operations by operating segment were as follows (in thousands):

	Fiscal 2010		Fiscal 2009		Fiscal 2008	
Continuing operations:						
Rendering	$ 536,935	74.1 %	$ 458,573	76.7 %	$ 585,108	72.5 %
Restaurant Services	177,750	24.5	139,233	23.3	222,384	27.5
Bakery	10,224	1.4	–	–	–	–
Total	$ 724,909	100.0 %	$ 597,806	100.0 %	$ 807,492	100.0 %

OPERATIONS

Rendering and restaurant services

The Company's largest business activity is rendering. Prior to the Merger, Darling was primarily a beef renderer. Following the acquisition of Griffin, the Company is one of the leading poultry renderers in the United States. The Company's rendering operations process poultry and animal by-products into protein (primarily MBM and PM (feed grade and pet food)), tallow (primarily BFT), PG, YG, hides and a variety of other value-added finished products. The Company also collects used cooking oil from restaurants and processes it into finished products, such as YG, which it sells to external customers as well as internal divisions. In addition to waste cooking oil, the Company collects trap grease from restaurants in exchange for a collection fee.

Raw materials

The Company's rendering operations collect two primary types of protein by-products, (i) beef and pork by-products and (ii) poultry by-products, which are collected primarily from independent meat and poultry processors, grocery stores, butcher shops and food service establishments.

Rendering materials are collected in one of two manners. Certain large suppliers, such as large meat processors and poultry processors, are furnished with bulk trailers in which the raw material is loaded. The Company provides the remaining suppliers, primarily grocery stores and butcher shops, with containers in which to deposit the raw material. The containers are picked up by or emptied into the Company’s trucks on a periodic basis. The type and frequency of service is determined by individual supplier requirements, the volume of raw material generated by the supplier, supplier location and weather, among other factors.

The raw materials collected by the Company are transported either directly to a processing plant or to a transfer station where materials from several collection routes are loaded into trailers and transported to a processing plant. Collections of animal processing by-products generally are made during the day, and materials are delivered to plants for processing within 24 hours of collection to deter spoilage.

Certain of the Company's rendering facilities are highly dependent on one or a few suppliers. During the 2010 fiscal year, the Company's 10 largest raw materials suppliers accounted for approximately 23% of the total raw material processed by the Company with no single supplier accounting for more than 4%. See "Risk factors—A significant percentage of the Company's revenue is attributable to a limited number of suppliers and customers." Should any of these suppliers choose alternate methods of disposal, cease or materially decrease their operations, have their operations interrupted by casualty or otherwise cease using or reduce the use of the Company’s collection services, these operating facilities would be materially and adversely affected. For a discussion of the Company’s competition for raw materials, see "Competition." Certain Griffin facilities are also heavily reliant on one or a few suppliers, and an interruption in the operations of one or more of those suppliers could likewise have a material impact on those Griffin facilities.

The restaurant services industry is highly fragmented. The Company collects used cooking oil and trap grease from restaurants, food service establishments and grocery stores. Many of the Company's customers operate stores that are parts of national food chains. No single customer represents a material percentage of the Company's total used cooking oil raw materials volume. Used cooking oil from food service establishments is placed in various sizes and types of containers which are supplied by the Company. In some instances, these containers are unloaded directly onto the trucks, while in other instances the oil is pumped through a vacuum hose into the truck. The Company sells two types of containers for used cooking oil collection to food service establishments called CleanStar® and BOSS, both of which are proprietary self-contained collection systems that are housed either inside or outside the

establishment, with the used cooking oil pumped directly into collection vehicles via an outside valve. The frequency of all forms of used cooking oil and trap grease raw material collection is determined by the volume of oil generated by the food service establishment.

The Company either transports trap grease to waste treatment centers or recycles it at its facilities into a host of environmentally safe product streams, including fuel and feed ingredients. The Company provides its customers with a comprehensive set of solutions to their trap grease disposal needs, including manifests for regulatory compliance, computerized routing for consistent cleaning and comprehensive trap cleaning.

Processing operations

The Company produces finished products primarily through the grinding, cooking, separating, drying, and blending of various raw materials. The process starts with the collection of animal processing by-products (including fat, bones, feathers, offal and other animal by-products). The animal processing by-products are ground and heated to extract water and separate oils and grease from animal tissue as well as to sterilize and make the material suitable as an ingredient for animal feed. The separated oils, tallows, and greases are then centrifuged and/or refined for purity. The remaining solid product is pressed to remove additional oils to create meals. The meal is then sifted through screens and ground further if necessary to produce an appropriately sized protein meal.

The primary finished products derived from the processing of animal by-products are tallow, PG, MBM, PM, feather meal, and blood meal. In addition, at certain of its facilities, the Company is able to operate multiple process lines simultaneously which provides it with the flexibility and capacity to manufacture a line of premium and value-added products in addition to its principal finished products. Because of these processing controls, the Company is able to blend end products together in order to produce premium products with specific mixes that typically have higher protein and energy content and lower moisture than principal finished products and command premium prices.

The Company's hides and skins operations process hides and skins from hog and beef processors into outputs used in commercial applications such as the leather industry. The Company sells treated hides and skins to external customers, the majority of which are tanneries.

The Company's fertilizer operations utilize finished products from the rendering division to manufacture fertilizers from USDA approved ingredients that contain no waste by-products (i.e., sludge or sewage waste). The Company's primary fertilizer product line is Nature Safe®, an organic, protein based fertilizer which is produced at its blending plant in Henderson, KY. The Company's fertilizer products are predominately sold to golf courses, sports facilities, organic farms and landscaping companies.

Used cooking oil, which is recovered from restaurants, is heated, settled, and purified for use as an animal feed additive or is further processed into biodiesel. Products derived from used cooking oil include YG, biodiesel, and Fat for Fuel®, which uses grease as a fuel source for industrial boilers and driers.

Bakery feed

The Company is a leading processor of bakery waste in the U.S. The bakery feed division collects bakery waste materials and processes the raw materials into BBP, including Cookie Meal®, an animal feed ingredient primarily used in poultry rations.

Raw materials

Bakery products are collected from large commercial bakeries that produce a variety of products, including cookies, crackers, cereal, bread, dough, potato chips, pretzels, sweet goods and biscuits, among others. The Company collects these materials by bulk loading onsite at the bakeries utilizing proprietary equipment, the majority of which is designed, manufactured, and installed by the Company. The Company has specifically engineered bulk collection systems for the handling of bakery waste. All of the bakery waste that the Company collects is bulk loaded which represents a significant advantage over competitors that receive a large percentage of raw materials from less efficient, manual methods. The receipt of bulk-loaded bakery waste allows the Company to significantly streamline its bakery recycling process, reduce personnel, eliminate a significant source of wastewater and maximize freight savings by hauling more tons per load.

Processing operations

The highly automated bakery feed production process involves sorting and separating raw material, mixing it to produce the appropriate nutritional content, drying it to reduce excess moisture, and grinding it to the consistency of animal feed. During the bakery waste process, packaging materials are removed. The packaging material is fed into a combustion chamber, along with sawdust from nearby sawmills and heat is produced. This heat is used in the dryers to remove moisture from the raw materials that have been partially ground. Finally, the dried meal is ground to the specified granularity. The finished product, which is continually tested to ensure that the caloric and nutrient contents meet specifications, is a nutritious additive used in animal feed.

Renewable fuels / Biodiesel

In addition to the rendering, restaurant and bakery waste services, on January 21, 2011, a wholly-owned subsidiary of the Company entered into a limited liability company agreement (the "JV Agreement") with a wholly-owned subsidiary of Valero Energy Corporation ("Valero") to form Diamond Green Diesel Holdings LLC (the "Joint Venture"). The Joint Venture will be owned 50% / 50% with Valero and was formed to design, engineer, construct and operate a renewable diesel plant (the "Facility") capable of producing approximately 9,300 barrels per day of renewable diesel, to be located adjacent to Valero's refinery in Norco, Louisiana. The Facility is expected to convert grease, primarily animal fats and used cooking oil supplied by the Company, and potentially other feed stocks that become economically and commercially viable, into renewable diesel. The Facility will use an advanced hydroprocessing-isomerization process licensed from UOP LLC, known as the Ecofining™ Process, and a pretreatment process developed by the Desmet Ballestra Group to convert approximately 1.1 billion pounds per year of recycled animal fats, recycled cooking oils and other feedstocks into renewable diesel product and certain other co-products.

In addition, the Company utilizes a portion of its rendered animal fats, recycled greases and plant oils to produce Bio G-3000TM Premium Diesel Fuel. The Company's biodiesel operations utilize raw material inputs sourced from its rendering and bakery feed operations as well as several third party additives in order to produce Bio G-3000TM. The Company has the annual capacity to produce two million gallons of Bio G-3000TM. The Company's biodiesel product is sold to its internal divisions as well as domestic commercial biodiesel producers to be used as biodiesel fuel, a clean burning additive for diesel fuel or as a biodegradable solvent or cleaning agent. Bio G-3000TM is currently processed at the Company's facility in Butler, Kentucky.

Raw materials pricing and supply contracts

The Company has two primary pricing arrangements—formula and non-formula arrangements—with its suppliers of poultry, beef, pork and bakery waste products and used cooking oil. Under a "formula" arrangement, the charge or credit for raw materials is tied to published finished product commodity prices after deducting a fixed processing fee. The Company also acquires raw material under "non-formula" arrangements whereby suppliers are either paid a fixed price, are not paid, or are charged a collection fee, depending on various economic and competitive factors. Approximately 58% of Darling's annual volume of raw materials is acquired on a "formula" basis. All of Griffin's poultry rendering and bakery feed raw materials are acquired on a "formula" basis.

The credit received or amount charged for raw material under both formula and non-formula arrangements is based on various factors, including the type of raw materials, demand for the raw materials, the expected value of the finished product to be produced, the anticipated yields, the volume of material generated by the supplier and processing and transportation costs.

Formula prices are generally adjusted on a weekly, monthly or quarterly basis while non-formula prices or charges are adjusted as needed to respond to changes in finished product prices or related operating costs.

Finished products

The Company's finished products are predominantly proteins (primarily MBM and PM), oils (primarily BFT, PG and YG), BBP and hides. MBM, PM and BBP are used primarily as high protein additives in pet food and animal feed. Oils are used as ingredients in the production of pet food, animal feed, soaps and as a substitute for traditional fuels. Oleo-chemical producers use these oils as feed stocks to produce specialty ingredients used in paint, rubber, paper, concrete, plastics and a variety of other consumer and industrial products. Hides are sold to leather distributors and manufacturers for the production of leather goods. Currently, substantially all of Darling's principal finished products and approximately half of Griffin's finished products compete with commodities such as

corn, soybean oil and soybean meal. While the Company's finished products are generally sold at prices prevailing at the time of sale, the Company's ability to deliver large quantities of finished products from multiple locations and to coordinate sales from a central location enables the Company to occasionally receive a premium over the then-prevailing market price.

Finished products

The Company's finished products include the following.

Protein Meals

The Company's meal products include MBM, PM, feather meal and blood meal. All of the Company's meal products are protein-rich and contain essential minerals and amino acids which are critically important components of animal feed. MBM, blood meal, PM and feather meal are sold to feed manufacturers while higher grade poultry meal is also sold to pet food manufacturers. Some of the Company’s meals are also used as ingredients in its fertilizer operations.

Animal Fats

The Company produces a range of animal fats from its rendering operations. Animal fats are an additive in livestock and pet foods that contains essential fatty acids and energy and enhances the taste of the foods. Animal fats are also frequently sold to soap and beauty products manufacturers as well as industrial manufacturers of paint, rubber, paper, concrete, plastics and other consumer products. The vast majority of the animal fat that the Company produces is used as a feed additive.

Grease

The Company produces several different types of grease including YG and brown grease. Grease, similar to tallow, is an essential ingredient in livestock and pet foods due to its fatty acid composition and high energy content. Due to its nutritional content, the majority of the Company's YG is sold to meat and poultry producers who use the grease as a feed additive. In addition, some of the grease produced by the Company's rendering operations is burned as Fat for Fuel® or used to manufacture biodiesel.

Hides and skins

The Company processes discarded hides and skins from beef, hog and other animal processing facilities. The hides and skins are trimmed and cured in a brine solution that prepares them for tanneries. Tanneries sell the tanned hides and skins primarily to leather companies that use the products in a variety of consumer goods including apparel and vehicle interiors.

Premium, value-added and branded products

The Company's premium, value-added and branded products command significantly higher pricing relative to its principal finished product lines due to their enhanced nutritional content, which is a function of the Company's proprietary processing techniques.

MARKETING, SALES AND DISTRIBUTION OF FINISHED PRODUCTS

The Company sells its finished products worldwide. Finished product sales are primarily managed through the Company's commodity trading departments which are located at Darling's corporate headquarters in Irving, Texas and Griffin’s corporate headquarters in Cold Spring, Kentucky. The Company also maintains sales offices in Des Moines, Iowa, New Orleans, Louisiana, and Memphis, Tennessee for the sale and distribution of selected products. This sales force is in contact with several hundred customers daily and coordinates the sale and assists in the distribution of most finished products produced at the Company's processing plants. The Company sells its finished products

internationally through commodities brokers, Company agents and directly to customers in various countries.

The Company sells its finished products primarily to producers of livestock feed, oleo-chemicals, bio-fuels, soaps, pet foods and leather goods for use as ingredients in their products or for further processing. Currently, substantially all of Darling's finished products and approximately half of Griffin’s finished products are commodities that are priced relative to competing commodities, primarily corn, soybean oil and soybean meal. Customers for the Company's premium, value added and branded products include feed mills, pet food manufacturers, integrated poultry producers, the dairy industry and golf courses, among others. Feed mills purchase meals, greases, tallows, and Cookie Meal® for use as feed ingredients. Oleo-chemical producers use oils as feed stocks to produce specialty ingredients used in paint, rubber, paper, concrete, plastics and a variety of other consumer and industrial products. Pet food manufacturers require stringent feed safety certifications and consistently demand premium additives that are high in protein and nutritional content. As a result, pet food manufacturers typically purchase only premium or value-added products. The Company typically enters into long-term supply contracts with pet food manufacturers.

The Company has no material foreign operations, but exports a portion of its products to customers in various foreign countries or regions including Asia, the European Union, Latin America, the Pacific Rim, North Africa, Mexico and South America. Total direct export sales were $71.0 million, $70.8 million and $132.2 million for the years ended January 1, 2011, January 2, 2010 and January 3, 2009, respectively. The Company also sells to third parties that export to various foreign countries. The level of export sales varies from year to year depending on the relative strength of domestic versus overseas markets. The Company obtains payment protection for most of its foreign sales by requiring payment before shipment or by requiring bank letters of credit or guarantees of payment from U.S. government agencies. The Company ordinarily is paid for its products in U.S. dollars and has not experienced any material currency translation losses or any material foreign exchange control difficulties. See Note 18 of Notes to Consolidated Financial Statements for a breakdown of the Company’s sales by domestic and foreign customers.

Following diagnosis of the first U.S. case of bovine spongiform encephalopathy ("BSE") on December 23, 2003, many countries banned imports of U.S.-produced beef and beef products, including MBM and initially BFT, though this initial ban on tallow was relaxed to permit imports of U.S.-produced tallow with less than 0.15% impurities. Most foreign markets that were closed to U.S. beef following the discovery of the first U.S. case of BSE have been reopened to U.S beef, although some countries only accept boneless beef or beef from cattle less than 30 months of age. Japan is more restrictive and only permits imports of U.S. beef from cattle that are age verified to be 20 months of age or younger at slaughter. Even though the export markets for U.S. beef have been significantly re-opened, most of these markets remain closed to MBM derived from U.S. beef.

The Company's management monitors market conditions and prices for its finished products on a daily basis. If market conditions or prices were to significantly change, the Company's management would evaluate and implement any measures that it may deem necessary to respond to the change in market conditions. For larger formula-based pricing suppliers, the indexing of finished product price to raw material cost effectively fixes the gross margin on finished product sales at a stable level, providing some protection to the Company from price declines.

Finished products produced by the Company are shipped primarily FOB plant by truck and rail from the Company's plants shortly following production. While there are some temporary inventory accumulations at various port locations for export shipments, inventories rarely exceed three weeks’ production and, therefore, the Company uses limited working capital to carry inventories and reduces its exposure to fluctuations in commodity prices. Other factors that influence competition, markets and the prices that the Company receives for its finished products include the quality of the Company's finished products, consumer health consciousness, worldwide credit conditions and U.S. government foreign aid. From time to time, the Company enters into arrangements with its suppliers of raw materials pursuant to which these suppliers buy back the Company’s finished products.

The Company operates a fleet of trucks, trailers and railcars to transport raw materials from suppliers and finished product to customers. It also utilizes third party freight to cost-effectively transfer materials and augment its in-house logistics fleet. Within the Company’s bakery feed division, all inbound and outbound freight is handled by third party logistics companies.

COMPETITION

Management of the Company believes that the most challenging aspect of the business is the procurement of raw materials rather than the sale of finished products. Pronounced consolidation within the meat processing industry has resulted in bigger and more efficient slaughtering operations, the majority of which utilize "captive" renderers (rendering operations integrated with the meat or poultry packing operation). Simultaneously, the number of small meat processors, which have historically been a dependable source of supply for non-captive renderers, such as the Company, has decreased significantly. The slaughter rates in the meat processing industry are subject to decline due

to economic conditions, and, as a result, during such periods of decline, the availability, quantity and quality of raw materials available to the independent renderers decreases. These factors have been offset, in part, however, by increasing environmental consciousness. The need for food service establishments to comply with environmental regulations concerning the proper disposal of used restaurant cooking oil should continue to provide a growth area for this raw material source. The rendering and restaurant services industries are highly fragmented and very competitive. The Company competes with other rendering and restaurant services businesses, bakery waste and alternative methods of disposal of animal processing by-products and used restaurant cooking oil provided by trash haulers, waste management companies and bio-diesel companies, as well as the alternative of illegal disposal. In addition, restaurants have increasingly experienced theft of used cooking oil. A number of the Company's competitors for the procurement of raw material are experienced, well-capitalized companies that have significant operating experience and historic supplier relationships. Competition for raw materials is based in large part on price and proximity to the supplier.

In marketing its finished products domestically and abroad, the Company faces competition from other processors and from producers of other suitable commodities. Tallows and greases are, in certain instances, substitutes for soybean oil and palm stearine, while MBM and PM are a substitute for