DARLING INTERNATIONAL INC
Form 10-Q
November 08, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

/ X / QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 29, 2007

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 0-24620

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 Number)
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**

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (check one).

Large accelerated filer ____ Accelerated filer __X__ Non-accelerated filer ____

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ____ No_X__

There were 81,342,450 shares of common stock, par value $0.01 per share, outstanding at November 1, 2007.

DARLING INTERNATIONAL INC. AND SUBSIDIARIES
FORM 10-Q FOR THE THREE MONTHS ENDED SEPTEMBER 29, 2007

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DARLING INTERNATIONAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
September 29, 2007 and December 30, 2006
(in thousands, except shares and per share data)

	September 29, 2007 (unaudited)	December 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,873	$ 5,281
Restricted cash	440	480
Accounts receivable, net	54,582	42,381
Inventories	20,623	14,562
Other current assets	12,776	5,036
Deferred income taxes	8,274	6,921
Total current assets	102,568	74,661
Property, plant and equipment, less accumulated depreciation of $195,156 at September 29, 2007 and $184,061 at December 30, 2006	128,675	132,149
Intangible assets, less accumulated amortization of $41,256 at September 29, 2007 and $37,599 at December 30, 2006	30,239	33,657
Goodwill	71,856	71,856
Other assets	6,128	6,683
Deferred income taxes	–	1,800
	$ 339,466	$ 320,806
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 5,000	$ 5,004
Accounts payable, principally trade	23,239	17,473
Accrued expenses	45,262	34,319
Total current liabilities	73,501	56,796
Long-term debt, net	49,750	78,000
Other non-current liabilities	31,113	34,685
Deferred income taxes	1,571	–
Total liabilities	155,935	169,481
Commitments and contingencies		
Stockholders' equity:		
Common stock, $0.01 par value; 100,000,000 shares authorized; 81,524,516 and 80,875,453 shares issued and outstanding	815	809

at September 29, 2007 and at December 30, 2006, respectively				
Additional paid-in capital		151,932		150,045
Treasury stock, at cost; 182,366 and 21,000 shares at September 29, 2007 and December 30, 2006, respectively		(1,547)		(172)
Accumulated other comprehensive loss		(11,348)		(11,733)
Retained earnings		43,679		12,376
Total stockholders' equity		183,531		151,325
	$	339,466	$	320,806

The accompanying notes are an integral part of these consolidated financial statements.

DARLING INTERNATIONAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
Three months and nine months ended September 29, 2007 and September 30, 2006
(in thousands, except per share data)
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Net sales	$ 171,831	$ 115,229	$ 469,868	$ 278,860
Costs and expenses:				
Cost of sales and operating expenses	130,889	92,761	356,058	222,273
Selling, general and administrative expenses	14,285	12,424	41,161	33,928
Depreciation and amortization	5,647	5,682	17,186	14,864
Total costs and expenses	150,821	110,867	414,405	271,065
Operating income	21,010	4,362	55,463	7,795
Other income/(expense):				
Interest expense	(1,166)	(2,022)	(4,125)	(5,324)
Other, net	(105)	138	(636)	(4,391)
Total other income/(expense)	(1,271)	(1,884)	(4,761)	(9,715)
Income/(loss) from continuing operations before income taxes	19,739	2,478	50,702	(1,920)
Income taxes expense/(benefit)	7,639	677	19,540	(938)
Net income/(loss)	$ 12,100	$ 1,801	$ 31,162	$ (982)
Basic income/(loss) per share:	$ 0.15	$ 0.02	$ 0.39	$ (0.01)
Diluted income/(loss) per share:	$ 0.15	$ 0.02	$ 0.38	$ (0.01)

The accompanying notes are an integral part of these consolidated financial statements.

DARLING INTERNATIONAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
Nine months ended September 29, 2007 and September 30, 2006
(in thousands)
(unaudited)

	September 29, 2007	September 30, 2006
Cash flows from operating activities:		
Net income/(loss)	$ 31,162	$ (982)
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:		
Depreciation and amortization	17,186	14,864
Loss (gain) on disposal of property, plant, equipment and other assets	46	(139)
Write-off deferred loan costs	–	2,569
Deferred taxes	2,018	(1,825)
Stock-based compensation expense	1,115	1,228
Changes in operating assets and liabilities, net of effect of acquisition:		
Restricted cash	40	1,865
Accounts receivable	(12,201)	4,528
Inventories and prepaid expenses	(9,195)	(867)
Accounts payable and accrued expenses	11,618	(5,887)
Other	(2,355)	(15)
Net cash provided by operating activities	39,434	15,339
Cash flows from investing activities:		
Capital expenditures	(10,208)	(8,224)
Acquisition of NBP, net of cash acquired	–	(80,007)
Gross proceeds from disposal of property, plant and equipment and other assets	131	459
Payments related to routes and other intangibles	(239)	–
Net cash used by investing activities	(10,316)	(87,772)
Cash flows from financing activities:		
Proceeds from debt	40,000	120,000
Payments on debt	(68,254)	(75,769)
Deferred loan costs	(20)	(1,612)
Contract payments	(121)	(112)
Issuance of common stock	495	29
Minimum withholding taxes paid on stock awards	(1,375)	–
Excess tax benefits from stock-based compensation	749	48
	(28,526)	42,584

Net cash provided/(used) by financing activities				
Net increase/(decrease) in cash and cash equivalents		592		(29,849)
Cash and cash equivalents at beginning of period		5,281		36,000
Cash and cash equivalents at end of period	$	5,873	$	6,151
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Interest	$	4,153	$	3,593
Income taxes, net of refunds	$	22,332	$	794

The accompanying notes are an integral part of these consolidated financial statements.

DARLING INTERNATIONAL INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements
September 29, 2007
(unaudited)

(1) General

The accompanying consolidated financial statements for the three and nine month periods ended September 29, 2007 and September 30, 2006 have been prepared in accordance with generally accepted accounting principles in the United States by Darling International Inc. ("Darling") and its subsidiaries (Darling and its subsidiaries are collectively referred to herein as the "Company") without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The information furnished herein reflects all adjustments (consisting only of normal recurring accruals) that are, in the opinion of management, necessary to present a fair statement of the financial position and operating results of the Company as of and for the respective periods. However, these operating results are not necessarily indicative of the results expected for a full fiscal year. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. However, management of the Company believes, to the best of their knowledge, that the disclosures herein are adequate to make the information presented not misleading. The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements contained in the Company's Form 10-K for the fiscal year ended December 30, 2006.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The consolidated financial statements include the accounts of Darling and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

(b) Fiscal Periods

The Company has a 52/53 week fiscal year ending on the Saturday nearest December 31. Fiscal periods for the consolidated financial statements included herein are as of September 29, 2007, and include the 13 weeks and 39 weeks ended September 29, 2007, and the 13 weeks and 39 weeks ended September 30, 2006.

(c) Earnings per Share

Basic income per common share is computed by dividing net income/(loss) by the weighted average number of common shares outstanding during the period. Diluted income/(loss) per common share is computed by dividing net income/(loss) by the weighted average number of common shares outstanding during the period increased by dilutive common equivalent shares determined using the treasury stock method.

Net Income/(Loss) per Common Share (in thousands, except per share data)

	Three Months Ended					
	September 29, 2007			September 30, 2006		
	Income /(loss)	Shares	Per Share	Income /(loss)	Shares	Per Share
Basic:						
Net Income/(loss)	$ 12,100	80,983	$ 0.15	$ 1,801	80,336	$ 0.02
Diluted:						
Effect of dilutive securities:						
Add: Option shares in the money		1,599			2,291	
Less: Pro forma treasury shares		(606)			(1,081)	
Diluted:						
Net income/(loss)	$ 12,100	81,976	$ 0.15	$ 1,801	81,546	$ 0.02

	Nine Months Ended					
	September 29, 2007			September 30, 2006		
	Income /(loss)	Shares	Per Share	Income /(loss)	Shares	Per Share
Basic:						
Net Income/(loss)	$ 31,162	80,675	$ 0.39	$ (982)	72,297	$ (0.01)
Diluted:						
Effect of dilutive securities:						
Add: Option shares in the money		1,865			–	
Less: Pro forma treasury shares		(690)			–	
Diluted:						
Net income/(loss)	$ 31,162	81,850	$ 0.38	$ (982)	72,297	$ (0.01)

For the three months ended September 29, 2007 and September 30, 2006, respectively, 8,000 and 30,000 outstanding stock options were excluded from diluted income per common share as the effect was antidilutive. For the three months ended September 29, 2007 and September 30, 2006, respectively, 92,923 and 217,944 shares of non-vested stock and restricted stock were excluded from diluted income per common share as the effect was antidilutive. For the three months ended September 29, 2007 and September 30, 2006, respectively, 11,852 and 166,455 shares of contingent issuable stock were excluded from diluted income per common share as the effect was antidilutive.

For the nine months ended September 29, 2007 and September 30, 2006, respectively, 8,000 and 1,701,810 outstanding stock options were excluded from diluted income per common share as the effect was antidilutive. For the nine months ended September 29, 2007 and September 30, 2006, respectively, 123,604 and 502,225 shares of non-vested stock and restricted stock were excluded from diluted income per common share as the effect was antidilutive. For the nine months ended September 29, 2007 and September 30, 2006, respectively, 75,134 and 150,965 shares of contingent issuable stock were excluded from diluted income per common share as the effect was antidilutive.

(3) Acquisition of National By-Products, LLC

On May 15, 2006, Darling, through its wholly-owned subsidiary Darling National LLC ("Darling National"), a Delaware limited liability company, completed the acquisition of substantially all of the assets (the "Transaction") of National By-Products, LLC ("NBP"), an Iowa limited liability company. The following table presents selected pro forma information, for comparative purposes, assuming the Transaction had occurred on January 1, 2006 for the periods presented (unaudited) (in thousands, except per share data):

The selected unaudited pro forma information is not necessarily indicative of the consolidated results of operations for future periods or the results of operations that would have been realized had the Transaction actually occurred on January 1, 2006.

	Nine Months Ended September 30, 2006
Net sales	$352,217
Net income/(loss)	3,105
Earnings per share	
Basic and diluted	$ 0.04

The purchase price for the Transaction totaled $150.7 million, which included the issuance of approximately 16.3 million shares of Darling common stock valued at $70.5 million. The asset purchase agreement contained a true-up adjustment in which additional shares could have been issuable to NBP based on Darling's stock price for an average of 90 days ending on June 30, 2007 (the "True-up Market Price"). The Company's stock price for an average of 90 days ending on June 30, 2007 exceeded the True-up Market Price and no additional shares were issued.

(4) Contingencies

LITIGATION

The Company is a party to several lawsuits, claims and loss contingencies arising in the ordinary course of its business, including assertions by certain regulatory agencies related to air, wastewater and storm water discharges from the Company's processing facilities.

The Company's workers' compensation, auto and general liability policies contain significant deductibles or self-insured retentions. The Company estimates and accrues its expected ultimate claim costs related to accidents occurring during each fiscal year and carries this accrual as a reserve until such claims are paid by the Company.

As a result of the matters discussed above, the Company has established loss reserves for insurance, environmental and litigation matters. At September 29, 2007 and December 30, 2006, the reserves for insurance, environmental and litigation contingencies reflected on the balance sheet in accrued expenses and other non-current liabilities for which there are no insurance recoveries were approximately $19.8 million and $17.9 million, respectively. Management of the Company believes these reserves for contingencies are reasonable and sufficient based upon present governmental regulations and information currently available to management; however, there can be no assurance that final costs related to these matters will not exceed current estimates. The Company believes that the likelihood is remote that any additional liability from such lawsuits and claims that may not be covered by insurance would have a material effect on the financial statements.

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In June 2006, the Company was awarded damages of approximately $7.4 million as a result of a service provider's failure to provide steam under a service agreement to one of the Company's plants. At the time the damages were awarded, collectibility of such damages was uncertain; however, on October 12, 2006, the Company entered into an agreement to sell its rights to such damages to a third party for $2.2 million in cash. The agreement was made subject to certain conditions that were satisfied on March 1, 2007. On March 8, 2007, the Company received $2.2 million and transferred its damage award to the third party. The Company recorded a gain with the receipt of the $2.2 million in proceeds in the first quarter of 2007.

The Company is a party to a litigation matter involving a contract dispute. In July 2007, a judgment was entered in the matter, which ruled against the Company on certain points and in favor of the Company on certain points. The judgment requires the Company to convey an unused parcel of property recorded on the books for approximately $500,000 to the counterparty for that amount. The Company prevailed on certain issues regarding a request for ongoing indemnity. The Company has filed an appeal of the judgment. The appellate court has not yet set a date for oral argument of the appeal. The counterparty has filed a motion with the trial court seeking approximately $2.6 million in attorneys' fees and costs. A hearing on the motion was held on November 7, 2007, at which the Company vigorously opposed the motion. The judge had not yet ruled on the motion as of the time of the filing of this report on Form 10-Q.

(5) Business Segments

The Company sells its products domestically and internationally and operates within two industry segments: Rendering and Restaurant Services. The measure of segment profit (loss) includes all revenues, operating expenses (excluding certain amortization of intangibles), and selling, general and administrative expenses incurred at all operating locations and excludes general corporate expenses.

Included in corporate activities are general corporate expenses and the amortization of intangibles. Assets of corporate activities include cash, unallocated prepaid expenses, deferred tax assets, prepaid pension and miscellaneous other assets. The assets from the Transaction are reflected primarily in the Rendering segment.

Rendering

Rendering consists of the collection and processing of animal by-products, including hides, from butcher shops, grocery stores, food service establishments and meat and poultry processors, and converting these into useable oils and proteins principally utilized by the agricultural, leather and oleo-chemical industries and in the production of bio-diesel.

Restaurant Services

Restaurant Services consists of the collection of used cooking oils from food service establishments and recycling them into similar products used as high-energy animal feed ingredients, industrial oils and in the production of bio-diesel. Restaurant Services also provides grease trap servicing. The National Service Center ("NSC") is included in Restaurant Services. The NSC contracts for and schedules services such as fat and bone and used cooking oil collection as well as trap cleaning for contracted customers using the Company's resources or third party providers.

As discussed above, the Company received proceeds of $2.2 million during the first quarter of fiscal 2007 as a result of a service provider's failure to provide steam under a service agreement to one of the Company's plants. The Company recorded approximately $1.2 million of the proceeds as a reduction of cost of sales in the Company's rendering segment and approximately $1.0 million as a reduction of selling and general and administrative costs in the corporate segment.

Business Segment Net Sales (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Rendering:				
Trade	$ 122,229	$ 82,592	$ 336,079	$ 188,507
Intersegment	12,728	6,399	31,106	20,655
	134,957	88,991	367,185	209,162
Restaurant Services:				
Trade	49,602	32,637	133,789	90,353
Intersegment	1,351	598	3,631	2,298
	50,953	33,235	137,420	92,651
Eliminations	(14,079)	(6,997)	(34,737)	(22,953)
Total	$ 171,831	$ 115,229	$ 469,868	$ 278,860

Business Segment Profit/(Loss) (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Rendering	$ 21,072	$ 9,021	$ 56,641	$ 19,644
Restaurant Services	9,395	2,920	26,604	8,938
Corporate	(17,201)	(8,118)	(47,958)	(24,240)
Interest expense	(1,166)	(2,022)	(4,125)	(5,324)
Income/(loss) from continuing operations	$ 12,100	$ 1,801	$ 31,162	$ (982)

Certain assets are not attributable to a single operating segment but instead relate to multiple operating segments operating out of individual locations. These assets are utilized by both the Rendering and Restaurant Services business segments and are identified in the category called Combined Rendering/Restaurant Services. Depreciation of Combined Rendering/Restaurant Services assets is allocated based upon management's estimate of the percentage of corresponding activity attributed to each segment.

Business Segment Assets (in thousands):

	September 29, 2007	December 30, 2006

Rendering	$ 159,738	$ 153,798
Restaurant Services	39,217	36,359
Combined Rendering/Restaurant Services	104,460	105,402
Corporate	36,051	25,247
Total	$ 339,466	$ 320,806

(6) Income Taxes

The Company has provided income taxes for the three-month and nine-month periods ended September 29, 2007 and September 30, 2006, based on its estimate of the effective tax rate for the entire 2007 and 2006 fiscal years.

In determining whether its deferred tax assets are more likely than not to be recoverable, the Company considers all positive and negative evidence currently available to support projections of future taxable income. The Company is unable to carry back any of its net operating losses and recent favorable operating results do provide sufficient historical evidence at this time of sustained future profitability sufficient to result in taxable income against which certain net operating losses can be carried forward and utilized.

In 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109* ("FIN 48"), which prescribes accounting for and disclosure of uncertainty in tax positions. This interpretation defines the criteria that must be met for the benefits of a tax position to be recognized in the financial statements and the measurement of tax benefits recognized. Effective December 31, 2006 the Company adopted the provisions of FIN 48 resulting in a reduction in the Company's existing reserves for uncertain state and federal income tax positions of approximately $0.1 million. This reduction was recorded as a cumulative effect adjustment to retained earnings. At the adoption date of December 31, 2006, the Company had $0.6 million of unrecognized tax benefits and a related deferred tax asset of $0.1 million. If the Company recognized such tax benefits, the net impact on the Company's effective tax rate would be $0.5 million, which includes the effect of the reversal of the $0.1 million deferred tax asset. Additionally, at December 31, 2006, the Company had an accrual for interest and penalties of $0.1 million. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

For federal income tax purposes, open tax years include 2005 and 2006. The statute for most state returns filed for the year 2003 expired in the third quarter of 2007. Statute of limitations are generally three to four years from the due date of the return, including extensions, depending upon the jurisdiction. The Company's state tax returns for 2004, 2005 and 2006 are still open. Additionally, it is expected that the amount of unrecognized tax benefits will change over the next 12 months, but the Company does not expect the change to have a significant impact on its results of operations or financial position.

(7) Financing

The Company entered into a new $175 million credit agreement (the "Credit Agreement") with new lenders on April 7, 2006 that replaced the former senior credit agreement executed in April 2004. The Credit Agreement provides for a total of $175.0 million in financing facilities, consisting of a $50.0 million term loan facility and a $125.0 million revolver facility, which includes a $35.0 million letter of c