BENCHMARK ELECTRONICS INC
Form 10-Q
May 07, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2010.

¨ 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: 1-10560

BENCHMARK ELECTRONICS, INC.
(Exact name of registrant as specified in its charter)

Texas (State or other jurisdiction of incorporation or organization)	74-2211011 (I.R.S. Employer Identification No.)
3000 Technology Drive Angleton, Texas (Address of principal executive offices)	77515 (Zip Code)

(979) 849-6550
(Registrant's telephone number, including area code)

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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 ¨ No ¨

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 Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b–2 of the Act). Yes ¨ No þ

As of May 6, 2010 there were 63,041,773 Common Shares of Benchmark Electronics, Inc., par value $0.10 per share, outstanding.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(in thousands, except par value)	March 31, 2010 (unaudited)	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 400,568	$ 421,243
Accounts receivable, net of allowance for doubtful accounts of $645 and $417, respectively	407,717	417,268
Inventories, net	361,962	315,743
Prepaid expenses and other assets	33,593	31,034
Income taxes receivable	3,526	3,526
Deferred income taxes	9,386	9,861
Total current assets	1,216,752	1,198,675
Long-term investments	45,209	45,686
Property, plant and equipment, net of accumulated depreciation of $284,023 and $280,107 respectively	126,763	126,250
Goodwill, net	37,912	37,912
Deferred income taxes	18,980	17,713
Other long-term assets, net	38,515	39,484
	$ 1,484,131	$ 1,465,720
Liabilities and Shareholders' Equity		
Current liabilities:		
Current installments of capital lease obligations	$ 314	$ 300
Accounts payable	296,664	275,900
Income taxes payable	7,859	6,464
Accrued liabilities	51,858	56,916
Total current liabilities	356,695	339,580
Capital lease obligations, less current installments	11,302	11,381
Other long-term liabilities	24,230	23,856
Shareholders' equity:		
Preferred shares, $0.10 par value; 5,000 shares authorized, none issued	—	—
Common shares, $0.10 par value; 145,000 shares authorized; issued – 63,405 and 64,208, respectively; outstanding – 63,294 and 64,097, respectively	6,329	6,410
Additional paid-in capital	726,972	732,956
Retained earnings	367,009	356,802
Accumulated other comprehensive loss	(8,134)	(4,993)
Less treasury shares, at cost; 111 shares	(272)	(272)
Total shareholders' equity	1,091,904	1,090,903
Commitments and contingencies		
	$ 1,484,131	$ 1,465,720

See accompanying notes to condensed consolidated financial statements.

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BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Income
(unaudited)

(in thousands, except per share data)	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Sales	$ 571,905	$ 496,767
Cost of sales	526,560	465,131
Gross profit	45,345	31,636
Selling, general and administrative expenses	22,516	20,334
Restructuring charges	1,697	1,130
Income from operations	21,132	10,172
Interest expense	(339)	(351)
Interest income	367	839
Other expense	(371)	(396)
Income before income taxes	20,789	10,264
Income tax expense	2,539	1,026
Net income	$ 18,250	$ 9,238
Earnings per share:		
Basic	$ 0.29	$ 0.14
Diluted	$ 0.29	$ 0.14
Weighted-average number of shares outstanding:		
Basic	63,403	65,097
Diluted	63,957	65,261

See accompanying notes to condensed consolidated financial statements.

BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income
(unaudited)

(in thousands)	Three Months Ended March 31, 2010	2009
Net income	$ 18,250	$ 9,238
Other comprehensive income (loss):		
Foreign currency translation adjustments	(2,954)	(3,963)
Unrealized loss on investments, net of tax	(177)	(541)
Other	(10)	15
Comprehensive income	$ 15,109	$ 4,749

The components of accumulated other comprehensive loss are as follows:

(in thousands)	March 31, 2010	December 31, 2009
Foreign currency translation losses	$ (3,407)	$ (453)
Unrealized loss on investments, net of tax	(4,566)	(4,389)
Other	(161)	(151)
Accumulated other comprehensive loss	$ (8,134)	$ (4,993)

See accompanying notes to condensed consolidated financial statements.

BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES
Condensed Consolidated Statement of Shareholders' Equity
(unaudited)

(in thousands)	Shares	Common shares	Additional paid-in capital	Retained earnings	Accumulated Other comprehensive loss	Treasury shares	Total shareholders' equity
Balances, December 31, 2009	64,097	$ 6,410	$ 732,956	$ 356,802	$ (4,993)	$ (272)	$ 1,090,903
Stock-based compensation expense	—	—	1,300	—	—	—	1,300
Shares repurchased and retired	(887)	(89)	(9,538)	(8,043)	—	—	(17,670)
Stock options exercised	87	8	1,150	—	—	—	1,158
Restricted shares cancelled	(3)	—	—	—	—	—	—
Excess tax benefit of stock-based compensation	—	—	1,104	—	—	—	1,104
Comprehensive income	—	—	—	18,250	(3,141)	—	15,109
Balances, March 31, 2010	63,294	$ 6,329	$ 726,972	$ 367,009	$ (8,134)	$ (272)	$ 1,091,904

See accompanying notes to condensed consolidated financial statements.

BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(unaudited)

(in thousands)	Three Months Ended March 31, 2010	2009
Cash flows from operating activities:		
Net income	$ 18,250	$ 9,238
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,291	9,661
Deferred income taxes	87	(50)
(Gain) loss on the sale of property, plant and equipment	33	(9)
Asset impairment	105	—
Stock-based compensation expense	1,300	1,419
Excess tax benefit of stock options exercised	(228)	(14)
Changes in operating assets and liabilities:		
Accounts receivable	8,249	83,136
Inventories	(47,367)	(3,745)
Prepaid expenses and other assets	(4,828)	4,130
Accounts payable	21,308	(31,621)
Accrued liabilities	(2,954)	(7,509)
Income taxes	1,664	(440)
Net cash provided by operations	5,910	64,196
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	300	250
Additions to property, plant and equipment	(9,489)	(4,665)
Proceeds from the sale of property, plant and equipment	30	10
Additions to purchased software	(70)	(68)
Purchase of intangible asset	—	(11,300)
Net cash used in investing activities	(9,229)	(15,773)
Cash flows from financing activities:		
Proceeds from stock options exercised	1,158	142
Excess tax benefit of stock options exercised	228	14
Principal payments on capital lease obligations	(65)	(58)
Share repurchases	(17,670)	—
Net cash provided by (used in) financing activities	(16,349)	98
Effect of exchange rate changes	(1,007)	(1,276)
Net increase (decrease) in cash and cash equivalents	(20,675)	47,245
Cash and cash equivalents at beginning of year	421,243	359,694
Cash and cash equivalents at March 31	$ 400,568	$ 406,939

See accompanying notes to condensed consolidated financial statements.

BENCHMARK ELECTRONICS, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(amounts in thousands, except per share data, unless otherwise noted)
(unaudited)

Note 1 – Basis of Presentation
Benchmark Electronics, Inc. (the Company) is a Texas corporation that provides world-wide integrated electronic manufacturing services. The Company provides services to original equipment manufacturers (OEMs) of computers and related products for business enterprises, medical devices, industrial control equipment, testing and instrumentation products and telecommunication equipment. The Company has manufacturing operations located in the Americas, Asia and Europe.

The condensed consolidated financial statements included herein have been prepared by the Company without an audit pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The financial statements reflect all normal and recurring adjustments which in the opinion of management are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in accordance with generally accepted accounting principles. Actual results could differ from those estimates.

Note 2 – Stock-Based Compensation

The Benchmark Electronics, Inc. 2000 Stock Awards Plan (the 2000 Plan) permits the grant of a variety of types of awards, including stock options, restricted stock awards, stock appreciation rights, performance awards, and phantom stock awards, or any combination thereof, to key employees of the Company. Stock options are granted to employees with an exercise price equal to the market price of the Company's common shares on the date of grant, vest over a four-year period from the date of grant and have a term of ten years. Restricted shares and phantom stock awards granted to employees vest over a four-year period from the date of grant, subject to the continued employment of the employee by the Company. The 2000 Plan expired on February 16, 2010 and no additional grants can be made under that plan. The 2000 Plan will be replaced by the Benchmark Electronics, Inc. 2010 Omnibus Incentive Compensation Plan (the 2010 Plan) if approved by the Company's shareholders in the upcoming Annual Meeting scheduled for May 18, 2010. Members of the Board of Directors of the Company who are not employees of the Company participate in a separate stock option plan that provides for the granting of stock options upon the occurrence of the non-employee director's election or re-election to the Board of Directors. All awards under the non-employee director stock option plan are fully vested upon the date of grant and have a term of ten years. As of March 31, 2010, 0.2 million additional options or other equity awards may be granted under the Company's existing plans.

All share-based payments to employees, including grants of employee stock options, are recognized in the financial statements based on their fair values. The total compensation cost recognized for stock-based awards was $1.3 million and $1.4 million for the three months ended March 31, 2010 and 2009. The compensation expense for stock-based awards includes an estimate for forfeitures and is recognized over the vesting period of the options using the straight-line method. Cash flows from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for stock-based awards (excess tax benefits) are classified as cash flows from financing activities. Awards of restricted shares and phantom stock are valued at the closing market price of the Company's common shares on the date of grant.

As of March 31, 2010, there was approximately $7.6 million of total unrecognized compensation cost related to nonvested stock options. That cost is expected to be recognized over a weighted-average period of 2.1 years. As of March 31, 2010, there was $3.6 million of total unrecognized compensation cost related to restricted share awards. That cost is expected to be recognized over a weighted-average period of 3.2 years. As of March 31, 2010, there was $1.1 million of total unrecognized compensation cost related to phantom stock awards. That cost is expected to be recognized over a weighted-average period of 3.3 years.

The Company did not issue any options during the three months ended March 31, 2010 or 2009. The total cash received as a result of stock option exercises for the three months ended March 31, 2010 and 2009 was $1.2 million and $0.1 million, respectively, and the excess tax benefit realized as a result of the stock option exercises was $1.1 million and $14 thousand, respectively. For the three months ended March 31, 2010 and 2009, the total intrinsic value of stock options exercised was $0.7 million and $48 thousand, respectively. The Company realized an excess tax benefit of $24 thousand during the three months ended March 31, 2010 related to the vesting of restricted shares, which has been recorded as an increase to additional paid-in capital.

The following table summarizes the activities relating to the Company's stock options:

	Number of Options		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)		Aggregate Intrinsic Value
Outstanding at December 31, 2009	5,531	$	19.20	6.18		
Granted	—		—			
Exercised	(87)	$	13.21			
Canceled	(49)	$	23.14			
Outstanding at March 31, 2010	5,395	$	19.27	6.01	$	17,758
Exercisable at March 31, 2010	3,346	$	20.42	4.53	$	9,181

The aggregate intrinsic value in the table above is before income taxes and is calculated as the difference between the exercise price of the underlying options and the Company's closing stock price of $20.74 as of the last business day of the period ended March 31, 2010 for options that had exercise prices that were below the closing price.

The following table summarizes the activities related to the Company's restricted shares:

	Shares		Weighted-Average Grant Date Fair Value
Non-vested shares outstanding at December 31, 2009	290	$	16.67
Vested	(19)	$	17.54
Forfeited	(3)	$	15.92
Non-vested shares outstanding at March 31, 2010	268	$	16.62

The following table summarizes the activities related to the Company's phantom stock awards:

	Shares		Weighted-Average Grant Date Fair Value
Non-vested shares outstanding at December 31, 2009	81	$	16.50
Granted	—		—
Forfeited	—		—
Non-vested shares outstanding at March 31, 2010	81	$	16.50

As of March 31, 2010, there were no vested phantom stock awards.

Note 3 – Earnings Per Share

Basic earnings per share is computed using the weighted-average number of shares outstanding. Diluted earnings per share is computed using the weighted-average number of shares outstanding adjusted for the incremental shares attributed to outstanding stock equivalents during the three months ended March 31, 2010 and 2009. Stock equivalents include common shares issuable upon the exercise of stock options and other equity instruments, and are computed using the treasury stock method. Under the treasury stock method, the exercise price of a share, the amount of compensation cost, if any, for future service that the Company has not yet recognized, and the amount of estimated tax benefits that would be recorded in paid-in-capital, if any, when the share is exercised are assumed to be used to repurchase shares in the current period.

The following table sets forth the calculation of basic and diluted earnings per share.

	Three Months Ended March 31,	
	2010	2009
Numerator for basic earnings per share - net income	$ 18,250	$ 9,238
Denominator for basic earnings per share -weighted-average number of common shares outstanding during the period	63,403	65,097
Incremental common shares attributable to exercise of outstanding dilutive options	464	160
Incremental common shares attributable to outstanding restricted shares and phantom stock	90	—
Incremental common shares attributable to exercise of warrants	—	4
Denominator for diluted earnings per share	63,957	65,261
Basic earnings per share	$ 0.29	$ 0.14
Diluted earnings per share	$ 0.29	$ 0.14

Options to purchase 2.5 million and 4.9 million common shares for the three months ended March 31, 2010 and 2009, respectively, were not included in the computation of diluted earnings per share because the option exercise price was greater than the average market price of the common shares. Outstanding restricted shares and phantom stock awards were not included in the computation of diluted earnings per share for the three months ended March 31, 2009 because they were anti-dilutive.

Note 4 – Goodwill and Other Intangible Assets

Goodwill associated with the Company's Asia business segment totaled $37.9 million at March 31, 2010 and December 31, 2009.

Other intangible assets included in other long-term assets in the accompanying condensed consolidated balance sheet as of March 31, 2010 and December 31, 2009 were as follows:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	$ 17,846	$ (5,847)	$ 11,999
Technology licenses	11,300	(2,495)	8,805
Other	868	(76)	792
Other intangible assets, March 31, 2010	$ 30,014	$ (8,418)	$ 21,596

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	$ 17,944	$ (5,432)	$ 12,512
Technology licenses	11,300	(1,698)	9,602
Other	868	(70)	798
Other intangible assets, December 31, 2009	$ 30,112	$ (7,200)	$ 22,912

Customer relationships are being amortized on a straight-line basis over a period of ten years. In March 2009, the Company acquired certain technology licenses for $11.3 million. Technology licenses are being amortized over their estimated useful lives in proportion to the economic benefits consumed. Amortization of other intangible assets for the three months ended March 31, 2010 and 2009 was $1.2 million and $0.4 million, respectively.

The estimated future amortization expense of other intangible assets for each of the next five years is as follows:

Year ending December 31,	Amount
2010 (remaining nine months)	$ 3,202
2011	4,391
2012	4,391
2013	3,614
2014	1,812

Note 5 – Borrowing Facilities

Under the terms of a Credit Agreement (the Credit Agreement), the Company has a $100 million five-year revolving credit facility for general corporate purposes with a maturity date of December 21, 2012. The Credit Agreement includes an accordion feature under which total commitments under the facility may be increased by an additional $100 million, subject to satisfaction of certain conditions and lender approval.

Interest on outstanding borrowings under the Credit Agreement is payable quarterly, at the Company's option, at either LIBOR plus 0.75% to 1.75% or a prime rate plus 0.00% to 0.25%, based upon the Company's debt ratio as specified in the Credit Agreement. A commitment fee of 0.15% to 0.35% per annum (based upon the Company's debt ratio) on the unused portion of the revolving credit line is payable quarterly in arrears. As of March 31, 2010, the Company had no borrowings outstanding under the Credit Agreement, $0.1 million in outstanding letters of credit and $99.9 million was available for future borrowings.

The Credit Agreement is secured by the Company's domestic inventory and accounts receivable, 100% of the stock of the Company's domestic subsidiaries, 65% of the voting capital stock of each direct foreign subsidiary and substantially all of the other tangible and intangible assets of the Company and its domestic subsidiaries. The Credit Agreement contains customary financial covenants as to working capital, debt leverage, fixed charges, and consolidated net worth, and restricts the ability of the Company to incur additional debt, pay dividends, sell assets, and to merge or consolidate with other persons. As of March 31, 2010, the Company was in compliance with all such covenants and restrictions.

The Company's Thailand subsidiary has a multi-purpose credit facility with Kasikornbank Public Company Limited (the Thai Credit Facility) that provides for approximately $10.8 million (350 million Thai baht) in working capital availability. The Thai Credit Facility is secured by land and buildings in Thailand. Availability of funds under the Thai Credit Facility is reviewed annually and is currently accessible through October 2010. As of March 31, 2010, the Company's Thailand subsidiary had no working capital borrowings outstanding.

Note 6 – Inventories

Inventory costs are summarized as follows:

	March 31, 2010	December 31, 2009
Raw materials	$ 272,230	$ 237,294
Work in process	63,334	54,197
Finished goods	26,398	24,252
	$ 361,962	$ 315,743

Note 7 – Income Taxes

Income tax expense consists of the following:

	Three Months Ended March 31,	
	2010	2009
Federal – Current	$ 402	$ 5
Foreign – Current	1,931	1,011
State – Current	119	60
Deferred	87	(50)
	$ 2,539	$ 1,026

In 2010 income tax expense differs from the amount computed by applying the U.S. federal statutory income tax rate to income before income tax primarily due to the impact of tax incentives and tax holidays in foreign locations, state income taxes (net of federal benefit), and adjustments to valuation allowances on deferred tax assets in the U.S.

The Company considers earnings from foreign subsidiaries to be indefinitely reinvested and, accordingly, no provision for U.S. federal and state income taxes has been made for these earnings. Upon distribution of foreign subsidiary earnings in the form of dividends or otherwise, such distributed earnings would be reportable for U.S. income tax purposes (subject to adjustment for foreign tax credits). Determination of the amount of any unrecognized deferred tax liability on these undistributed earnings is not practical.

The Company has been granted certain tax incentives, including tax holidays, for its subsidiaries in China, Ireland, Malaysia and Thailand. These tax incentives, including tax holidays, expire on various dates through 2015, and are subject to certain conditions with which the Company expects to comply. The net impact of these tax incentives was to lower income tax expense for the three month periods ended March 31, 2010 and 2009 by approximately $2.2 million (approximately $0.03 per diluted share) and $2.1 million (approximately $0.03 per diluted share), respectively.

As of March 31, 2010, the total amount of the reserve for uncertain tax benefits including interest and penalties is $19.7 million. The reserve is classified as a long-term liability in the consolidated balance sheet unless cash settlement is expected in the next 12 months. The amount of accrued potential interest and penalties on unrecognized tax benefits included in the reserve as of March 31, 2010 is $2.1 million and $1.6 million, respectively. No material changes affected the reserve during the three months ended March 31, 2010.

During the next twelve months, it is reasonably possible that the reserve for uncertain tax benefits will decrease by approximately $1.3 million primarily due to the expiration of the statute of limitations for various prior year unrecognized tax benefits. As of March 31, 2010, the Company’s business locations in Brazil, China, Ireland, Luxembourg, Malaysia, Mexico, the Netherlands, Romania, Singapore, Thailand and the United States remain open to examination by the various local taxing authorities, in total or in part, for fiscal years 2001 to 2009.

The Company is subject to examination by tax authorities for varying periods in various U.S. and foreign tax jurisdictions. During the course of such examinations disputes occur as to matters of fact and/or law. Also, in most tax jurisdictions the passage of time without examination will result in the expiration of applicable statutes of limitations thereby precluding the taxing authority from conducting an examination of the tax period(s) for which such statute of limitation has expired. The Company believes that it has adequately provided for its tax liabilities.

Note 8 – Segment and Geographic Information

The Company has manufacturing facilities in the Americas, Asia and Europe to serve its customers. The Company is operated and managed geographically. The Company’s management evaluates performance and allocates the Company’s resources on a geographic basis. Intersegment sales are generally recorded at prices that approximate arm’s length transactions. Operating segments’ measure of profitability is based on income from operations. The accounting policies for the reportable operating segments are the same as for the Company taken as a whole. The Company has three reportable operating segments: the Americas, Asia, and Europe. Information about operating segments was as follows:

	Three Months Ended March 31,		
	2010	2009	
Net sales:			
Americas	$ 362,155	$ 295,299	
Asia	207,174	175,338	
Europe	46,261	46,957	
Elimination of intersegment sales	(43,685)	(20,827)	
	$ 571,905	$ 496,767	
Depreciation and amortization:			
Americas	$ 5,278	$ 4,336	
Asia	3,393	3,562	
Europe	733	652	
Corporate	887	1,111	
	$ 10,291	$ 9,661	The fair value of the senior notes is based on market quotation from a third-party bank.

(14) New Accounting Pronouncements

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. The ASU amends ASC Topic 220, Comprehensive Income. The new standard eliminates the option to report other comprehensive income and its components in the statement of changes in equity and instead requires entities to present net income and other comprehensive income in either a single continuous statement or in two separate, but consecutive, statements of net income and other comprehensive income. Reclassification adjustments between net income and other comprehensive income must be shown on the face of the statement(s), with no resulting change in net earnings. In December 2011, the FASB issued ASU No. 2011-12, Deferral of Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. This ASU amends ASC Topic 220, Comprehensive Income. The new standard deferred the requirement to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income while the FASB further deliberates this aspect of the proposal. This update is effective for the Company on January 1, 2012 and must be applied retrospectively. The Company adopted this standard as of March 31, 2012. The adoption did not have a material impact on the Company's consolidated financial

statements.

In September 2011, the FASB issued ASU No. 2011-08, Testing Goodwill for Impairment. The ASU amends ASC Topic 350, Intangibles - Goodwill and Other. The new standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a “qualitative” assessment to determine whether further impairment testing is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permissible. The Company adopted this standard in the first quarter of 2012 and the adoption did not have a material impact on the Company's consolidated financial statements.

(15) Guarantor Financial Information

The Company's Notes (see Note 7) are guaranteed on an unsecured basis by the Company's 100% directly and indirectly owned subsidiaries Darling National, Griffin and its subsidiary Craig Protein (collectively, the "Guarantors"). The Guarantors fully and unconditionally guaranteed the Notes on a joint and several basis. The following financial statements present condensed consolidating financial data for (i) Darling, the issuer of the Notes, (ii) the combined Guarantors, (iii) the combined other subsidiaries of the Company that did not guarantee the Notes (the "Non-guarantors"), and (iv) eliminations necessary to arrive at the Company's consolidated financial statements, which include condensed consolidated balance sheets as of March 31, 2012 and December 31, 2011, and the condensed consolidating statements of operations, the condensed consolidating statements of comprehensive income and the condensed consolidating statements of cash flows for the three months ended March 31, 2012 and April 2, 2011.

Condensed Consolidating Balance Sheet
As of March 31, 2012
(in thousands)

	Issuer	Guarantors	Non-guarantors	Eliminations	Consolidated
ASSETS					
Total current assets	$101,566	$366,530	$2,183	$(276,555)	$193,724
Investment in subsidiaries	1,327,883	—	—	(1,327,883)	—
Property, plant and equipment, net	121,893	286,654	—	—	408,547
Intangible assets, net	14,080	341,564	287	—	355,931
Goodwill	21,860	359,243	266	—	381,369
Investment in unconsolidated subsidiary	—	—	32,848	—	32,848
Other assets	26,168	3,619	—	—	29,787
	$1,613,450	$1,357,610	$35,584	$(1,604,438)	$1,402,206
LIABILITIES AND STOCKHOLDERS' EQUITY					
Total current liabilities	$327,136	$52,039	$1,021	$(276,555)	$103,641
Long-term debt, net of current portion	250,000	18	—	—	250,018
Other noncurrent liabilities	45,377	12,052	181	—	57,610
Deferred income taxes	34,971	—	—	—	34,971
Total liabilities	657,484	64,109	1,202	(276,555)	446,240
Stockholders' equity:					
Common stock, additional paid-in capital and treasury stock	589,402	1,022,544	39,358	(1,061,902)	589,402
Retained earnings and accumulated other comprehensive loss	366,564	270,957	(4,976)	(265,981)	366,564
Total stockholders' equity	955,966	1,293,501	34,382	(1,327,883)	955,966
	$1,613,450	$1,357,610	$35,584	$(1,604,438)	$1,402,206

Condensed Consolidating Balance Sheet
As of December 31, 2011
(in thousands)

	Issuer	Guarantors	Non-guarantors	Eliminations	Consolidated
ASSETS					
Total current assets	$124,675	$347,989	$3,980	$(256,964)	$219,680
Investment in subsidiaries	1,286,175	—	—	(1,286,175)	—
Property, plant and equipment, net	119,898	280,324	—	—	400,222
Intangible assets, net	14,747	347,874	293	—	362,914
Goodwill	21,860	359,243	266	—	381,369
Investment in unconsolidated subsidiary	—	—	21,733	—	21,733
Other assets	27,725	3,387	—	—	31,112
	$1,595,080	$1,338,817	$26,272	$(1,543,139)	$1,417,030
LIABILITIES AND STOCKHOLDERS' EQUITY					
Total current liabilities	$317,561	$63,718	$2,942	$(256,964)	$127,257
Long-term debt, net of current portion	280,000	20	—	—	280,020
Other noncurrent liabilities	46,011	12,052	182	—	58,245
Deferred income taxes	31,133	—	—	—	31,133
Total liabilities	674,705	75,790	3,124	(256,964)	496,655
Stockholders' equity:					
Common stock, additional paid-in capital and treasury stock	583,273	1,022,544	27,982	(1,050,526)	583,273
Retained earnings and accumulated other comprehensive loss	337,102	240,483	(4,834)	(235,649)	337,102
Total stockholders' equity	920,375	1,263,027	23,148	(1,286,175)	920,375
	$1,595,080	$1,338,817	$26,272	$(1,543,139)	$1,417,030

Condensed Consolidating Statements of Operations
For the three months ended March 31, 2012
(in thousands)

	Issuer	Guarantors	Non-guarantors	Eliminations	Consolidated
Net sales	$152,988	$273,509	$2,554	$(41,943)	$387,108
Cost and expenses:					
Cost of sales and operating expenses	121,097	194,813	2,502	(41,943)	276,469
Selling, general and administrative expenses	20,785	16,545	39	—	37,369
Depreciation and amortization	6,296	14,458	6	—	20,760
Total costs and expenses	148,178	225,816	2,547	(41,943)	334,598
Operating income	4,810	47,693	7	—	52,510
Interest expense	(6,925)	—	—	—	(6,925)
Other, net	(642)	27	7	—	(608)
Equity in net loss of unconsolidated subsidiary	—	—	(236)	—	(236)
Earnings in investments in subsidiaries	30,332	—	—	(30,332)	—

Income/(loss) before taxes	27,575	47,720	(222)	(30,332)	44,741
Income taxes (Benefit)	(996)	17,246	(80)	—	16,170
Net income (loss)	$28,571	$30,474	$(142)	$(30,332)	$28,571

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Condensed Consolidating Statements of Operations
For the three months ended April 2, 2011
(in thousands)

	Issuer	Guarantors	Non-guarantors	Eliminations	Consolidated
Net sales	$174,655	$307,114	$6,549	$(48,420)	$439,898
Cost and expenses:					
Cost of sales and operating expenses	131,988	211,525	6,257	(48,419)	301,351
Selling, general and administrative expenses	15,187	15,466	40	—	30,693
Depreciation and amortization	6,184	13,497	—	—	19,681
Total costs and expenses	153,359	240,488	6,297	(48,419)	351,725
Operating income	21,296	66,626	252	(1)	88,173
Interest expense	(14,227)	(1)	—	—	(14,228)
Other, net	(524)	(76)	(7)	1	(606)
Earnings in investments in subsidiaries	42,407	—	—	(42,407)	—
Income/(loss) before taxes	48,952	66,549	245	(42,407)	73,339
Income taxes	2,390	24,297	90	—	26,777
Net income (loss)	$46,562	$42,252	$155	$(42,407)	$46,562

Condensed Consolidating Statements of Comprehensive Income (Loss)
For the three months ended March 31, 2012
(in thousands)

	Issuer	Guarantors	Non-guarantors	Eliminations	Consolidated
Net income	$28,571	$30,474	$(142)	$(30,332)	$28,571
Other comprehensive income (loss):					
Pension adjustments, net of tax	742	—	—	—	742
Natural gas swap derivative adjustments, net of tax	7	—	—	—	7
Interest rate swap derivative adjustment, net of tax	142	—	—	—	142
Total other comprehensive income (loss)	891	—	—	—	891
Total comprehensive income (loss)	$29,462	$30,474	$(142)	$(30,332)	$29,462

Condensed Consolidating Statements of Comprehensive Income (Loss)
For the three months ended April 2, 2011
(in thousands)

	Issuer	Guarantors	Non-guarantors	Eliminations	Consolidated
Net income	$46,562	$42,252	$155	$(42,407)	$46,562
Other comprehensive income (loss):					
Pension adjustments, net of tax	431	—	—	—	431
Natural gas swap derivative adjustments, net of tax	(39)	—	—	—	(39)
Interest rate swap derivative adjustment, net of tax	195	—	—	—	195
Total other comprehensive income (loss)	587	—	—	—	587

Total comprehensive income (loss)	$47,149	$42,252	$155	$(42,407)	$47,149

Condensed Consolidating Statements of Cash Flows
For the three months ended March 31, 2012
(in thousands)

	Issuer	Guarantors	Non-guarantors	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	$28,571	$30,474	$(142)	$(30,332)	$28,571
Earnings in investments in subsidiaries	(30,332)	—	—	30,332	—
Other operating cash flows	31,598	(16,795)	10,197	—	25,000
Net cash provided by operating activities	29,837	13,679	10,055	—	53,571
Cash flows from investing activities:					
Capital expenditures	(8,123)	(16,567)	—	—	(24,690)
Investment in unconsolidated subsidiary	—	—	(11,351)	—	(11,351)
Gross proceeds from sale of property, plant and equipment and other assets	1,111	1,117	—	—	2,228
Net cash used in investing activities	(7,012)	(15,450)	(11,351)	—	(33,813)
Cash flows from financing activities:					
Payments on long-term debt	(30,000)	(2)	—	—	(30,002)
Issuances of common stock	64	—	—	—	64
Minimum withholding taxes paid on stock awards	(2,157)	—	—	—	(2,157)
Excess tax benefits from stock-based compensation	985	—	—	—	985
Net cash used in financing activities	(31,108)	(2)	—	—	(31,110)
Net decrease in cash and cash equivalents	(8,283)	(1,773)	(1,296)	—	(11,352)
Cash and cash equivalents at beginning of year	35,207	1,773	1,956	—	38,936
Cash and cash equivalents at end of year	$26,924	$—	$660	$—	$27,584

Condensed Consolidating Statements of Cash Flows
For the three months ended April 2, 2011
(in thousands)

	Issuer	Guarantors	Non-guarantors	Eliminations	Consolidated
Cash flows from operating activities:					
Net income	$46,562	$42,252	$155	$(42,407)	$46,562
Earnings in investments in subsidiaries	(42,407)	—	—	42,407	—
Other operating cash flows	65,061	(32,202)	1,279	—	34,138
Net cash provided by operating activities	69,216	10,050	1,434	—	80,700
Cash flows from investing activities:					
Capital expenditures	(5,047)	(7,710)	—	—	(12,757)
Investment in unconsolidated subsidiary	—	—	(1,601)	—	(1,601)
Gross proceeds from sale of property, plant and equipment and other assets	198	75	—	—	273
Net cash used in investing activities	(4,849)	(7,635)	(1,601)	—	(14,085)
Cash flows from financing activities:					
Payments on long-term debt	(240,000)	(2)	—	—	(240,002)
Borrowings from revolving credit facility	90,000	—	—	—	90,000
Payments on revolving credit facility	(190,000)	—	—	—	(190,000)
Deferred loan costs	(267)	—	—	—	(267)
Issuances of common stock	292,843	—	—	—	292,843
Minimum withholding taxes paid on stock awards	(1,154)	—	—	—	(1,154)
Excess tax benefits from stock-based compensation	809	—	—	—	809
Net cash used in financing activities	(47,769)	(2)	—	—	(47,771)
Net increase/(decrease) in cash and cash equivalents	16,598	2,413	(167)	—	18,844
Cash and cash equivalents at beginning of year	13,108	5,480	614	—	19,202
Cash and cash equivalents at end of year	$29,706	$7,893	$447	$—	$38,046

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth below under the heading “Forward Looking Statements” and elsewhere in this report, and under the heading “Risk Factors” in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, and in the Company's other public filings with the SEC.

The following discussion should be read in conjunction with the historical consolidated financial statements and notes thereto.

Overview

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. The Company operates over 120 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”)), hides, fats (primarily bleachable fancy tallow (“BFT”), poultry grease (“PG”) and yellow grease (“YG”)), and bakery by-product (“BBP”) 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. All of the Company's finished products are commodities and are priced relative to competing commodities, primarily corn, soybean oil and soybean meal. Finished product prices will track as to nutritional and industry value to the ultimate customer's use of the product. 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 31, 2011.

The Company's operating performance for the first quarter of fiscal 2012 moderated relative to the first quarter of fiscal 2011. Year over year, lower finished product selling prices for proteins and fats were the primary driver as export volumes all but came to a standstill. As compared to the fourth quarter of fiscal 2011, finished product prices continued to decline through most of the first quarter of fiscal 2012 before rapidly escalating in March 2012. As a result, the Company built significant inventories during the quarter. Rendering raw material volumes as compared to the fourth quarter of fiscal 2011 remained steady; however, mild winter weather had a mixed impact on the Company as it provided historically low rendering volume from mortalities but positively influenced operating costs in the factory. Energy costs for natural gas continued to decline and positively influenced earnings.

The bakery business segment made a solid contribution during the first quarter of fiscal 2012 but business segment net sales and profit were lower as compared to the first quarter of fiscal 2011. First quarter volumes were lower as commercial bakeries took abnormally longer winter shutdowns while selling prices for the Company's finished products remained flat.

Operating income decreased by $35.7 million in the first quarter of fiscal 2012 compared to the first quarter of fiscal 2011. The challenges faced by the Company indicate there can be no assurance that operating results achieved by the Company in the first quarter of fiscal 2012 are indicative of future operating performance of the Company.

Summary of Critical Issues Faced by the Company during the First Quarter of 2012

- Lower finished product prices for MBM, BFT, PG, YG and BPP as compared to the first quarter of fiscal 2011 is a sign of decreased demand due to a slowdown in the domestic and international markets. These lower prices were partially offset by an overall increase in average PM (both feed grade and pet food grade) prices. Overall, finished product prices were unfavorable to the Company's sales revenue, but this unfavorable result was partially offset by the positive impact on raw material cost, due to the Company's formula pricing arrangements with raw material suppliers, which index raw material cost to the prices of finished product derived from the raw material. The financial impact of finished goods prices on sales revenue and raw material cost is summarized below in Results of Operations. Comparative sales price information from the Jacobsen index, an established trading exchange publisher used by management to monitor performance, is provided below in Summary of Key Indicators.

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- Lower raw material volumes were collected from suppliers during the first quarter of fiscal 2012 as compared to the first quarter of fiscal 2011. Management believes the decline in raw material volume is due to weaker slaughter and processor rates resulting from a slowdown of the economy that contributed to a decline in raw material volumes collected by the Company during the quarter. The financial impact of lower raw material volumes is summarized below in Results of Operations.
- Energy prices for natural gas decreased and diesel fuel decreased slightly during the first quarter of fiscal 2012 as compared to the first quarter of fiscal 2011. The financial impact of energy costs is summarized below in Results of Operations.

Summary of Critical Issues and Known Trends Faced by the Company in 2012 and Thereafter

Critical Issues and Challenges:

- The Company collected lower raw material volumes due to the slowdown of the economy resulting in weaker slaughter and processor rates in the first quarter of fiscal 2012. If this reduction continues or accelerates, there could be a negative impact on the Company's ability to obtain raw materials for the Company's operation.
- Finished product prices for MBM, BFT, PG, YG and BBP commodities have decreased during the first quarter of fiscal 2012 as compared to the same period of fiscal 2011. No assurance can be given that this decrease in commodity prices for various proteins, fats and bakery products will not continue in the future, as commodity prices are volatile by their nature. A further decrease in commodity prices could have a significant impact on the Company’s earnings for the remainder of fiscal 2012 and into future periods.
- The Company consumes significant volumes of natural gas to operate boilers in its plants, which generate steam to heat raw material. Natural gas prices represent a significant cost of factory operation included in cost of sales. The Company also consumes significant volumes of diesel fuel to operate its fleet of tractors and trucks used to collect raw material. Diesel fuel prices represent a significant component of cost of collection expenses included in cost of sales. Lower natural gas and diesel fuel prices were incurred during the first quarter of fiscal 2012 as compared to the same period of fiscal 2011. These prices can be volatile and there can be no assurance that these prices will not increase in the near future, thereby representing an ongoing challenge to the Company’s operating results for future periods. A material increase in energy prices for natural gas and/or diesel fuel over a sustained period of time could materially adversely affect the Company’s business, financial condition and results of operations.

Worldwide Government Policies

- Pursuant to the requirements established by the Energy Independence and Security Act of 2007, on February 3, 2010 the EPA finalized regulations for the National Renewable Fuel Standard Program (“RFS2”). The regulation mandates the domestic use of biomass-based diesel (biodiesel or renewable diesel) of 1.0 billion gallons in 2012. Beyond 2012 the regulation requires a minimum of 1.0 billion gallons of biomass-based diesel for each year through 2022, which amount is subject to increase by the EPA Administrator. On June 20, 2011, the EPA issued a proposed rule which would require 1.28 billion gallons for the calendar year 2013. Biomass-based diesel also qualifies to fulfill the non-specified portion of the advanced bio-fuel requirement. In order to qualify as a “renewable fuel” each type of fuel from each type of feedstock is required to lower greenhouse gas emissions (“GHG”) by levels specified in the regulation. The EPA has determined that bio-fuels (either biodiesel or renewable diesel) produced from waste oils, fats and greases result in an 86% reduction in GHG emissions, exceeding the 50% requirement established by the regulation. Prices for the Company’s finished products may be impacted by worldwide government policies relating to renewable fuels and GHG. Programs like RFS2 and tax credits for bio-fuels both in the U.S. and abroad may positively impact the demand for the Company’s finished products. Accordingly, changes to, a failure to enforce or discontinuing of any of these programs could have a negative impact on the Company’s business and results of operations.
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The Company's exports are subject to the imposition of tariffs, quotas, trade barriers and other trade protection measures imposed by foreign countries regarding the import of the Company's MBM, BFT and YG. General economic and political conditions as well as the closing of borders by foreign countries to the import of the Company's products due to animal disease or other perceived health or safety issues impact the Company. As a result trade policies of both U.S and foreign countries could have a negative impact on the Company's business and results of operations.

Other Food Safety and Regulatory Issues

Effective August 1997, the FDA promulgated a rule prohibiting the use of mammalian proteins, with some exceptions, in feeds for cattle, sheep and other ruminant animals (referred to herein as the "BSE Feed Rule") to prevent further spread of BSE, commonly referred to as "mad cow disease." Detection of the first case of BSE in the United States in December 2003 resulted in additional U.S. government regulations, finished product export restrictions by foreign governments, market price fluctuations for the Company's finished products and reduced demand for beef and beef products by consumers. Even though the export markets for U.S. beef rebounded to record volumes in fiscal 2011 that exceeded pre-BSE levels, most export markets remain closed to MBM derived from U.S. beef. On April 24, 2012, the United States Department of Agriculture ("USDA") confirmed the occurrence of a new, single case of BSE in a dairy cow in central California. Even though the USDA confirmed that material derived from the cow did not enter the food or feed supply and that this appears to be a single, isolated incident of "atypical" BSE which is not spread through feed and does not affect humans, Indonesia closed its markets to MBM derived from U.S. beef, and those markets remain closed as of the filing date of this Report. The Company does not expect this trade disruption to have material impact on the Company's business, financial condition or results of operations. Continued concern about BSE in the United States may result in additional regulatory and market related challenges that may affect the Company's operations or increase the Company's operating costs.

With respect to BSE in the United States, on October 26, 2009, the FDA began enforcing new regulations intended to further reduce the risk of spreading BSE ("Enhanced BSE Rule"). These new regulations included amending the BSE Feed Rule to prohibit the use of tallow having more than 0.15% insoluble impurities in feed for cattle or other ruminant animals. In addition, the FDA implemented rules that prohibit the use of brain and spinal cord material from cattle aged 30 months and older or the carcasses of such cattle, if the brain and spinal cord are not removed, in the feed or food for all animals ("Prohibited Cattle Materials"). Tallow derived from Prohibited Cattle Materials that also contains more than 0.15% insoluble impurities cannot be fed to any animal. The Company has followed the Enhanced BSE Rule since it was first published in 2008 and has made capital expenditures and implemented new processes and procedures to be compliant with the Enhanced BSE Rule at all of the Company's operations. Based on the foregoing, while the Company acknowledges that unanticipated issues may arise as the FDA continues to implement the Enhanced BSE Rule and conducts compliance inspections, the Company does not currently anticipate that the Enhanced BSE Rule will have a significant impact on the Company operations or financial performance. Notwithstanding the foregoing, the Company can provide no assurance that unanticipated costs and/or reductions in raw material volumes related to the Company's compliance with the Enhanced BSE Rule will not negatively impact the Company's operations and financial performance.

With respect to human food, pet food and animal feed safety, the Food and Drug Administration Amendments Act of 2007 (the "FDAAA") was signed into law on September 27, 2007 as a result of Congressional concern for pet and livestock food safety, following the discovery in March 2007 of pet and livestock food that contained adulterated imported ingredients. The FDAAA directs the Secretary of Health and Human Services and the FDA to promulgate significant new requirements for the pet food and animal feed industries. As a prerequisite to new requirements specified by the FDAAA, the FDA was directed to establish a Reportable Food Registry, which was implemented on September 8, 2009. On June 11, 2009, the FDA issued "Guidance for Industry: Questions and Answers Regarding the Reportable Food Registry as Established by the Food and Drug Administration Amendments Act of 2007: Draft Guidance." Stakeholder comments and questions about the Reportable Food Registry that were submitted to the docket or during public meetings were incorporated into a second draft guidance ("RFR Draft Guidance"), which was published on September 8, 2009. In the RFR Draft Guidance, the FDA defined a reportable food, which the manufacturer or distributor would be required to report in the Reportable Food Registry, to include materials used as ingredients in animal feeds and pet foods, if there is reasonable probability that the use of such materials will cause serious adverse health consequences or death to humans or animals. The FDA issued a second version of its RFR Draft Guidance in May 2010 without finalizing it. On July 27, 2010, the FDA released "Compliance Policy guide Sec. 690.800, Salmonella in Animal Feed, Draft Guidance" ("Draft CPG"), which describes differing criteria to determine whether pet food and farmed animal feeds that are contaminated with salmonella will be considered to be adulterated

under section 402(a)(1) of the Food Drug and Cosmetic Act. According to the Draft CPG, any finished pet food contaminated with any species of salmonella will be considered adulterated because such feeds have direct human contact. Finished animal feeds intended for pigs, poultry and other farmed animals, however, will be considered to be adulterated only if the feed is contaminated with a species of salmonella that is considered to be pathogenic for the animal species that the feed is intended for. The impact of the FDAAA and implementation of the Reportable Food Registry on the Company, if any, will not be clear until the FDA finalizes its RFR Draft Guidance and the Draft CPG, neither of which were finalized as of the date of this report. The Company believes that it has adequate procedures in place to assure that its finished products are safe to use in animal feed and pet food and the

Company does not currently anticipate that the FDAAA will have a significant impact on the Company's operations or financial performance. Any pathogen, such as salmonella, that is correctly or incorrectly associated with the Company's finished products could have a negative impact on the demand for the Company's finished products.

- In addition, on January 4, 2011, President Barack Obama signed the Food Safety Modernization Act (“FSMA”) into law. As enacted, the FSMA gave the FDA new authorities, which became effective immediately. Included among these is mandatory recall authority for adulterated foods that are likely to cause serious adverse health consequences or death to humans or animals, if the responsible party fails to cease distribution and recall such adulterated foods voluntarily. The FSMA further instructed the FDA to amend existing regulations that define its administrative detention authority so that the criteria needed for detaining human or animal food are lowered. Prior to the FSMA becoming law, FDA had authority to order that an article of food be detained only if there was credible evidence or information indicating that the article of food presented a threat of serious adverse health consequences or death to humans or animals. On May 5, 2011, FDA issued an interim final rule amending its administrative detention authority and lowering both the level of proof and the degree of risk required for detaining an article of food. This interim final rule, which became effective on July 3, 2011, gives the FDA authority to detain an article of food if there is reason to believe the food is adulterated or misbranded. In addition to amending existing regulations, the FSMA requires the FDA to develop new regulations that, among other provisions, place additional registration requirements on food and feed producing firms; require registered facilities to perform hazard analysis and to implement preventive plans to control those hazards identified to be reasonably likely to occur; increase the length of time that records are required to be retained; and regulate the sanitary transportation of food. Such new food safety provisions will require new FDA rule making. The Company has followed the FSMA throughout its legislative history and implemented hazard prevention controls and other procedures that the Company believes will be needed to comply with the FSMA. Such rule-making could, among other things, require the Company to amend certain of the Company's other operational policies and procedures. While unforeseen issues and requirements may arise as the FDA promulgates the new regulations provided for by the FSMA, the Company does not anticipate that the costs of compliance with the FSMA will materially impact the Company's business or operations.
- The emergence of diseases such as 2009 H1N1 flu (initially know as “Swine Flu”) and H5N1 avian influenza (“Bird Flu”) that are in or associated with animals and have the potential to also threaten humans has created concern that such diseases could spread and cause a global pandemic. Even though such a pandemic has not occurred, governments may be pressured to address these concerns and prohibit imports of animals, meat and animal by-products from countries or regions where the disease is detected. The occurrence of Swine Flu, Bird Flu or any other disease in the United States that is correctly or incorrectly linked to animals and has a negative impact on meat or poultry consumption or animal production could have a material negative impact on the volume of raw materials available to the Company or the demand for the Company's finished products.

Results of Operations

Three Months Ended March 31, 2012 Compared to Three Months Ended April 2, 2011

Summary of Key Factors Impacting First Quarter 2012 Results:

Principal factors that contributed to a $35.7 million decrease in operating income, which are discussed in greater detail in the following section, were:

- Decrease in raw material volumes,
- Decrease in finished product prices,
- Increases in payroll and related benefits costs, and
- A prior year purchase accounting contingency gain not in the current year.

These decreases were partially offset by:

•Decreases in energy costs, primarily natural gas and diesel fuel.

Summary of Key Indicators of 2012 Performance:

Principal indicators which management routinely monitors and compares to previous periods as an indicator of problems or improvements in operating results include:

- Finished product commodity prices,
- Raw material volume,
- Production volume and related yield of finished product,
- Energy prices for natural gas quoted on the NYMEX index and diesel fuel,
- Collection fees and collection operating expense, and
- Factory operating expenses.

These indicators and their importance are discussed below in greater detail.

Finished Product Commodity Prices. Prices for finished product commodities that the Company produces are reported each business day on the Jacobsen index, an established trading exchange price publisher. The Jacobsen index reports industry sales from the prior day's activity by product. The Jacobsen index includes reported prices for MBM, PM (both feed grade and pet food), BFT, PG and YG, which are end products of the Company's Rendering Segment. During the first quarter of fiscal 2012, the Jacobsen index stopped reporting BBP, which is the end product of the Company's Bakery Segment. As a result, the Company is reporting prices for corn, which is a substitute commodity for BBP. The Company regularly monitors Jacobsen index reports on MBM, PM, BFT, PG, YG and corn because they provide a daily indication of the Company's revenue performance against business plan benchmarks. Although the Jacobsen index provides one useful metric of performance, the Company's finished products are commodities that compete with other commodities such as corn, soybean oil, palm oil complex, soybean meal and heating oil on nutritional and functional values and therefore actual pricing for the Company's finished products, as well as competing products, can be quite volatile. In addition, the Jacobsen index does not provide forward or future period pricing. The Jacobsen prices quoted below are for delivery of the finished product at a specified location. Although the Company's prices generally move in concert with reported Jacobsen prices, the Company's actual sales prices for its finished products may vary significantly from the Jacobsen index because of delivery timing differences and because the Company's finished products are delivered to multiple locations in different geographic regions which utilize different price indexes. In addition, certain of the Company's premium branded finished products may also sell at prices that may be higher than the closest product on the related Jacobsen index. During the first quarter of fiscal 2012, the Company's actual sales prices by product trended with the disclosed Jacobsen prices. Average Jacobsen prices (at the specified delivery point) for the first quarter of fiscal 2012, compared to average Jacobsen prices for the first quarter of fiscal 2011 follow:

	Avg. Price 1st Quarter 2012	Avg. Price 1st Quarter 2011	Increase/(Decrease)	% Increase/(Decrease)
Rendering Segment:				
MBM (Illinois)	$ 315.56/ton	$ 335.81/ton	$ (20.25)/ton	(6.0)%
Feed Grade PM (Carolina)	$ 386.51/ton	$ 360.24/ton	$ 26.27/ton	7.3 %
Pet Food PM (Southeast)	$ 658.93/ton	$ 563.93/ton	$ 95.00/ton	16.8 %
BFT (Chicago)	$ 46.06/cwt	$ 48.14/cwt	$ (2.08)/cwt	(4.3)%
PG (Southeast)	$ 44.03/cwt	$ 44.89/cwt	$ (0.86)/cwt	(1.9)%
YG (Illinois)	$ 38.83/cwt	$ 42.40/cwt	$ (3.57)/cwt	(8.4)%
Bakery Segment:				
Corn (Illinois)	$ 6.62/bushel	$ 6.64/bushel	$ (0.02)/bushel	(0.3)%

The overall decrease in average MBM, BFT, PG, YG and BPP prices of the finished products the Company sells had an unfavorable impact on revenue that was partially offset by an overall increase in average PM (both feed grade and pet food) prices and the positive impact to the Company's raw material cost resulting from formula pricing arrangements, which compute raw material cost based upon the price of finished product.

Raw Material Volume. Raw material volume represents the quantity (pounds) of raw material collected from Rendering Segment suppliers, such as butcher shops, grocery stores and independent beef, pork and poultry processors and food service establishments, or in the case of the Bakery Segment, commercial bakeries. Raw material volumes from the

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Company's Rendering Segment suppliers provide an indication of the future production of MBM, PM (feed grade and pet food), BFT, PG and YG finished products while raw material volumes from the Company's Bakery Segment suppliers provide an indication of the future production of BBP finished products.

Production Volume and Related Yield of Finished Product. Finished product production volumes are the end result of the Company's production processes, and directly impact goods available for sale, and thus become an important component of sales revenue. In addition, physical inventory turn-over is impacted by both the availability of credit to the Company's customers and suppliers and reduced market demand which can lower finished product inventory values. Yield on production is a ratio of production volume (pounds), divided by raw material volume (pounds) and provides an indication of effectiveness of the Company's production process. Factors impacting yield on production include quality of raw material and warm weather during summer months, which rapidly degrades raw material. The quantities of finished products produced varies depending on the mix of raw materials used in production. For example, raw material from cattle yields more fat and protein than raw material from pork or poultry. Accordingly, the mix of finished products produced by the Company can vary from quarter to quarter depending on the type of raw material being received by the Company. The Company cannot increase the production of protein or fat based on demand since the type of raw material available will dictate the yield of each finished product.

Energy Prices for Natural Gas Quoted on the NYMEX Index and Diesel Fuel. Natural gas and heating oil commodity prices are quoted each day on the NYMEX exchange for future months of delivery of natural gas and delivery of diesel fuel. The prices are important to the Company because natural gas and diesel fuel are major components of factory operating and collection costs and natural gas and diesel fuel prices are an indicator of achievement of the Company's business plan.

Collection Fees and Collection Operating Expense. The Company charges collection fees which are included in net sales. Each month the Company monitors both the collection fee charged to suppliers, which is included in net sales, and collection expense, which is included in cost of sales. The importance of monitoring collection fees and collection expense is that they provide an indication of achievement of the Company's business plan. Furthermore, management monitors collection fees and collection expense so that the Company can consider implementing measures to mitigate against unforeseen increases in these expenses.

Factory Operating Expenses. The Company incurs factory operating expenses which are included in cost of sales. Each month the Company monitors factory operating expense. The importance of monitoring factory operating expense is that it provides an indication of achievement of the Company's business plan. Furthermore, when unforeseen expense increases occur, the Company can consider implementing measures to mitigate such increases.

Net Sales. The Company collects and processes animal by-products (fat, bones and offal), including hides, commercial bakery waste and used restaurant cooking oil principally to produce finished products of MBM, PM (feed grade and pet food), BFT, PG, YG, BBP and hides as well as a range of branded and value-added products. Sales are significantly affected by finished goods prices, quality and mix of raw material, and volume of raw material. Net sales include the sales of produced finished goods, collection fees, fees for grease trap services, and finished goods purchased for resale.

During the first quarter of fiscal 2012, net sales were $387.1 million as compared to $439.9 million during the first quarter of fiscal 2011. The Rendering operations process poultry, animal by-products and used cooking oil into fats (primarily BFT, PG and YG), protein (primarily MBM and PM (feed grade and pet food)) and hides. Fat was approximately $194.0 million and $236.2 million of net sales for the three months ended March 31, 2012 and April 2, 2011, respectively, and protein was approximately $103.5 million and $110.1 million of net sales for the three months ended March 31, 2012 and April 2, 2011, respectively. The decrease in net sales was primarily due to the following (in millions of dollars):

	Rendering	Bakery	Corporate	Total
Decrease in finished product prices	$(31.4)	$(0.3)	$—	$(31.7)
Decrease in raw material volume	(18.4)	(3.5)	—	(21.9)
Increase in other sales	0.5	0.3	—	0.8
	$(49.3)	$(3.5)	$—	$(52.8)

Further detail regarding the $49.3 million decrease in sales in the Rendering Segment and the $3.5 million decrease in sales in the Bakery Segment in the first quarter of fiscal 2012 is as follows:

Rendering

Finished Product Prices: Lower prices in the overall commodity market for corn, soybean oil and soybean meal, which are competing proteins and fats to MBM, BFT and PG, negatively impacted the Company's finished product prices. In addition a decrease in global demand for use of YG in bio-fuels negatively impacted the Company's finished product prices. The $31.4 million decrease in Rendering sales resulting from decreases in finished product prices is due to a market-wide decrease in MBM, BFT, PG and YG prices, but was slightly offset by an increase in PM(both feed grade and pet food) prices. The market decreases were due to changes in supply/demand in both the domestic and export markets for commodity fats and meals, including MBM, BFT, PG and YG.

Raw Material Volume: Rendering volumes have decreased Rendering sales by approximately $18.4 million, which is a result of weaker slaughter and processor rates due to a slowdown of the economy in the first quarter of fiscal 2012 as compared to the first quarter of fiscal 2011.

Other Sales: The $0.5 million increase in other Rendering Segment sales was primarily due to an increase in yields and the purchase of finished product for resale that more than offset lower collection and processing fees and product sales.

Bakery

Raw Material Volume: The Bakery volumes have decreased Bakery sales by approximately $3.5 million, which is due to production cutbacks by the Company's commercial bakery suppliers.

Finished Product Prices: The slightly lower prices in the commodity market for corn negatively impacted the Company's BBP finished product prices by approximately $0.3 million.

Other Sales: The $0.3 million increase in other Bakery Segment sales is due to a slight increase in yields.

Cost of Sales and Operating Expenses. Cost of sales and operating expenses include the cost of raw material, the cost of product purchased for resale and the cost to collect raw material, which includes diesel fuel and processing costs including natural gas. The Company utilizes both fixed and formula pricing methods for the purchase of raw materials. Fixed prices are adjusted where possible for changes in competition. Significant changes in finished goods market conditions impact finished product inventory values, while raw materials purchased under formula prices are correlated with specific finished goods prices. Energy costs, particularly diesel fuel and natural gas, are significant components of the Company’s cost structure. The Company has the ability to burn alternative fuels at a majority of its plants to help manage the Company’s price exposure to volatile energy markets.

During the first quarter of fiscal 2012, cost of sales and operating expenses was $276.5 million as compared to $301.4 million during the first quarter of fiscal 2011. Decreases in Rendering Segment cost of sales and operating expenses of $25.1 million and the decrease in Bakery Segment cost of sales and operating expenses of $0.4 million accounted for substantially all of the $24.9 million decrease in cost of sales and operating expenses. The decrease in cost of sales and operating expenses was primarily due to the following (in millions of dollars):

	Rendering	Bakery	Corporate	Total
Increase/(decrease) in raw material costs	$(20.4)	$1.8	$—	$(18.6)
Decrease in raw material volume	(6.1)	(1.7)	—	(7.8)
Decrease in energy costs, primarily natural gas and diesel fuel	(2.4)	(0.2)	(0.2)	(2.8)
Increase/(decrease) in other costs of sales	3.8	(0.3)	0.8	4.3
	$(25.1)	$(0.4)	$0.6	$(24.9)

Further detail regarding the $25.1 million decrease in cost of sales and operating expenses in the Rendering Segment and the $0.4 million decrease in the Bakery Segment in the first quarter of fiscal 2012 is as follows:

Rendering

Raw Material Costs: A portion of the Company’s volume of raw material is acquired on a formula basis. Under a formula arrangement, the cost of raw material is tied to the finished product market for MBM, PM (both feed grade and pet food), BFT, PG and YG. Since finished product prices overall were lower in the first quarter of fiscal 2012 as compared to the same period in fiscal 2011, the raw material costs decreased $20.4 million.

Raw Material Volume: Production cutbacks from packers and processors resulted in lower raw material available to be processed and formula pricing resulted in lower cost of sales of approximately $6.1 million.

Energy Costs: Both natural gas and diesel fuel are major components of collection and factory operating costs. During the first quarter of fiscal 2012 energy costs, primarily natural gas, were lower as compared to the first quarter of fiscal 2011 and are reflected in the $2.4 million decrease in cost of sales.

Other Expense: The $3.8 million increase in other expense includes increases in purchases of finished product for resale and increases in repairs and maintenance.

Bakery

Raw Material Costs: The increase in raw material cost of sales of approximately $1.8 million is due mainly from an increase in finished product blending costs in the first quarter of fiscal 2012 as compared to the same period in fiscal 2011.

Raw Material Volume: Production cutbacks from the Company's bread and cake suppliers resulted in lower raw material available to be processed and formula pricing resulted in lower cost of sales of approximately $1.7 million.

Energy Costs: Natural gas is a component of factory operating costs. During the first quarter of fiscal 2012 natural gas costs were lower and are reflected in the $0.2 million decrease in the first quarter of fiscal 2012 as compared to the same period in fiscal 2011.

Other Expense: The $0.3 million decrease in other expense includes decreases in repairs and maintenance and general reductions as a result of less raw material processed.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $37.4 million during the first quarter of fiscal 2012, a $6.7 million increase (21.8%) from $30.7 million during the first quarter of fiscal 2011. Selling, general and administrative expenses increased primarily due to payroll and related expense increases and an increase in expense from a fiscal 2011 purchase accounting contingency gain that did not occur in the first quarter of fiscal 2012. The increase was primarily due to the following (in millions of dollars):

	Rendering	Bakery	Corporate	Total
Increase in payroll and incentive-related benefits	$0.7	$0.1	$2.5	$3.3
Increase from prior year purchase accounting contingency	2.1	0.5	—	2.6
Increase/(decrease) in other expense	—	(0.1)	0.9	0.8
	$2.8	$0.5	$3.4	$6.7

Depreciation and Amortization. Depreciation and amortization charges increased $1.1 million (5.6%) to $20.8 million during the first quarter of fiscal 2012 as compared to $19.7 million during the first quarter of fiscal 2011. The increase in depreciation and amortization is primarily due to a general increase in capital expenditures.

Interest Expense. Interest expense was $6.9 million during the first quarter of fiscal 2012 compared to $14.2 million during the first quarter of fiscal 2011, a decrease of $7.3 million, primarily due to a decrease in debt outstanding as a result of prior year and current year payoffs of the Company's revolver and term debt facilities, which includes a reduction in the amount of the Company's term loan facilities deferred loan cost write-offs of approximately $3.5 million when compared to the same period in fiscal 2011.

Equity in Net Loss in Investment of Unconsolidated Subsidiary. Represents the Company's portion of the expenses of the Joint Venture with Valero for the first quarter of fiscal 2012.

Income Taxes. The Company recorded income tax expense of $16.2 million for the first quarter of fiscal 2012, compared to $26.8 million recorded in the first quarter of fiscal 2011, a decrease of $10.6 million, primarily due to decreased pre-tax earnings of the Company in the first quarter of fiscal 2012. The effective tax rate for the first quarter of fiscal 2012 and fiscal 2011 is 36.1% and 36.5%, respectively, and differs from the statutory rate of 35% due primarily to state income taxes and qualified production deductions.

FINANCING, LIQUIDITY AND CAPITAL RESOURCES

Credit Facilities

Senior Secured Credit Facilities. On December 17, 2010, the Company entered into a $625 million credit agreement (the "Credit Agreement") consisting of a five-year senior secured revolving loan facility and a six-year senior secured term loan facility. On March 25, 2011, the Company amended its Credit Agreement to increase the aggregate available principal amount under the revolving loan facility from $325.0 million to $415.0 million (approximately $75.0 million of which will be available for a letter of credit sub-facility and $15.0 million of which will be available for a swingline sub-facility) and to add additional stepdowns to the pricing grid providing lower spread margins to the applicable base or libor rate under the Credit Agreement based on defined leverage ratio levels. The principal components of the Credit Agreement consist of the following:

- As of March 31, 2012, the Company had availability of $389.3 million under the revolving loan facility, taking into account no outstanding borrowings and letters of credit issued of $25.7 million.
- As of March 31, 2012, the Company has repaid all of the original $300.0 million term loan facility issued under the credit agreement. The amounts that have been repaid on the term loan may not be reborrowed.
- The obligations under the Company's credit agreement are guaranteed by Darling National, Griffin, and its subsidiary, Craig Protein Division, Inc. and are secured by substantially all of the property of the Company.

Senior Notes. On December 17, 2010, Darling issued $250.0 million in aggregate principal amount of its 8.5% Senior Notes due 2018 (the "Notes") under an indenture with U.S. Bank National Association, as trustee. The Company will pay 8.5% annual cash interest on the Notes on June 15 and December 15 of each year, commencing June 15, 2011. Other than for extraordinary events such as change of control and defined assets sales, the Company is not required to make any mandatory redemption or sinking fund payments on the Notes.

- The Notes are guaranteed on an unsecured basis by Darling's existing restricted subsidiaries, including Darling National, Griffin and all of its subsidiaries, other than Darling's foreign subsidiaries, its captive insurance subsidiary and any inactive subsidiary with nominal assets. The Notes rank equally in right of payment to any existing and future senior debt of Darling. The Notes will be effectively junior to existing and future secured debt of Darling and the guarantors, including debt under the Credit Agreement, to the extent of the value of assets securing such debt. The Notes will be structurally subordinated to all of the existing and future liabilities (including trade payables) of each of the subsidiaries of Darling that do not guarantee the Notes. The guarantees by the guarantors (the "Guarantees") rank equally in right of payment to any existing and future senior indebtedness of the guarantors. The Guarantees will be effectively junior to existing and future secured debt of the guarantors including debt under the Credit Agreement, to the extent the value of the assets securing such debt. The Guarantees will be structurally subordinated to all of the existing and future liabilities (including trade payables) of each of the subsidiaries of each Guarantor that do not guarantee the Notes.

As of March 31, 2012, the Company believes it is in compliance with all of the covenants, including financial covenants, under the Credit Agreement and the Notes indenture.

The Credit Agreement and Notes consisted of the following elements at March 31, 2012 (in thousands):

Senior Notes:	
8.5% Senior Notes Due 2018	$250,000
Senior Secured Credit Facilities:	
Term Loan	$—
Revolving Credit Facility:	
Maximum availability	$415,000
Borrowings outstanding	—
Letters of credit issued	25,652
Availability	$389,348

The classification of long-term debt in the accompanying March 31, 2012 consolidated balance sheet is based on the contractual repayment terms of the debt issued under the Credit Agreement and the Notes.

On March 31, 2012, the Company had working capital of $90.1 million and its working capital ratio was 1.87 to 1 compared to working capital of $92.4 million and a working capital ratio of 1.73 to 1 on December 31, 2011. The decrease in working capital is primarily due to a decrease in commodity prices. At March 31, 2012, the Company had unrestricted cash of $27.6 million and funds available under the revolving credit facility of $389.3 million, compared to unrestricted cash of $38.9 million and funds available under the revolving credit facility of $391.6 million at December 31, 2011.

Net cash provided by operating activities was $53.6 million and $80.7 million for the three months ended March 31, 2012 and April 2, 2011, respectively, a decrease of $27.1 million due primarily to a decrease in net income of approximately $18.0 million and to changes in operating assets and liabilities that include a decrease in income taxes refundable/payable of approximately $10.8 million. Cash used by investing activities was $33.8 million for the three months ended March 31, 2012, compared to $14.1 million for the three months ended April 2, 2011, an increase of $19.7 million primarily due to current year investments in an unconsolidated subsidiary and an increase in cash paid for capital expenditures. Net cash used by financing activities was $31.1 million for the three months ended March 31, 2012, compared to $47.8 million for the three months ended April 2, 2011, a decrease in the use of cash of $16.7 million, primarily due to less repayments of debt as compared to the prior year.

Capital expenditures of $24.7 million were made during the first three months of fiscal 2012, compared to $12.8 million in the first three months of fiscal 2011, for a net increase of $11.9 million (93.0%), due primarily to the initiation of a number of capital projects in the first quarter of 2012. Capital expenditures related to compliance with environmental regulations were $0.6 million and $0.3 million during the three months ended March 31, 2012 and April 2, 2011, respectively.

Based upon the annual actuarial estimate, current accruals and claims paid during the first three months of fiscal 2012, the Company has accrued approximately $9.6 million it expects will become due during the next twelve months in order to meet obligations related to the Company's self insurance reserves and accrued insurance obligations, which are included in current accrued expenses at March 31, 2012. The self insurance reserve is composed of estimated liability for claims arising for workers' compensation, and for auto liability and general liability claims. The self insurance reserve liability is determined annually, based upon a third party actuarial estimate. The actuarial estimate may vary from year to year due to changes in cost of health care, the pending number of claims or other factors beyond the control of management of the Company. No assurance can be given that the Company's funding obligations under its self insurance reserve will not increase in the future.

Based upon current actuarial estimates, the Company expects to contribute approximately $2.4 million to its pension plans in order to meet minimum pension funding requirements during the next twelve months. The minimum pension funding requirements are determined annually, based upon a third party actuarial estimate. The actuarial estimate may vary from year to year due to fluctuations in return on investments or other factors beyond the control of management of the Company or the administrator of the Company's pension funds. No assurance can be given that the minimum pension funding requirements will not increase in the future. Additionally, the Company has made tax deductible discretionary and required contributions to its pension plans for the three months ended March 31, 2012 of approximately $0.4 million.

The Pension Protection Act of 2006 ("PPA") was signed into law in August 2006 and went into effect in January 2008. The stated goal of the PPA is to improve the funding of pension plans. Plans in an under-funded status will be required to increase employer contributions to improve the funding level within PPA timelines. The impact of recent declines in the world equity and other financial markets have had and could continue to have a material negative impact on pension plan assets and the status of required funding under the PPA. The Company participates in various multi-employer pension plans

which provide defined benefits to certain employees covered by labor contracts. These plans are not administered by the Company and contributions are determined in accordance with provisions of negotiated labor contracts to meet their pension benefit obligations to their participants. The Company's contributions to each individual multi-employer plan represent less than 5% of the total contributions to each such plan. Based on the most currently available information, the Company has determined that, if a withdrawal were to occur, withdrawal liabilities on two of the plans in which the Company currently participates could be material to the Company, with one of these material plans certified as critical or red zone. With respect to the other multi-employer pension plans in which the Company participates and which are not individually significant, five plans have certified as critical or red zone and one plan has certified as endangered or yellow zone as defined by the PPA. In June 2009, the Company received a notice of a mass withdrawal termination and a notice of initial withdrawal liability from a multi-employer plan in which it participated. The Company had anticipated this event and as a result had accrued approximately $3.2 million as of January 3, 2009 based on the most recent information that was probable and estimable for this plan. The plan had given a notice of redetermination liability in December 2009. In fiscal 2010, the Company received further third party information confirming the future payout related to this multi-employer plan. As a result, the Company reduced its liability to approximately $1.2 million. In fiscal 2010, another underfunded multi-employer plan in which the Company participates gave notification of partial withdrawal liability. As of March 31, 2012, the Company has an accrued liability of approximately $1.0 million representing the present value of scheduled withdrawal liability payments under this multi-employer plan. While the Company has no ability to calculate a possible current liability for under-funded multi-employer plans that could terminate or could require additional funding under the PPA, the amounts could be material.

The Company has the ability to burn alternative fuels, including its fats and greases, at a majority of its plants as a way to help manage the Company’s exposure to high natural gas prices. Beginning October 1, 2006, the federal government effected a program which provides federal tax credits under certain circumstances for commercial use of alternative fuels in lieu of fossil-based fuels. Beginning in the fourth quarter of 2006, the Company filed documentation with the IRS to recover these Alternative Fuel Mixture Credits as a result of its use of fats and greases to fuel boilers at its plants. The Company has received approval from the IRS to apply for these credits. However, the federal regulations relating to the Alternative Fuel Mixture Credits are complex and further clarification is needed by the Company prior to recognition of certain tax credits received. This and other federal bio-fuel tax incentive programs expired on December 31, 2009. On December 17, 2010, however, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 was signed into public law which extended through 2011 and made retroactive to January 1, 2010 the Alternative Fuel Mixture Credits. As of March 31, 2012, this alternative federal tax credit program has expired and has not been extended or reinstituted as of the filing of this report on Form 10-Q. No assurance can be given that the Alternative Fuel Mixture Credits will be reinstated in the future. The Company will, therefore continue to evaluate the option of burning alternative fuels at its plants in future periods depending on the price relationship between alternative fuels and natural gas.

The Company announced on January 21, 2011 that a wholly-owned subsidiary of Darling entered into a limited liability company agreement with a wholly-owned subsidiary of Valero Energy Corporation (“Valero”) to form Diamond Green Diesel Holdings LLC (the “Joint Venture”). The Joint Venture is owned 50% / 50% with Valero and was formed to design, engineer, construct and operate a renewable diesel plant (the “Facility”), which will be capable of producing approximately 9,300 barrels per day of renewable diesel fuel and certain other co-products, to be located adjacent to Valero's refinery in Norco, Louisiana. The Joint Venture is in the process of constructing the Facility under an engineering, procurement and construction contract that is intended to fix the Company's maximum economic exposure for the cost of the Facility.

On May 31, 2011, the Joint Venture and Diamond Green Diesel LLC, a wholly-owned subsidiary of the Joint Venture (“Opco”), entered into (i) a facility agreement (the “Facility Agreement”) with Diamond Alternative Energy, LLC, a wholly-owned subsidiary of Valero (the “Lender”), and (ii) a loan agreement (the “Loan Agreement”) with the Lender,

which will provide the Joint Venture with a 14 year multiple advance term loan facility of approximately $221,300,000 (the “JV Loan”) to support the design, engineering and construction of the Facility, which is now under construction. The Facility Agreement and the Loan Agreement prohibit the Lender from assigning all or any portion of the Facility Agreement or the Loan Agreement to unaffiliated third parties. Opco has also pledged substantially all of its assets to the Lender, and the Joint Venture has pledged all of Opco's equity interests to the Lender, until the JV Loan has been paid in full and the JV Loan has terminated in accordance with its terms.

Pursuant to sponsor support agreements executed in connection with the Facility Agreement and the Loan Agreement, each of the Company and Valero are committed to contributing approximately $93.2 million of the estimated aggregate costs of approximately $407.7 million for the completion of the Facility. The Company is also required to pay for 50% of any cost overruns incurred in connection with the construction of the Facility, including relating to any project scope changes and working capital funding. As of March 31, 2012 under the equity method of accounting, the Company has an investment in the Joint Venture of approximately $32.8 million included on the consolidated balance sheet.

The Company's management believes that cash flows from operating activities consistent with the level generated in the first three months of fiscal 2012, unrestricted cash and funds available under the Credit Agreement will be sufficient to meet the Company's working capital needs and maintenance and compliance-related capital expenditures, scheduled debt and interest payments, income tax obligations, continued funding of the Joint Venture and other contemplated needs through the next twelve months. Numerous factors could have adverse consequences to the Company that cannot be estimated at this time, such as: reductions in raw material volumes available to the Company due to weak margins in the meat production industry as a result of higher feed costs or other factors, reduced volume from food service establishments, reduced demand for animal feed, or otherwise; a reduction in finished product prices; changes to worldwide government policies relating to renewable fuels and greenhouse gas emissions that adversely affect programs like RFS2 and tax credits for bio-fuels both in the U.S. and abroad; possible product recall resulting from developments relating to the discovery of unauthorized adulterations to food or feed additives; the occurrence of Bird Flu in the U.S.; any additional occurrence of BSE in the U.S. or elsewhere; unanticipated costs and/or reductions in raw material volumes related to the Company's compliance with the Enhanced BSE Rule; unforeseen new U.S. or foreign regulations affecting the rendering industry (including new or modified animal feed, 2009 H1N1 flu, Bird Flu or BSE regulations); increased contributions to the Company's multi-employer and employer-sponsored defined benefit pension plans as required by the PPA or resulting from a mass withdrawal event; bad debt write-offs; loss of or failure to obtain necessary permits and registrations; unexpected cost overruns related to the Joint Venture; continued or escalated conflict in the Middle East; and/or unfavorable export markets. These factors, coupled with volatile prices for natural gas and diesel fuel, general performance of the U.S. and global economies and declining consumer confidence including the inability of consumers and companies to obtain credit due to the current lack of liquidity in the financial markets, among others, could negatively impact the Company's results of operations in fiscal 2012 and thereafter. The Company cannot provide assurance that the cash flows from operating activities generated in the first three months of fiscal 2012 are indicative of the future cash flows from operating activities that will be generated by the Company's operations. The Company reviews the appropriate use of unrestricted cash periodically. Except for contributions to the Joint Venture and expenditures relating to the Company's ongoing enterprise resource planning system project, no decision has been made as to non-ordinary course cash usages at this time; however, potential usages could include: opportunistic capital expenditures and/or acquisitions; investments relating to the Company's developing a comprehensive renewable energy strategy, including, without limitation, potential investments in additional renewable diesel and/or biodiesel projects; investments in response to governmental regulations relating to human and animal food safety or other regulations; unexpected funding required by the PPA requirements or mass termination of multi-employer plans; and paying dividends or repurchasing stock, subject to limitations under the Credit Agreement and the Notes, as well as suitable cash conservation to withstand adverse commodity cycles.

The current economic environment in the Company's markets has the potential to adversely impact its liquidity in a variety of ways, including through reduced raw materials availability, reduced finished product prices, reduced sales, potential inventory buildup, increased bad debt reserves, potential impairment charges and/or higher operating costs.

The principal products that the Company sells are commodities, the prices of which are based on established commodity markets and are subject to volatile changes. Any decline in these prices has the potential to adversely impact the Company's liquidity. Any of a decline in raw material availability, a decline in commodities prices, increases in energy prices and the impact of the PPA has the potential to adversely impact the Company's liquidity. A decline in commodities prices, a rise in energy prices, a slowdown in the U.S. or international economy, continued or escalated conflict in the Middle East, cost overruns in the construction of the Facility or other factors, could cause the Company to fail to meet management's expectations or could cause liquidity concerns.

OFF BALANCE SHEET OBLIGATIONS

Based upon the underlying purchase agreements, the Company has commitments to purchase $18.2 million of commodity products consisting of approximately $12.6 million of finished products and approximately $5.6 million of natural gas and diesel fuel during the next twelve months, which are not included in liabilities on the Company's balance sheet at March 31, 2012. These purchase agreements are entered into in the normal course of the Company's business and are not subject to derivative accounting. The commitments will be recorded on the balance sheet of the Company when delivery of these commodities occurs and ownership passes to the Company during the remainder of fiscal 2012 and into fiscal 2013, in accordance with accounting principles generally accepted in the U.S.

Based on the sponsor support agreements executed in connection with the Facility Agreement and the Loan Agreement relating to the Joint Venture with Valero, the Company has committed to contribute approximately $93.2 million of the estimated aggregate costs for completion of the Facility. As of March 31, 2012, the Company has contributed approximately $34.7 million and will incur the remaining amount of the commitment through the completion date of the Facility which is expected by the end of fiscal 2012 or early in fiscal 2013. The Company is also required to pay for 50% of any cost overruns incurred in connection with the construction of the Facility, including relating to any project scope changes and working capital funding.

Based upon the underlying lease agreements, the Company expects to pay approximately $15.3 million in operating lease obligations during the next twelve months, which are not included in liabilities on the Company's balance sheet at March 31, 2012. These lease obligations are included in cost of sales or selling, general and administrative expense as the underlying lease obligation comes due, in accordance with accounting principles generally accepted in the U.S.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. The ASU amends ASC Topic 220, Comprehensive Income. The new standard eliminates the option to report other comprehensive income and its components in the statement of changes in equity and instead requires entities to present net income and other comprehensive income in either a single continuous statement or in two separate, but consecutive, statements of net income and other comprehensive income. Reclassification adjustments between net income and other comprehensive income must be shown on the face of the statement(s), with no resulting change in net earnings. In December 2011, the FASB issued ASU No. 2011-12, Deferral of Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. This ASU amends ASC Topic 220, Comprehensive Income. The new standard deferred the requirement to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income while the FASB further deliberates this aspect of the proposal. This update is effective for the Company on January 1, 2012 and must be applied retrospectively. The Company adopted this standard as of March 31, 2012. The adoption did not have a material impact on the Company's consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, Testing Goodwill for Impairment. The ASU amends ASC Topic 350, Intangibles - Goodwill and Other. The new standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a "qualitative" assessment to determine whether further impairment testing is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company adopted this standard in the first quarter of 2012 and the adoption did not have a material impact on the Company's consolidated financial statements.

FORWARD LOOKING STATEMENTS

This Quarterly Report on Form 10-Q includes "forward-looking" statements that involve risks and uncertainties.   The words "believe," "anticipate," "expect," "estimate," "intend," "could," "may," "will," "should," "planned," "potential," and sin expressions identify forward-looking statements. All statements other than statements of historical facts included in the Quarterly Report on Form 10-Q, including, without limitation, the statements under the sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and located elsewhere herein regarding industry prospects, expectations for construction of the Facility and the Company's financial position are

forward-looking statements. Actual results could differ materially from those discussed in the forward-looking statements as a result of certain factors, including many that are beyond the control of the Company. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable, it can give no assurance that these expectations will prove to be correct.

In addition to those factors discussed under the heading “Risk Factors” in Item 1A of Part I of the Company’s annual report on Form 10-K for the year ended December 31, 2011, and in the Company’s other public filings with the SEC, important factors that could cause actual results to differ materially from the Company’s expectations include: the Company’s continued ability to obtain sources of supply for its rendering operations; general economic conditions in the American, European and Asian markets; a decline in consumer confidence; prices in the competing commodity markets which are volatile and are beyond the Company’s control; energy prices; changes to worldwide government policies relating to renewable fuels and greenhouse gas emissions; the implementation of the Enhanced BSE Rule; BSE and its impact on finished product prices,

export markets, energy prices and government regulations, which are still evolving and are beyond the Company's control; the occurrence of Bird Flu in the U.S.; possible product recall resulting from developments relating to the discovery of unauthorized adulterations (such as melamine or salmonella) to food additives; increased contributions to the Company's multi-employer defined benefit pension plans as required by the PPA or required by a withdrawal event; risks, including future expenditures, relating to the Company's Joint Venture with Valero to construct and complete a renewable diesel plant in Norco, Louisiana and possible difficulties completing and obtaining operational viability with the plant; challenges associated with the Company's ongoing enterprise resource planning system project, including material deviations from the project or unsuccessful execution of the implementation plan for the project; and the Company's ability to combine Darling's business and Griffin's business and to realize the anticipated growth opportunities and cost synergies and to integrate the two businesses efficiently. Among other things, future profitability may be affected by the Company's ability to grow its business, which faces competition from companies that may have substantially greater resources than the Company. The Company cautions readers that all forward-looking statements speak only as of the date made, and the Company undertakes no obligation to update any forward-looking statements, whether as a result of changes in circumstances, new events or otherwise.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

Market risks affecting the Company are exposures to changes in prices of the finished products the Company sells, interest rates on debt, availability of raw material supply and the price of natural gas and diesel fuel used in the Company's plants. Raw materials available to the Company are impacted by seasonal factors, including holidays, when raw material volume declines; warm weather, which can adversely affect the quality of raw material processed and finished products produced; and cold weather, which can impact the collection of raw material. Predominantly all of the Company's finished products are commodities that are generally sold at prices prevailing at the time of sale. The Company makes limited use of derivative instruments to manage cash flow risks related to interest expense, natural gas usage, diesel fuel usage and inventory. The Company does not use derivative instruments for trading purposes. Interest rate swaps are entered into with the intent of managing overall borrowing costs by reducing the potential impact of increases in interest rates on floating-rate long-term debt. Natural gas swaps and options are entered into with the intent of managing the overall cost of natural gas usage by reducing the potential impact of seasonal weather demands on natural gas that increases natural gas prices. Heating oil swaps and options are entered into with the intent of managing the overall cost of diesel fuel usage by reducing the potential impact of seasonal weather demands on diesel fuel that increases diesel fuel prices. Inventory swaps and options are entered into with the intent of managing seasonally high concentrations of MBM, PM, BFT, PG, YG and BBP inventories by reducing the potential impact of decreasing prices. The interest rate swaps and the natural gas swaps are subject to the requirements of FASB authoritative guidance. Some of the Company's natural gas and diesel fuel instruments are not subject to the requirements of FASB authoritative guidance because some of the natural gas and diesel fuel instruments qualify as normal purchases as defined in FASB authoritative guidance. At March 31, 2012, the Company had natural gas swaps outstanding that qualified and were designated for hedge accounting as well as heating oil swaps and options that did not qualify and were not designated for hedge accounting.

In fiscal 2011 and the first quarter of fiscal 2012, the Company has entered into natural gas contracts that are considered cash flow hedges according to FASB authoritative guidance. Under the terms of the natural gas swap contracts the Company fixed the expected purchase cost of a portion of its plants expected natural gas usage into the third quarter of fiscal 2012. As of March 31, 2012, the aggregate fair value of these natural gas swaps was approximately $0.7 million and is included in accrued expenses on the balance sheet, with an offset recorded in accumulated other comprehensive income for the effective portion.

Additionally, the Company had heating oil swaps and options that are marked to market because they did not qualify for hedge accounting at March 31, 2012. The heating oil swaps and options had an aggregate fair value of approximately less than $0.1 million and are included in other current assets and accrued expenses at March 31, 2012.

As of March 31, 2012, the Company had forward purchase agreements in place for purchases of approximately $5.6 million of natural gas and diesel fuel in fiscal 2012. As of March 31, 2012, the Company had forward purchase agreements in place for purchases of approximately $12.6 million of finished product in fiscal 2012.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. As required by Exchange Act Rule 13a-15(b), the Company's management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation, as of the end of the period covered by this report, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. As defined in Exchange Act Rules 13a-15(e) and 15d-15(e) under the Exchange Act, disclosure controls and

procedures are controls and other procedures of the Company that are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on management’s evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting. As required by Exchange Act Rule 13a-15(d), the Company’s management, including the Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of the Company’s internal control over financial reporting to determine whether any change occurred during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting. Based on that evaluation, there has been no change in the Company’s internal control over financial reporting during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

DARLING INTERNATIONAL INC. AND SUBSIDIARIES
FORM 10-Q FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2012

PART II: Other Information

Item 1. LEGAL PROCEEDINGS

Fresno Facility Permit Issue. The Company has been named as a defendant and a real party in interest in a lawsuit filed on April 9, 2012 in the Superior Court of the State of California, Fresno County, styled Concerned Citizens of West Fresno vs. The City of Fresno and Darling International Inc. In the complaint, the plaintiff alleges that the City of Fresno has failed to enforce its own zoning ordinances and engaged in a number of discriminatory practices against the citizens of West Fresno. In addition, the complaint alleges that the Company's Fresno facility is operating without a proper use permit. Rendering operations have been conducted on the site since 1955, and the Company believes that it possesses all of the required federal, state and local permits to continue to operate the facility in the manner currently conducted and intends to defend itself vigorously in this matter. While management cannot predict the ultimate outcome of this matter, management does not believe the outcome will have a material effect on the Company's financial condition or results of operations.

Item 6. EXHIBITS

The following exhibits are filed herewith:

31.1	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, of Randall C. Stuewe, the Chief Executive Officer of the Company.
31.2	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, of John O. Muse, the Chief Financial Officer of the Company.
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Randall C. Stuewe, the Chief Executive Officer of the Company, and of John O. Muse, the Chief Financial Officer of the Company.
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Consolidated Balance Sheets as of March 31, 2012 and December 31, 2011; (ii) Consolidated Statements of Operations for the three months ended March 31, 2012 and April 2, 2011; (iii) Consolidated Statements of Comprehensive Income for the three months ended March 31, 2012 and April 2, 2011; (iv) Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and April 2, 2011; (v) Notes to the Consolidated Financial Statements

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DARLING INTERNATIONAL INC.

Date: May 10, 2012

By: /s/ Randall C. Stuewe
Randall C. Stuewe
Chairman and
Chief Executive Officer

Date: May 10, 2012

By: /s/ John O. Muse
John O. Muse
Executive Vice President
Administration and Finance
(Principal Financial Officer)