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CONFERENCE CALL PARTICIPANTS
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MIKE RYSKIN: Thank you for joining us. My name is Mike Ryskin. I'm on the Bank of America Life Science Tools and Diagnostics team, but I also have the privilege of covering the animal health space. And for our next session, joining us is Phibro Animal Health. We're joined by Jack Bendheim, Chairman President and CEO, and Dick Johnson, CFO. Thank you for taking the time and thank you for being with us today.

JACK BENDHEIM: Again, thank you for having us.

MIKE RYSKIN: Just to really get into it right off the bat, I think we'll start with a big question first, and that's been on everyone's mind. And that's the impact of COVID-19 on livestock markets. You guys obviously gave us a very timely update last week on your earnings call on what you're seeing. But I'd like to go a little bit deeper.

If we could really just start with what I think have been the three main issues affecting livestock markets, which is slaughterhouse closures we've read on reports across the country. Second, I would highlight the shift from food service and people eating out of restaurants to now grocery and meat store shopping. And the third hit is the potential hit from a recession later this year in 2021, to be determined.

For all three of these issues, if you could just give us your high-level overview of the near-term, medium-term, long-term dynamic -- how you're thinking about the timing of the magnitude of these. What are the components that are affecting your business the most? And if you could talk through, also, species by species because you're going to see different dynamics for all of these, for cattle versus swine versus poultry. So very high-level, very big question, but just set your framework as you're thinking about COVID-19 impact throughout 2020 and beyond.

JACK BENDHEIM: OK. It's a small question, and we only have a half an hour. Let me start, and Dick, just jump in if I forget something. So overall, I just want to start by saying that there is no protein shortage in the United States. And so that brings us to the slaughterhouse closings.

I'm not inviting anybody here on this call to ever go visit a slaughterhouse. But just by the nature of how products are prepared, if you think of it, the animal comes in on a shackle. It's shackled.

Its head is taken off. And it then moves down the line to where at the end of this line it is completely packaged in a form which is consumer-friendly. It's consumer-friendly down the line.

So it's packaged right to go either to supermarkets or could be packaged to go into the food service industry. The nature of all that work-- and that work, believe me, if it could be done by robots, it would be. But so far, that has been impossible. It's done by live human beings.

And subsequently when you have a virus like we have, which is in a way as we say, pandemic-- it's jumping one to the other. The odds of having all these people together-- and it's not just a question of having them together at the slaughterhouse. It's also when they go home, they're also living together with other families.

It's not running out to the Hamptons to protect themselves. So the odds of them getting sick are high. And what we've seen in this scenario in the United States, a lot of them have gotten sick.

And correctly so, the people running the slaughterhouses have closed them down, cleaned them out, and then are looking to put as many barriers as they can put in to protect the workers. That's extremely important to everybody in the industry, and also continue producing.

So what's happened, as these plants closed down, it creates an upset. And the one where it has the most impact has been in the hog business. Because in this situation I've described, the hog comes in and the hog will weigh usually within four or five pounds of all the other hogs.

They're raised on specific weight. They're timed from the time-- piglets take possibly five months to grow. So you know when you're a producer, you put the sows in. The piglets will be born from the sows. And then 5 months later, 5.1 month later, it's ending up on the shackle always in a certain weight.

And you plan this. So it's not like having a soybean crop. I have to get it in within 30 days. Here, you want this process to go throughout the year. Because you have a certain contract with the slaughterhouse, or they have with you. You're growing so many pigs on this system.

So when that slaughterhouse shuts down, everything backs up. Because they can't take the pigs, I got to find a place for these big pigs. If they continue growing to be too big, really too big, well the slaughterhouse can't take them. So I have to find space.

And when I see this thing, what I need to do is I need to slow down this growth. And if it really goes for a while, luckily we've seen these slaughterhouses that closed, within two weeks be cleaned out and then to be able to start again.

But you can imagine across the country, we're slaughtering in the United States approximately into this process over 100 million pigs a year. Now, luckily no one slaughterhouse does it all. But each slaughterhouse serves a specific area.

So if a slaughterhouse closes in Minnesota, the farms in that area within 100 miles would be affected. And that's exactly what we've seen. It backs up. It creates a lot of problems.

It's in this sort of mix that this has caused a great amount of upset. It's obviously worse for pigs. It's happened also in cattle. In cattle it's not as such a big deal. You have room on the farms. You have room on the range. You have room to let the cattle go out there and grow with different effects.

And in the poultry houses, it's all integrated. So there, you can turn things around pretty quickly. And the process is a bit more automated. So that's what's happened with the slaughterhouses. It's creating upsets, upsets in parts of the country, upset in some of the export markets.

But overall I think that they're trying to get this back in hand. It will continue as long as we don't have a vaccine for COVID. But it will pop up and be settled and pop down. So it's going to create upsets.

But as I started by saying, notwithstanding what you're reading in the papers, there is no protein shortage in the United States. There might be this certain cut that you like, you might not get. But overall, you might not be able to find bacon one day. You might have to buy some turkey out of season. But overall, I think we're in fairly good shape.

A more interesting question, I mean part of this interesting question. Sorry, Mike. Going forward, if we go into a deep recession-- and I think you can't look at all the furloughs and all the job losses today and take those numbers and say-- oh, my God, we're in the worst recession we've been in since the Great Depression.

Because the real question is, how many of these jobs come back? And if most jobs come back or many jobs come back, then this is a recession like all other recessions. And if that's the case, I think the industry, if I look back to 2008, which was a pretty deep recession, the industry suffered a little bit.

People who lost jobs, they didn't give up eating protein. They might have gone down from steaks to pig, pig to chicken. But it sort of moved around. And I think overall, the fundamentals of our business, why we love this business, which is why you as investors should love this business, is that people continue to eat-- at least in the United States and at least in Europe and at least in South America.

The places where we are seeing a little bit of a blip is some of these developing countries, markets in the Far East, where people for the first time in their lives had decent enough jobs they were able to start eating protein. And most of that protein in that part of the world tends to be fish and tends to be chicken. There we've seen a drop.

Until those jobs come back-- and a lot of those jobs are totally related to where people in Europe and where people in the United States shop and what they shop. That might take a bit longer.

The question I think about every day is what change in habits are we in the United States? What change in habits of myself? What am I going to be doing differently as we come out of this thing?

Because the shock of this pandemic is something which was just not on my personal radar screen, and maybe I would doubt on many people on the call's radar screen. So I don't think I'm going to eat differently, will I spend less time in restaurants? Again, I don't know.

I think you have to wait for the vaccine and see the effectiveness of the vaccine to see what comfort level. My guess will be within a year we will have two, three, four, or five different vaccines that will be effective. Maybe not 100%, but maybe over 80% effective.

And then we'll start looking at this virus not much differently than we look at the annual winter virus. Yes, I took a vaccine. It didn't work that well, or it worked OK. But I'm comfortable to be out and about. So I think that's my view. And I don't know, Mike, if I covered that.

MIKE RYSKIN: No, Jack, that was great. That was a great overview. I think it covered a lot of exactly I was trying to get at. Going back to the earlier point you touched on, so this would be on the slaughterhouse closures and some of the more near-term impacts that we're starting to see in April, May-- that we expect to see for the next couple of months.

When we think about those sectors-- you highlighted the difference between swine, cattle, and poultry in the US. When we think about them recovering and heading back to normal over the next few months, what are the leading indicators we should be monitoring? And is it really just slaughter capacity?

You know, right now for swine, it's down 30%, 40%. As long as I get back to 90%, 95% of prior, is that good enough for swine to start moving again? Or do you also monitor futures markets for lean hogs or for live cattle? Are there any other indicators that we should be paying attention to?

And do you think there will be any-- you mentioned that if it's a relatively short-lived shutdown of the slaughterhouse, a couple of weeks and they open it back up again, you'll be able to work through it. Could you scenario it out for us?

What happens if it's a more protracted downturn where you see-- do you anticipate people could cull the herd, reduce the number of animals? I realize it's a worst case scenario right now. But do you still think about the various possibilities that we could be looking at?

JACK BENDHEIM: I mean, that's obviously a good question. I think going forward, the impact and the changes in the slaughterhouse of moving the food from the restaurant pack to supermarket packs is causing a bit more of an upset. That has to be done because even if we-- am I still on?

MIKE RYSKIN: Yes.

JACK BENDHEIM: Hello?

MIKE RYSKIN: Yes, you're still on.

JACK BENDHEIM: So even if there are changes, I think the production will go. And I do think from a producer point of view, they want to create a bit more space. They don't want to run into this problem that literally they had no room to put any single animal at any stage in the growing. Again, as I said, the only person with space are cattle producers.

So I think, across species, people are going to-- I wouldn't say cull, because that gets expensive. Even though in some cases, with some of these plants closing down, you'll have no choice but to cull the animals. But going forward, I think people are going to be backing up. And I would generally think across all the protein species, we could see a 5% drop in production.

And that could be for absolutely every single-- it's going to be true for poultry. It's going to be true for swine. It's going to be true for cattle. Overall this thing, the Chinese are out there, and they are buying more pork from the United States the last six months than they did for the last 6 years. And that's continually being out they're buying.

And I think with the last trade agreement, the tariffs the Chinese were charging for US pork has dropped. So there are lots of opportunities for the US producers. I know our customers in Brazil are producing and shipping to China. I know our customers in Mexico are producing and shipping to China. And that's true for many places around the world.

So overall this is a dynamic business. But I do think if I needed to put a number on what we will see in decline over the next year or over the next 12 months from where we are right now, I think generally we'll see approximately in the US about a 5% decline, and maybe in other markets as well-- which will be a combination of response to COVID and to recession.

MIKE RYSKIN: That's really helpful. Thanks. And then just to follow up from that, since you highlighted China, it seems like a year ago, we thought African swine fever the worst thing that could happen to livestock markets. And it turns out, never ask the question of, is this as bad as it's going to get right?

So thinking back to African swine fever, you highlighted the growing exports from the US to China and from Latin American and Australia and other parts of the world as well. Could you give us an update on what you're seeing in that region? I know that when you first laid out your guide for the current fiscal year, you'd indicated you don't really expect to make any revenues over there.

It seems like there's been some volatility there as well. And potentially some of those markets have started to regain ground earlier than we thought. Could you give us an update on what you're seeing in China and also potentially in other parts of APAC that have been affected by ASF?

JACK BENDHEIM: So we are seeing, in China, just a slight re-populating of the pig market, of the swine market. It's not going quickly. People are still very, very hesitant, without a vaccine to go ahead and put on a lot of pigs. And what COVID has done in a way is drop prices around the world to the producers.

So the Chinese, I am sure are out there every day now and buying up. And they'll refill their freezes, the country's freezers, with pork meat. And yes, as I said, we are benefiting to the extent that we do business in Mexico and in Brazil, and even the United States. On the ability for these producers in these countries to export to that market, we will participate in that.

For ourselves, the business that we had in China, I don't think it's going to come back for a long time, until there's a vaccine. And people in China talk about a country that's facing two pandemics, to your earlier point. Because they had African swine fever that really affected their business, their livelihood, their cost of a basic commodity. And then they were hit with COVID. So it's two huge problems.

MIKE RYSKIN: Got it. Thanks. Coming back to the United States and some of the near-term market conditions, if we look specifically at your performance in the third fiscal quarter, and over the last couple of quarters, you've seen a little bit of a rebound in your animal health business. Specifically if you look at nutritional specialties and vaccines, part of that has been contribution from Osprey.

But a lot of it has been, I think, slightly better performance in dairy and some of the other poultry markets. Focusing specifically on dairy, that's been a market that's seen really challenging conditions for a couple years now. If we look to late 2019, it seemed like it was starting to stabilize. And then COVID came around again.

So do you think looking forward, are we due for another period of challenge and uncertainty in dairy? How is that market in particular positioned here, especially with school closures, school lunches, things like that? Do we have to reset the clock again on a dairy recovery?

JACK BENDHEIM: I mean, that's not clear. As I said on our earnings call the other day, just because schools are closed and there's no one out there consuming milk, doesn't mean the cow doesn't produce the milk. So there are a lot of cows out there in the United States, a lot of dairy cows producing milk every day. And if you're the farmer, you want to keep that dairy cow healthy.

So it's obviously better-- you would invest more in the herd if you're making money. If you're not making money, you're still not going to abandon-- I take that back. What you will do is you will abandon the worst performers. So you might reduce your herd a bit. And that will be converted to hamburgers. And that will help the protein supply or whatever we were talking about before.

But I think the milk price and the dairy prices will turn around faster. And we've spent all this time with new guidance two months away from our end of our fiscal year, because of all the uncertainties of COVID. But had that not been the case, I would have been talking about how

even with the low price of milk, our nutritional specialty business in the dairy market has been doing better.

And these other product lines that we've launched are starting to contribute. And the story we've been telling for the last two quarters-- we spent more time talking about it in the third quarter and hoping and figuring it's going to go through all four quarters.

COVID has occupied our lives. It's obviously all we talk about all day long. But I think there will be more smaller dairies in the United States closing down. It's hard to operate.

But overall, if I look back, when we start entering the dairy business over 20 years ago, I think there were a little bit over 9 million dairy cows in the United States. Here we are 20 years later, lots and lots and lots of thousands of farms have closed down. We still have over 9 million dairy cows in the United States.

And the dairy cows are our customers. So as long as we got those customers, yeah, we want the farmers to make money. And they'll buy a little less or more, but their business is to keep those cows, which are quite expensive, alive, well, and producing milk. That's what they do.

And that milk gets converted to powder. It'll get converted to ice cream. It'll get converted to cheese, et cetera, et cetera. It'll come back more to a recession question, because a lot of that dairy powder and cheese gets exported. But the US is a very, very low cost producer of protein and milk, et cetera, et cetera. So I'm confident about the US produces.

And we'll see where this recession goes. We've all given up on a v-shaped recovery. But let's hope it's not a-- I don't know, whatever the current talk is.

MIKE RYSKIN: Yeah. We've gone through all the letters-- V, U, W, L. That's really helpful, Jack. I appreciate your call today. I want to just follow up on that a little bit. We've got about five minutes left.

I want to squeeze in a couple of last questions. Your comments on the consolidation among dairy and how your customers think about the value add from Phibro-- if you could walk us through the decision making process-- what are the key considerations and inputs that your customers look at when they're making purchasing decisions?

I think on our call, you highlighted some interesting points. Profitability is obviously the main driver. The more money the farmers and the ranchers have, the more they want to spend on vaccines and therapeutics. And Phibro typically has some of the more premium products, so therefore you could feel a little bit of trade down.

Could you talk about some of the dynamics you expect there? As profitability moves down, as these end market conditions persist, what are the decisions they are going to be making? What is the break-even point where they go from premium product to average product to low end product to no therapeutic at all? How are you positioned relative to that?

JACK BENDHEIM: We have a unique position in the dairy business. What our data has shown is that if the dairy man buys our products, overall, he will get a higher level of quality milk production. And he'll do that with a cow that stays healthier.

And what that means in the calf staying healthier is it uses less antibiotics. It doesn't get sick. It won't get bacterial disease as quickly. So what happens when the cow gets sick, as I've said many times, he gets put in what's called a hospital on the farm. And the milk it produces is thrown away. And obviously you don't make any money when that happens.

So the products that we sell, and there are three main products, will help the dairy farmer again produce more milk, better quality. And overall, because of all that's happening with good growth, we'll do it by lowering his feed costs and lowering his costs of drugs, et cetera, et cetera.

So the value proposition is there. What happens, when prices are very low and a recession comes-- and depending on the size of the dairy-- historically we did very well where the owner was the dairy man and had 100, 200, 500 cows and saw the results.

But in some of these larger farms, it's become more challenging for us because the owner or the manager is not out on the farms, and is just looking at a spreadsheet and literally wants whoever's making the decision to spend nothing beyond the feed cost. Because feed cost is a basic cost, anything above that, don't spend, because I'm not making any money.

And those guys, they're not seeing the results. They're seeing overall results, but they're not seeing the healthier cow. They might run some risk getting a little bit less healthy because it's saving them money.

So that's the battle. We're starting to win that battle. So the discussion we would've had, as I said a little bit earlier, our nutritional business and dairy did better this last quarter. Again, we didn't have a chance to talk about, because we all were talking about COVID. So that's where our products fit in.

MIKE RYSKIN: Got it. That's really helpful. I think we're almost up to the end of our allotted time. We've got a couple of minutes left. Is there anything you feel like we haven't addressed on the call or anything in particular that sticks out to you that you think is noteworthy, whether it's related to COVID or ASF or underlying market conditions?

Maybe some of new product constructions you've seen or Osprey, how that acquisition has gone. What do you think is most noteworthy that's gotten overlooked over the last couple of weeks?

JACK BENDHEIM: Well, I want to make a pitch for our industry. Obviously also I'll include Phibro in our industry. We see time and again, and especially under these bad-shape times-- and that's why I happily get out of bed and go down to my library every day, not to the office, and do this.

We're in a basic business that is involved in the production of protein, with great customers. And it's really adding real value. Now the other part of the business is with keeping pets healthier and happier.

And as we see, really through COVID, there's nothing really more basic than food, than the comfort that companion animals give you. And these businesses are going to be here for a very, very long time.

I mean, who knows what we're going to see out of this pandemic? Who knows what we're going to see after the next one? But one thing I'm 100% confident in is that people will continue eating and continue eating protein, continue taking care of their pets, continue taking care of their own health. And those are the businesses I think one should invest in.

MIKE RYSKIN: Great. That's really well said, Jack. Thank you so much. I think we're at the end of our allotted time. So I want to thank you for participating. I want to thank all of our clients and investors for listening in. And good luck out there. Stay safe, stay healthy, and we'll talk soon. Thanks, Jack.

JACK BENDHEIM: Thanks, Mike.

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