Phibro Animal Health Corporation
September 16, 2020
10:15 AM EDT

David Risinger: Great, so good morning, everyone. This is Dave Risinger from Morgan Stanley. I cover both major and specialty pharmaceuticals. And it's my pleasure to host Phibro for our discussion. I do need to start with a disclaimer and that is please note that this webcast is for Morgan Stanley's clients and appropriate Morgan Stanley employees only. It's not for members of the press. If you're a member of the press, please disconnect and reach out separately. For important disclosures, please see the website www.morganstanley.com/research disclosures. And if you have any questions, please reach out to your Morgan Stanley sales representative.

So I'm pleased to have Dani Bendheim, who is a company director and Executive Vice President of Corporate Strategy. He's held a variety of operational and leadership roles at the company since 1997. And also Dick Johnson, who is the CFO, and has been with Phibro since 2002.

So I thought, Dani, it would be great to start with you. If you could just kick it off at a high level by discussing your vision for Phibro, including expanding into higher-growth animal markets.

Daniel Bendheim: Thanks, David. Appreciate you guys hosting us. So I think on your stage, in person over the last few years, we've discussed our vision truly is to be agnostic as far as proteins that people eat. And what that means is we'd like to be selling into all species and all markets. And whether someone wants a conventional meat, or organic, or aqua, et cetera; we'd like to be there.

So we're not there yet. We are growing in our reach around the world. We continue to grow into more countries in Southeast Asia and strengthen our organization in Europe as well, which is a huge market. It's one that we have had historically a small presence. And so as far as our ability to grow, we are looking at growing obviously in aquaculture. And we've talked about the first few years. And we're also looking to grow in the pet space.

We are probably the largest multinational animal health company that does not have a real presence in pets. We are taking baby steps towards entering the space. We've launched our first product into that space, and we have other products in our pipeline. And we do see a tremendous amount of opportunity, as that industry consolidates, most recently with Elanco buying Bayer. There are fewer and fewer places where people with innovative ideas, and there are a lot of innovative ideas out there. There are fewer and fewer places for those folks to go. And we see ourselves as planting a flag that we're entering this business for real, and we see over the next – I wouldn’t say necessarily over

the short term or next year or two; but over the medium to long term, we see real opportunity there.

David Risinger: Excellent. Thank you. And Dick, you had guided to roughly flat sales sequentially in the September quarter of $190 million. Could you just provide an update on that and discuss the pushes and pulls?

Richard Johnson: Yeah, I think we're seeing similar dynamics in our September quarter that we saw in our June quarter. Our customers in the industry is still dealing with COVID. We are seeing improvement. Our customers are seeing improvement. In fact, the darkest, the most difficult days are behind us, knock wood. Let's hope for that. And we're seeing recovery. Recovery is slow but steady. Some of the recovery is -- let's just take a couple of examples.

The US swine is still kind of recovering from the shutdown of the slaughterhouses and that recovery will certainly continue through the rest of the calendar year. US dairy prices, which were trending very nicely in favor of the producer pre-COVID, the producer really saw a dramatic drop in prices during COVID. Prices now are back to at or above breakeven levels, so a lot more optimism for the dairy producer out there. And it continues to improve, but it's not back to the better pricing levels of maybe roughly a year ago.

We are starting to regain face-to-face customer contact. In many cases it has to be still somewhat innovative, because you can't have just the traditional person-to-person meetings. So we're, as we said in our call recently, we're optimistic that the industry is recovering. I think we're seeing that in the quarter, and so that optimism and that expectation for ongoing recovery over the course of our fiscal year is still in place, and we haven't changed that.

David Risinger: Great. That's very helpful. So within your animal health segment, I want to start with the growth, the fastest growth areas first. So nutritional specialties and vaccines I believe are about 40% of animal health sales, and have been key growth drivers for Phibro. Could you talk about future prospects for those areas?

Richard Johnson: Yeah, Dani, do you want to take that one?

Daniel Bendheim: Sure. Yes I think we've guided, in general, for a belief that over the -- maybe not on a quarter-by-quarter basis, but overall we expect double-digit growth in those areas. And we still feel that way. Nutritional specialties, so these are the equivalent of I'd say on the human side of products you'd get at GNC or a Vitamin Shoppe. These are high-value relatively high margin performance-based products, less heavily regulated than a medicated feed additive would be, and typically help the immune system or something along those lines.

And we have a very strong position. I'd say we have a leading position in dairy and in poultry for sure in the US, and rolling those out internationally. In both dairy and poultry, in each of those categories we have two products that are doing really well. And in general, we're very bullish about our ability to find and create new products in those

categories for truthfully every species out there.

If you look at our acquisitions over the years, a number of them are in the nutritional specialties space, and we are getting more and more basic in our ability to really create those products. Most recently, about a year ago, we bought Osprey Biotechnics, which is a direct-fed microbial producer, or we got to them because they produce microbials that could be used in DFMs. We've launched over the last year a product called Provia Prime, which is how we met Osprey. We developed it, but they created our strain, and already we've seen a lot of success in that. And we see the technologies that we acquired at Osprey as being key drivers as we continue to grow out our nutritional space in the years to come.

On the vaccine side, also an area where we see a lot of growth, truthfully our numbers have been way down on the bottom line, the dollars, the OpEx that we're spending in creating a new vaccine facility in Sligo, Ireland. This will be in addition to our commercial vaccine facility in Israel that is doing extremely well, and will open up, will further open up the European market for us, as well as serving Muslim countries that for geopolitical reasons will not buy from Israel, although obviously that's changing as we speak.

So we see and we've seen tremendous growth from the Israeli product line, and we think that will be accelerated once Sligo opens up, which initial sales within the next 12 to 18 months, but full scale with registrations probably 2 years away. So that will also be a driver, and we have also a US-based autogenous vaccine business, which is focused on swine and to a lesser extent cattle and poultry. And that also has some very unique technologies that we're able to build on, and is growing nicely.

David Risinger: That's very helpful. And with respect to nutritional specialties, so I'm assuming that organic producers can utilize those products and still have an organic label, or is that not always the case? Could you help us understand that?

Daniel Bendheim: That's not always the case. Nutritional specialty product does not necessarily mean that it's an all-natural product. We do have products that have OMRI certification that we do sell into the organic space. But you could be using a GMO-based product, and still be in nutritional, for instance. So there are different categories within. Nutritional though is something, again, the regulatory barriers are a little bit lighter, but there are still -- depending on the country, still regulatory areas that they're typically sourced largely from plants or things of that nature, or bacteria, or direct-fed microbials I should say. But there's no one specific way to define it.

David Risinger: Okay, got it. And so --

Richard Johnson: And just -- sorry, David -- to jump in and maybe Dani said this and I missed it. But the majority of our -- really the demand for this category of product is driven in fairly large measure because some of the traditional products, i.e. antibiotics, are no longer being used for in many cases consumer preferences. But the producer still needs to keep his animal healthy, still needs to deal with the same health challenges he's always dealt with. So he's looking for alternative products, substitute products. And that's really what's

driven a lot of the success and the growth in this product category for us.

David Risinger: Got it. Okay, thank you. And then just so that I understand nutritional specialties a little bit better, are your larger competitors introducing offerings in this area, or are they mainly focused on introducing new patented medicines?

Daniel Bendheim: So our classical larger animal health competitors that David, maybe you cover companies like Elanco or Zoetis, they do have some presence in nutritional specialties. And certainly they've stated that they look to have a stronger presence. Some of them have announced alliances with other companies. They're really not the people that we see right now so much in our space. It is a competitive space. The margin profile I think of a nutritional specialty product is probably slightly lower than the thresholds that they have publicly stated that they're looking to make for products. So I'm not necessarily assuming that they'll have a larger presence in the space. But there are certainly companies like Novozymes, a company called Diamond V which was bought by Cargill. So Cargill, Church and Dwight with their specialty division. There's many large significant players in the nutritional specialties space that we compete with.

David Risinger: And what drives your leadership position in a couple of the animal categories?

Daniel Bendheim: You know, I think it's a matter of products and people. And we have excellent products and excellent people with really strong relations. I think when we come out with a product, the industries know that these products deserve to be -- there's a look should be taken on them, and not everyone has that. So a lot of people have come up with nutritional specialty products and oftentimes getting the trial is the challenge. And I think the overall challenge on the nutritional specialty products are repeatability. In other words, oftentimes you can have a product that works well once or twice. But the ability to in complex after complex, time after time deliver the results, is not something that you see in a lot of products. And the products that we bring to market, the industry knows we'll show that. And I think we've earned a strong reputation on the backs of that.

David Risinger: Great. That's very helpful color. Okay, and then pivoting to MFA, could you just remind us what percentage of your animal health sales are MFA? And then talk about some of the potential regulatory changes that we should be watching.

Richard Johnson: Right. So about, well within the animal health category, roughly 60% of our sales are MFAs. And just for the audience, MFAs are a broad category of regulated drugs, regulated pharmaceuticals. So within that category are antibiotics, which have seen a lot of pressure on sales in the last few years. But there are also a large number of other products that have other means of action and are not in that category.

So the regulatory front is fundamentally around antibiotics. We saw it in the United States. The process really finished up 3 or 4 years ago where the historical labels for many antibiotics were -- there was sort of a general overall claim, which was called growth promotion or something similar. And the regulatory authorities around the world -- and it's happened in Europe, it's happened in the United States, it's happened in most countries -- are in the process of either have completely done it or are in the process of updating and requiring the producer to update the label for therapeutic use only, and

typically that also involves the active participation of a veterinarian and you've got to have a script.

And that's happened. What's happened in some markets is consumer pressure has now outpaced the regulatory. And so in the United States, where our antibiotic business is down to -- the sales are down to next to nothing; it's due to consumer preferences, not due to regulatory. In other countries, regulatory can be more of an issue. In China, we got caught in a very quick transition of the regulations. We have our applications in and our data in to update our labels for therapeutic purposes. But in the meantime, we're precluded from selling those antibiotics into the market in China.

In Brazil, for example, there's a transition in place. We have submitted our data and we've submitted the applications for new therapeutic claims. We continue to sell in our existing labels at the moment. And that transition has some time to run, and we think we're in fine shape in Brazil. In China, coming back to that, we think we'll be back in the market once we get our labels updated. The timing really depends on the regulatory authorities. We're thinking perhaps a year, then we'll be back in that market with those products. And not to say that -- we do sell other products into China, but focusing specifically on MFAs and antibiotics, that's been a drag on sales the last year, year-and-a-half.

David Risinger: Got it. Very helpful. So then maybe you could just put some numbers on this a little bit more. So in MFAs, what percentage of your MFA sales are antibiotics? And then within that category of antibiotics, what percentage of that figure would be medically important antibiotics?

Richard Johnson: Yeah, that's not information that we typically break out. Let me just say that antibiotics are still an important product for us. They're used extensively in many of our markets around the world. But they are certainly far less than half of the overall category.

David Risinger: Okay. And then with respect to the potential Virginiamycin regulatory change in Brazil, could you just help us understand how it might impact the actual farmer use of the product? I mean is it -- I understand that it could be that the growth claim is removed and then the vet has to be involved with writing a script. But obviously the product would continue to be used in feed. And I just don't have a sense for the magnitude of the risk. It's obviously not going to be a severe cutoff like happened in China. But could you help us understand that a little better?

Richard Johnson: Yeah. There will be some pushes and pulls there. I think our expectation is that the involvement of a vet and the need for a script could bring down sales slightly. On the other hand, we think there are other factors that may actually open up more demand for our product. And so on balance, we think sales will be basically unaffected, and the opportunity will continue to grow there.

David Risinger: And have you quantified that exposure in Brazil? And what are some of the positive offsetting factors?

Richard Johnson: We haven't quantified it. It's -- the ability to use it in certain other instances versus perhaps some other products. And this whole labeling situation may improve our

competitive position, and in addition it may open up some segments of the production industry that we're really not in today or in as much. Those are the positive offsets.

David Risinger: Okay. Thank you. And then one more question on regulation, and then I wanted to turn to other new product initiatives. So the FDA is planning some draft guidance for duration of use of medically important antimicrobials. Could you just explain that and explain the potential exposure of your US MFAs?

Richard Johnson: I think I'll let Dani handle the technical part. But our exposure is next to nothing. And Dani, you have some additional information on this additional FDA aspect?

Daniel Bendheim: Yeah. I mean so as Dick said, we're not selling very much, because of the consumer preference right now in the US. But in general, historically even the therapeutic claims that you receive oftentimes they were open-ended. So you could be treating a disease; You could be treating it the entire life of the animal, or preventing the disease for the entire life. They're now looking to create a maximum amount of time that you can be using it without -- you'd still have the ability to kind of continue using it over the course with the renewal from the vet. But the initial script will have a certain maximum amount of time limit.

David Risinger: Okay. That's helpful. And then in terms of livestock branded generic offerings, how do you think about the opportunity to offer branded generic versions of competitors' large products like Elanco's Rumensin or Zoetis' DRAXXIN? Are those opportunities for Phibro?

Daniel Bendheim: So the answer is, we sell generic products of that sort outside the United States currently. So in many regions of the world, we will be selling a generic Rumensin or DRAXXIN -- well not DRAXXIN, but generic Rumensin which I think the DRAXXIN patent expires in February.

As far as the United States is concerned, we are not currently selling that. There's nothing -- we look at it like we look at every business opportunity. The economics have to make sense. So it's not something we're currently doing. But if it made sense to do so, we would certainly take a strong look at it.

David Risinger: Okay. Thank you. And then just to wrap up, so you had mentioned early on in the conversation, Dani, that Phibro recently launched a companion animal product. Could you give us an update there and talk about opportunities for other product launches ahead?

Daniel Bendheim: Sure. So as you're aware, we launched a product called Rejensa. It's an over-the-counter butylated glucosamine. But we're only selling it through the vet channel. It's a premium product, and it's appropriately sold through vets. And the rollout, it continues. I'd say we're in close to, not yet, a thousand US vets. To us, as we look at the market, there's about 10,000 vets that matter from a financial point of view. And so it gives you a sense of kind of where we are on the rollout.

But Rejensa is, like the other products we've talked about, is a very strong product. The

social media response, the response we get from vets and from their customers has been very positive. And the reorder rate of Rejensa has been very positive. The challenge for us is getting into more clinics, and obviously that's been slowed by the inability to call on vets in the COVID environment where even if the vet is open, it's very hard to get -- they're not seeing salespeople right now very easily and very readily.

But we continue to make progress on that. And then I think big picture, we expect Rejensa to continue to grow, and we are looking to supplement it with other products. And the other products that we see and we've had a lot of discussions across a lot of different categories. And there's a lot of opportunity out there, a mixture of short-term, mid-term and some bigger -- or not necessarily bigger bets, but longer-term bets. And we're committed to increasing our presence in this space, and our expectation would be that over this year we'll find some other opportunities, and continue to kind of roll out our pet business. We see this long term as being hundreds of millions of dollars of opportunity, just like that of our larger competitors.

David Risinger: Great. All right, well that's a good place to wrap up. We're actually a few minutes over time here. So thank you, both, Dani and Dick, for joining us today, and hope you have a great rest of the week. And operator, you can close out the call.

Richard Johnson: Thank you, David.

Daniel Bendheim: Thank you.