Phibro Animal Health Corp.

MICHAEL RYSKIN: OK, thanks for joining us. My name is Mike Ryskin. I'm on the Bank of America Life Science Tools and Diagnostics Team. And we also cover animal health here.
So for our next session, we're joined by Phibro Animal Health. CEO Jack Bendheim, CFO Damian Finio, and Danny Bendheim will be covering some of the companion animal business for us. So gentlemen, thank you for joining us.

DAMIAN FINIO: Thank you.

JACK BENDHEIM: Good to see you.

MICHAEL RYSKIN: I think, to start, maybe we'll just kick things off with you, Jack, if you don't mind. You just reported fiscal 2Q results about a week ago. Can you give us just a quick recap of some of the key points from the earnings print of the call? What were the most notable takeaways, just to get the background in all of it?

JACK BENDHEIM: I'm going to say the most notable takeaways in words was that, in many of the markets, there has been a fairly complete recovery from the shock with COVID, which obviously hit everybody, hit us last April, May, June. Recovery in the United States has gone well. Recovery in other markets in the world have gone pretty well. And recovery in the Far East and some of the countries that rely on the US for its economic steam engine-- that's still gone pretty slowly. Those are the takeaways. Business is going a little bit better than we expected and see that going forward in the next quarter and the rest of the year.

MICHAEL RYSKIN: OK, that's a great jumping off point, because I think there's a lot there that we want to dig a little bit deeper into. I guess the first one is I know you commented on the phasing of recovery around the world. What do you think's really driving that? I think one of the things we expected-- if we could start in the US, for example, one of the things we thought was that the recovery would be tied more to when food service and restaurants opened back up again. And that was to drive demand again. And we're not quite there yet from the restaurant front. So what do you think are the key things we need to monitor here? And are you focusing on any particular species? Or is this just a little bit broader that you're seeing things?

JACK BENDHEIM: So I think, when we look at the US and look at recovery, earlier today someone asked me a question about looking at people going back to cruise lines and that recovery being, whatever, 1,000% or 1 million% from zero up, and what the impact will be in the production animal side. So what I noted is that, when people go on cruise lines, they start eating on the boat. But then they stop eating at home.

I think what's happened in the United States and people need to recognize, yes, people stopped eating at restaurants. In many parts of the country, that has not come back. And that will come back slowly. But people have more than made up for it by eating the protein in their own houses. And it was disruption when it first happened. And now the producers have worked out how they get their food to the supermarkets, as well as to restaurants. I think, from the production side and the US side, we're pretty much back to pre-COVID levels of productions of chickens and pigs, dairy, and beef cattle. Now, here and there, it's a little bit off-- but overall, that is not the concern anymore.

Now, that's different in different parts of the world. The example I give is looking at the amount of Amazon boxes-- well, what's contained in them-- in front of my house. There are lots of boxes always, but very little clothing. And clothing pretty much, at least what's sold in the United States, is finished in Malaysia, and Indonesia, and Bangladesh. We're not buying clothing. And Europe is not buying clothing. And somebody's not working in those countries. And if they're not working, they're not buying protein. So those markets are going to come back slower. It's going to be tied to how fast we all go back to work, and how fast we get back into the groove of shopping again - hat will be a slower part of the recovery. But, in the western world, markets that we're active in, where it's the biggest consumption, that is back already or will be back very quickly.

MICHAEL RYSKIN: OK, that's a very helpful color. I appreciate that. Going a little bit deeper there, you touched on the Far East. What about China, in particular?
Because China is a little bit of a unique story in that, obviously, very exposed to swine. They had Africa swine fever outbreak from, let's say, August 2018 through present day. But they're starting to rebuild the herd.

I think you took a pretty big hit from China when that first happened, because you assumed that that business would stall out for a little bit. But now we've seen rebuilding, I would say, faster than we expected. Can you give us an update on what's going on there, and how that recovery has progressed?

JACK BENDHEIM: I'm not sure we're seeing rebuilding faster than we expected, but it definitely is rebuilding. It's expensive rebuilding, because the producers have gone and built big facilities with not a big population of pigs to have good biosecurity and so, if there is a breakout, to be able to segment the pigs that got sick and to take them away, they must cut them out of the herd. So yes, they are rebuilding the herd. The price of pigs in China are three or four times what they are in the United States. There's a lot of incentive for people to grow pigs. And I would say, for some of our competitors, they are regaining market, because the market disappeared in wo18 and 2019. We have a somewhat different story. Yes, our business disappeared in 2018 and2019 with our pigs. But, we were also ready to register our products. And because of COVID, Chinese government agencies were not open. Everything was shut down throughout the country. We were delayed in getting our registration package in, but those packages are now in. And, we don't expect to be back in the market for another year and a half.

And then, when we come back-- we were doing about $40 million - we expect it to start at about $20 million annually and then build up from there. That's our story in China having to deal with the change in the marketplace.

MICHAEL RYSKIN: OK. Appreciate that cover there. Pivoting all of the way back to the United States, you talked through a lot of the major markets. The one I would say that we had the biggest question on, that we've discussed the most back and forth in the past, has been the dairy markets. And again, that was some place that was challenged before COVID even happened, went through its ups and downs, a couple of times looked like it was in recovery, but then didn't really quite make it. And obviously, dairy has its own challenges with COVID. So what are your thoughts on dairy in 2021? What do we need to see there to feel confident in that market again?

JACK BENDHEIM: I think, in the US, 2021 is going to be a great year for all protein producers. I think everyone is making money, some more, some a little less. Depending on where you are, it might be a little bit less, but the markets are strong. Demand is strong. Exports are good in many of these markets around the world. Even the dairy market, which-- again, we've spoken about that often - hose guys are making money as well. The big challenge all of them will be facing going forward is the higher cost of input costs. The grain prices-- corn, soybeans-- are at prices people haven't seen in 10, 15 years. So that is a challenge, a challenge to pass those costs on. But I think what has also happened during this last year of COVID is that people got used to seeing higher prices in the supermarket that was made by the distributors - because it was difficult to change how products were moved. I think some of that money will shift back to the producer’s pockets. But I think, from most of what we're hearing, the producers we're talking to are optimistic.

MICHAEL RYSKIN: You touched on something there that I want to discuss in a little more detail, and that's the input cost side of the equation. The feed costs-- we've definitely seen that in corn over the last couple months-- have gotten relatively different feedback in terms of when it will matter, how much it will matter. On the one hand, as you said, as long as the end product is selling, producers are still going to produce. And they're still going to buy your products. But is there any consideration on your part in terms of profitability for the producers? Is there a threshold where the price is so high that they really do have to cut down maybe on some of the products they buy from you? Or is that really not a consideration? As long as there is that market demand, you guys are in a good position.

JACK BENDHEIM: I think the last time we saw high prices, which was a long time ago, it was for hogs-- not chickens. But the way hogs were produced in the United States were on a lot smaller farms. And in that situation, when the high prices didn't keep up with the input costs, the grain prices, there were problems. And people stopped feeding. And people cut out products. I think now definitely chickens, pigs, cattle are all raised by large producers. Many of them have hedged their input costs. So, we're not going to see the effect maybe for the next six months, maybe for a year. But they all know that the products that they buy from us and our competitors enhances the value.

So, if you remember, you're feeding a cow and you're a month away from slaughter, and the cow gets sick you're not going to give it a drug? You want the cow to die? There's no economic sense to that. The other products that they're using, our products and our competitors' products, enhance the animal's ability to stay well. And if it stays well, it's going to convert more of that high-cost grain to meat on the bone. So effectively, there's no reason for them to cut back. If they see that they can't get these prices in the supermarket, then they'll lower production. They won't keep producing. And as you know so well, the chicken protein cycle is four to six weeks. Hog cycle is six months. So, fairly quickly, you can fix the problem. And as long as the exports are strong-- and they will be strong for this year-- I think our business will be good.

MICHAEL RYSKIN: OK. OK, that's really helpful. Maybe sticking on the livestock side of things a little bit longer, can we talk about some of the particular products that you've watched recently? For example, Omnicell-- any updates you can give us there? What's been the uptake? Have these launches and introductions of new products been disrupted in any way in 2020 because of COVID? What's been the market reception there?

JACK BENDHEIM: I think the disruption of COVID across many industries has been the inability to get out in front of the customer and sell. If you're launching a new product, you can't just do it with a website. You need to get in front of the customer. And that has been impossible. Customers don't want to see salespeople, because they're concerned about keeping themselves healthy, keeping their factories healthy, and their plants healthy. So that's slowed down the ability to move out new products. Nonetheless, we've invested. And we've done a pretty good job with web conferences just like this where we call on customers. And I would say the launches have gone OK. Not as well as we wanted them to go because of COVID, but we're gaining steam. And the newer products that we put out there definitely are selling more this year than they sold last year. So, it's going to be a slower incline than we would have liked and we expected, but we invested. We're seeing, as the level of COVID vaccinations across the country increases and across the world, that we'll get back to whatever we were hoping to get back to.

MICHAEL RYSKIN: And once the vaccinations do come in, and once business gradually returns back to normal, how quickly are you going to revert back to your historic ways of travel, of T&E, sales and marketing? Is it going to be-- are you going to go back to exactly the way before? Is it going to be some hybrid approach where you're doing a little bit more on technology? What's the business approach there?

JACK BENDHEIM: I think, from an economic point of view, our hope would be some sort of a hybrid. We've all been educated at the power of Webex, Zoom. So why give that up quickly? It really does work. And if we can, get people who are not Zoomed out to come back on and spend another 20 minutes with you. But on the other hand, they also want to see sales people. They want to see the technology people. They want to hear what's going on. I think it's going to be a balance. It will be a ramp up. I'm not sure how high the ramp will go. But we will definitely start spending money again on T&E and getting in front of the customers and we also will continue spending on technology.

MICHAEL RYSKIN: Great. Maybe this will be a good time to switch over to Danny and talk a bit more about the companion animal business and the investments there, especially because it is a little bit of a new area where you have to start it from scratch. So could you talk about Rejensa? How that's trended? Maybe give a little bit of an introduction to the product for people that aren't as familiar with it, and how that feeds into your longer term strategy on the companion animal side.

DANIEL BENDHEIM: Sure. Thank you. Rejensa is a N-butyryl glucosamine. Glucosamine is a well-known product for joint health aimed at the canine market. We introduced it nationwide a bit before the pandemic hit. It's an over-the-counter product, but we're selling it exclusively through the vet channel. And what we've seen is that from a product point of view, it works really well. There are a number of glucosamine products out there. We've done some nice head-to-head tests and we feel very confident in our positioning of this as a premium product within the space.

We have seen though that distribution within the pet industry is really, really hungry. I know you follow some of our bigger competitors and they have squeezed the distributors. And, what it has created is an opportunity to work with them on unique propositions and to find a niche-- or not even necessarily a niche, but to find opportunities where they will partner with us more than the traditional level of detailing that they would get into. We have gone with Rejensa exclusively with one of the national distributors. We are a major product in their portfolio, as far as their focus. It's a major focus for us as well. We tag team it. And the growth has been strong -- as we mentioned on the last call, the last six months was double the previous six months.

Now, that's obviously starting from a low base. But we're continuing to see some really strong growth there. Growth is continuing through February, despite the weather. And we are excited, because we know the category's a pretty large category.
And we are confident that-- touching on the themes that we just talked about- about being able to get in front of the customer, obviously, in the last year, it's been next to impossible to get in front of the vet.

Even a pet parent can't get in front of the vet. They might have to leave the dog or cat at the door so it's been a slower slog.

But the reorder rate has been much higher than we expected. We know that once we get the product in front of the customer, the customer will love it. And we've seen that through the reorders and also through social media. We are very confident in the success of this product.
And, this is the first of a number of products that we are looking to launch. We are making it very clear to the innovators within the pet space that we are here and that, as someone looks to a new product, and they survey the landscape-- which has gotten more and more consolidated-- there's very few people out there that you can be confident are committed to this space and, at the same time, don't have a conflict within the product category that you're looking for. So, Rejensa is our first product.

We have announced previously about a differentiated delivery system for Lyme vaccine that's still in development,that has been slowed. And I apologize for hitting the broken record of COVID, but the work on that, based on the state that the work is in, was limited during this period. We hope to restart that later this spring or early summer. And, then we also announced a new license deal for a derma care product for atopic dermatitis that we are extremely excited about,and that market is huge. We have a unique compound, which we're not getting into the details of at this stage. It's obviously a very early stage, so don't want to overstate or understate the risks involved but if it does what we think it can do, it will be a significant product in this market.

MICHAEL RYSKIN: Great. Thanks, Dani. You covered a lot of ground there that, again, I want to go a little bit deeper in. Going back to Rejensa, starting at the top, could you give us a little bit more of an idea on what the competitive landscape for that product looks like? How many entrenched players are there? Have you been able to-- do you have any statistics on taking share, or market penetration in terms of the number of vets that are ordering, anything like that?

DANIEL BENDHEIM: So, we're in at about 1,000 vets right now. The market for this type of product is omnichannel. The number-one player is a company called Nutramax. and they have a significant share. At this stage, we're in the low single digits. So, we have a tremendous amount of runway ahead of us It's a well-understood—that this space is probably around $400 to $500 million. It's hard to get complete statistics on that and as I said, we have a premium product that we'll be competing in the upper echelons of the space, as far as pricing and positioning.

MICHAEL RYSKIN: That's helpful. And then, in terms of the go-to-market strategy, could you walk us through the rationale for-- even though it's over the counter, you're selling it exclusively via the vet's office. Why not explore some of the retail or alternate channels with that? What's the argument there?

DANIEL BENDHEIM: We obviously are a new company within the space and it is important that we get the the vet recognizing the quality of the product that we're bringing. We thought that the first product we go out with, this is actually-- vets do sell glucosamine products. And historically, the higher-end products will be sold through the vet. And the lower-end products will be sold through the retail channel. This is obviously a higher-end product, but I think one of the things that we bring to the table is that we are a blank slate at this point so we are taking this approach. We're seeing success in this approach. If we stall out, or if we see a better opportunity someplace else, we have the ability to switch quickly. As I said before, there is a lot of compelling information here -- the vets want unique products. And so this is a unique product for the vets. The distributors want unique products. There is a benefit right now to selling exclusively through the vet, not being on Chewy, not having the customer of the vet be able to price shop, and things of that nature so we're happy. We obviously would like the pace to have been faster and it would have been had COVID not hit. But overall, the trajectory is very strong and we have a lot of confidence in our strategy at this stage.

MICHAEL RYSKIN: Got it. No, that makes a lot of sense. That makes a lot of sense, certainly. If we think about using this as a stepping stone and building out the rest of the companion animal portfolio, I know you guys have in the past gone after some assets that were up for sale in the animal health industry. And obviously, you talked about the in-licensing of these atopic dermatitis compound. Is there an opportunity for inorganic bolt-ons, of either specific brands, or maybe small pockets of portfolios out there? How are you thinking about building out the rest of the companion animal business and balancing organic investment versus taking something that's already on the market that's already established?

DANIEL BENDHEIM: I think we're open to everything. The reality is the multiples in this industry are very, very strong and force you to go earlier in the life cycle to sometimes take a bet on a product that hasn't necessarily proven itself in order for the economics to really work. So I think, ideally, we would like to gain bulk in multiple ways. Obviously, starting out, we don't necessarily have the synergies that our competitors do in looking at bolt-ons. But, as we build up Rejensa and our other products, and as we build up our sales forces as a result of working with the distributors in the case of Rejensa, the economics then start to get stronger. So I think, over time, we'll look to grow in multiple ways.

MICHAEL RYSKIN: And so on that front, how are you balancing-- and maybe this is-- I don't know if this is for Dani, or maybe for Damian. How are you balancing reinvestment in the business between the companion animal side of the portfolio, and building out that pipeline, versus some of the more legacy livestock, and nutritional specialties, and vaccines, businesses both from an R&D and a manufacturing and commercial organization? Where is the incremental dollar going?

DANIEL BENDHEIM: Damian, do you want to take that? Or do you want me to take that?

DAMIAN FINIO: You can start if you'd like. I'm happy to jump in though.

DANIEL BENDHEIM: I think the answer is that we are going to feed both parts of the business. So, as we look at the incremental dollar, it's not just the incremental dollar, as far as having some sort of a metric to use for determining what it's worth. It's also just making sure that there's new products feeding the production side as well as the companion animal side. Now, the growth of the companion animal business worldwide-- not just for Phibro, I'm saying-- is obviously faster at this stage than the production animal. But these things go in cycles and I think part of what we still bring to the table is we are largely a production animal business. And a lot of our competitors are focusing more on the companion animal. There might be some more opportunities, in our opinion, where people have maybe taken their eye off the ball a little bit to grow and to strengthen their production animal business. So I think it's spread out across both, obviously relative to the base. The dollars we're spending on companion animals today are a much higher percentage versus historical, because historical was zero or close to zero but the bulk of our spend is still on the production animal.

JACK BENDHEIM: Right. And it's across a lot of areas. We're still opening up new sales offices in parts of the world we weren't in. We are still expanding our production, as you may remember. What we sell, we produce about 70% of it. And in many of those areas, we're approaching sold out in those facilities.
So, we keep investing in capex in the plants. And we're building out the new vaccine facility in Ireland that we announced a year and a half ago. And we'll have products on the market in a year's time.
So I think we're spending money across the board, and as Dani said, effectively, the smaller dollars are in the companion, because it's starting at such a small base. But we're busy across all sectors and we see opportunities across all sectors.

DAMIAN FINIO: And maybe I'd add we've reported profitability metrics that are up the last quarter and year to date, as well as year on year. Between capital improvements and what we invest in R&D annually, right now it's about $50 million if you add those two together. Those are all in our public filings. So, I think we have the cash flow to fund the companion animal research and development that we need in the near term.

MICHAEL RYSKIN: Got it. Thanks. Yeah. And on your comments on balancing companion and livestock, the other area I wanted to touch on was, for example, I think it was announced maybe a month or two ago, maybe the end of December, that you're going to be marketing-- I think it's Virbac's Tulissin tulathromycin in Canada. What do you see as the opportunity there? Is there a product you could bring to market in the US? How did that agreement come about? And how do you see that market, that generic opportunity?

JACK BENDHEIM: It came about because we have sales ability in Canada, and Virbac doesn't. And Virbac will be one of a couple of generics coming in looking to grow the market. So I think it's opportunistic all around. It will build slowly. Competitors are not going to walk away easily from the business. No one is looking for the same share, as you always say, but again, we have feet on the ground and we are calling on the customers. So, we'll get our share of the share as well and that's not a grand scheme thing. This is simple and we don't have it for the US. Virbac has their own people in the United States.

MICHAEL RYSKIN: Is there an opportunity for you to partner with someone else for the US market? Or is that likely not in the cards?

JACK BENDHEIM: It's likely not in the cards. I think the US market is so big. The competition is coming out with a Virbac. Everyone has its sales force. We might extend the Virbac agreements in some other smaller markets. But all these are very small markets. It would be incremental. It would be nice money. But that's it, nothing huge.

MICHAEL RYSKIN: OK. OK, that's helpful. And then Danny, going back to you on the companion side of things, just to round things out a little bit, again, Rejensa's obviously the lead. And you've got a couple of

things early in development. Anything we should think about in terms of the pace of product introductions? Is this still just getting the wheels moving? Or is there a particular cadence you want to achieve over time from [INAUDIBLE] market?

DANIEL BENDHEIM: Truthfully, at this stage, I don't think we know enough. We're too far away to really give a cadence. If everything fell into place, we'd have, about every couple of years, a new product within the current pipeline. But the fact is that we are early stage. And I would expect delays along the way. So it would be wrong to give that guidance.

MICHAEL RYSKIN: OK, that's fair. No, that makes sense. Definitely makes sense there. Anything you can cite on COVID impact on R&D, on clinical trial? I'll be honest. I'm not exactly sure what the regulatory and approval process is for some of these nutritionals and things like that. Have you seen any challenges there? Or is it mostly on the commercial side of things that you've seen the destruction from COVID?

JACK BENDHEIM: Listen, I think COVID, in-- different markets and different countries, is disruptive. I mentioned earlier how, in China, they shut down the whole regulatory industry. You couldn't put a package in for new regulatory approvals. It's slowed down other markets. You couldn't run tests in some markets, because you couldn't get there to put the animals on the ground. It definitely slowed down in most markets we're in around the world and it will slowly come out the same way. It went down very quickly, but we'll slowly come out. It's hard to put your finger on. We try to do it. What's the cost with COVID running our factory? We didn't shut down any of our factories throughout this period. They asked me exactly, what's the COVID cost in it? It's hard to put your finger on it. I do know we had a lot more overtime. In some cases, we had to bring people from their homes by taxi, because we wouldn't put them on a bus together. So besides investing in the facility, and PPE, and partitions, you have all these other costs out there, which is hard to figure out. But it was there. Not just ourselves, it's true for everyone else who kept their plants going. So, there was a pretty big cost and we'll only know what we spend when we start spending.

MICHAEL RYSKIN: Yeah. Yeah. OK, makes sense. And I guess that should start flowing through probably middle of this calendar year towards the end of this calendar year. So hopefully, those improvements will start showing up.

JACK BENDHEIM: Would agree, would agree.

MICHAEL RYSKIN: What about again, as we look forward, and as we get beyond COVID and some of these-- especially as Rejensa and some of these new products start to ramp up, how should we think the mix and the business shifting over time impacts the profit margin and the P&L, Damian?
I mean, I realize it's still very, very early stage, and it'll take time for it to be material. But I would imagine it would be pretty meaningfully accretive to the overall company. But could you give us a sense of the differences between the different buckets and when we should start seeing it show up in numbers?

DAMIAN FINIO: From a gross margin perspective, we still feel like there's some room for improvement as we build capacity across species, across geographies. And when it comes to operating expenses, you mentioned some of those costs to stay-- keep all the employees safe, et cetera-- may be behind us as we get past COVID-19, but the offset is the T&E that will start up as we get out in front of customers again. So, you're going to see-- when you talk about EBITDA margins, et cetera, - that we had some offs, some puts and takes, But generally speaking, I think the things that we're investing in the future are probably a better margin profile than the consolidated aggregate profile of the products we have now so we should see improvement over time.

MICHAEL RYSKIN: But still probably a couple of years until the magnitude of the contribution's meaningful enough to move the entire business, right, just given the--

DAMIAN FINIO: I think that's fair. Yeah, I think that's fair.

MICHAEL RYSKIN: OK. I'm going to remind investors that, if you've got any questions, don't hesitate to put them in the chat. Or send them over via email. I guess we're almost at the top of the hour, so maybe time for one or two more. I guess maybe just the big-picture one I'd like to ask you is, of the changes in the market that were affected as a result of COVID, ignoring the cost on the factories, on the T&E, things like that, but in terms of demand, in terms of how the livestock industry manages through things, do you think any of it could potentially be permanent? Or are you anticipating that, a year or two from now, we'll be more or less back to how things were before? Are there any lingering impacts of COVID on the markets that we should be thinking of?

JACK BENDHEIM: Well, definitely on the companion animal side, I think the uptake in dogs and cats around the world was significant. I think those businesses will grow all over the world, China included. But I think, on the production side, we'll get back to the norm of-- listen, I think once people have the ability to get out of their homes and go to restaurants, that's going to be huge for a while. People who never ate in a restaurant in their lives are going to want to go to a restaurant. But overall, that's just a rebalancing of where that chicken or that steak goes. But we'll get back to the steady growth that we've seen, which was always, we've seen in this business, low single-digit growth across the world. But that's on a huge number. And that will bring out real opportunities for Phibro. We'll see, as we've always seen, we'll get low single digit on the production animal side. But in that will be double digits on our vaccines, and double digits on nutritional specialty, and double digits on our EBITDA. And everything we see, as best we can see from our living room, where we've been stuck for the year, it's quite optimistic out there.

MICHAEL RYSKIN: Yeah. Great. Great. Certainly, that makes sense. I think we're right around the top of the hour, so to say.

I want to say, thank you so much for participating Jack, Dani, Damian. It's great to see you in person. Great to meet you, even though it's in virtual. Thanks so much for your participation. And we'll speak soon.

JACK BENDHEIM: Michael, thank you.
DAMIAN FINIO: All right. Thanks, Michael.
MICHAEL RYSKIN: I look forward to it.
DANIEL BENDHEIM: All right.
MICHAEL RYSKIN: Thank you so much.
[MUSIC PLAYING]