Phibro Animal Health Corporation

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Balaji Prasad: Good morning, everyone. My name is Balaji Prasad, I'm the senior analyst for special pharmaceuticals coverage. For our next session of the day, we have the CFO for Phibro Animal Health Corporation, Damian Finio with us. Damian, thank you for joining us today, I know you have a busy week this week between conferences, but I appreciate you joining us here.

Damian Finio: Thank you very much for having us again, and good to see you, Balaji.

Balaji Prasad: Likewise. Damian, start with considering that most of the companies had their earnings calls recently, we're just requesting maybe you could highlight any key highlights from your recent earnings call and then jump into Q&A.

Damian Finio: Yes, absolutely. So, as you know, we are a June 30 year-end, so we just reported our second quarter results earlier in February. We had a really strong quarter, and strong first half of the year. Sales for the quarter were $245 million, up 5% versus the same quarter prior year. Our adjusted EBITDA was $31 million, up 6% versus same quarter prior year.

And what we talked about on the call that we really wanted to highlight was within Animal Health, which is our biggest segment, two-thirds of our company, we have three product categories. As you know, MFAs and other, vaccines, and nutritional specialties. For seven consecutive quarters, versus same quarter prior year, sales have gone up in each of those three categories.

So really, our portfolio is hitting on all cylinders across regions, across product categories so we feel really confident in the sales line. There was a little bit of noise in our GAAP numbers, I'll address that. We took an environmental charge of $6.6 million related to a legacy site, it's our smallest segment called Performance Products, a site that we bought a long time ago out in California. The lawsuit started in 2014. It was part of what was called the Omega Chemical Site. We were downstream from -- and in the middle of -- the plume. Long story short, we settled out of court before it went to court in July.

Although the cash needs to be paid and the settlement was made outside of court, we're glad to have this overhang behind us. Going forward, we won't need to be concerned with that any longer. It's a disclosure we've had in our SEC filings since we went public in 2014 and that's behind us. So, overall, great quarter and first half of the year.

Balaji Prasad: Great, thank you. And you also reiterated guidance here. So, maybe just setting aside the guidance, as we think about 2023 broadly, can you take us through the key moving pieces that you're seeing within each of your major livestock species?

Damian Finio: Yes. So, we reiterated our guidance for sales and adjusted EBITDA. Just as a reminder,

sales $960 million to $1 billion for this fiscal year. As you can imagine, myself, employees, Jack Bendheim and the rest of the management team, we're excited for the opportunity to hit one billion in sales and $113 million to $118 million of EBITDA.

When we look -- and that implies a stronger second half than first half of the year, but consistent with the half year split we saw last year. We tend to start off the year a little bit slow, our slowest quarter for seasonality reasons is the quarter ending September 30. So, top line consolidated sales, stronger second half and growth over the prior year. When we look at where the growth is coming from, again, as I mentioned in our half year results, it's really coming across all categories in Animal Health and Performance Products has been pretty steady too.

I'd say the one segment that's down a bit in the first half of the year was Mineral Nutrition. So, Mineral Nutrition, rough number is about 25% of sales. Mineral Nutrition is a U.S. business, and it does have some exposure to beef cattle in the U.S. But we've also -- that was part of the reason why we were down -- another part of the reason why we were down is last year was such a strong year, so, a tough comp.

And third is the customers that we sell to, because of the cost of capital and other economic pressures, we see them lowering their inventories. So, there was a bit of lowering inventories as well in the second half of -- or in the first half of our year. Mineral Nutrition was a bit behind, and Animal Health picked up some of the slack whereas last year, it was a slightly different story, Mineral Nutrition had such a strong year. So, overall, across segments, with the exception of Mineral Nutrition and across product categories with Animal Health, strong performance.

Balaji Prasad: Fantastic. And maybe just focusing on the cattle side of things. What are you seeing within the U.S. market and maybe ex-U.S.? I think last year, we had a few, again, blips with the drought situation and then of course, the continued pressure on dairy. And so, what are you seeing now currently?

Damian Finio: Yes. So, just to ground everyone, about a third of our sales globally is in cattle. If I break that down, 20 of those 33 points are in dairy and 13 are in beef cattle, okay? The dairy cattle business is primarily in the U.S. and the beef cattle is primarily in Mexico and Brazil. So, really different markets, different cattle. On the dairy side in the U.S., we had a decent first half of the year and expect more growth in the second half of the year. So, although you may have read about things like feedlot placements being down, etc., that's a beef cattle dynamic, not dairy. So, we don't have exposure to that.

In fact, I did read earlier this morning that I think dairy cattle was up in January. I haven't seen the February numbers, but some speculation that prices in 2023 on the dairy side may come down. We like to think whether our customers are making money or not, there's always a spot for our products because our products help animals reach peak performance and stay healthy. But obviously, if there's cost constraints on the farmers, we, at times, feel impacts of that as well. But overall, dairy is U.S., and we think it will be a stronger second half.

On the beef cattle side, Mexico and Brazil, I'm sure people have heard about the inability to export to China. That's the majority of the exports in Brazil. I think it's about two-

thirds of the exports. You can go back to 2021, a similar situation occurred. It took about 90 days, I think, for the embargo to be lifted. If you go back to 2019, again, similar dynamic, it was about 30 days. The instance we have right now, I believe, is in the fourth week. Our team is confident in the next -- in the near-term, it will be remediated, and exports will resume. What it would mean for us is timing really. It's just a shift from one quarter to the next in terms of sales but not an aggregate weakening of demand. So, it's more of a timing blip than anything. That's the assumption we have at the moment, knowing what we know.

Balaji Prasad: Understood. And of course, swine has been an important component for you after cattle. So, again, multiple moving pieces there. But can you take us through what you're seeing there within Latin America and then China specifically?

Damian Finio: Yes. So, maybe start with China. We had a product on the market in 2019, taken off market in China. Since then, we've been doing our best to try to get back into China. To be fair, I would say progress has been slow. We don't have that product back in the market in China. Asia Pacific, in general, is our smallest segment -- regional segment, but it's also the fastest growing. So, we have other business in other countries outside of China, but in Asia Pacific. So, that's China. In general, we think on the pork side, again, I think we're steady as it goes, doing pretty well in pork across regions, across products.

Balaji Prasad: So, with regard to China, when do you expect to get back into the market with your products and what's causing the delay?

Damian Finio: Yes. It's hard to put a finger on it. I would say, partially the U.S. and China relationship has been strained for some time, partially because of COVID and thankfully, the restrictions have recently been lifted, so, things should open up. And partly, the registration -- the regulatory authorities concern about antibiotics, etc. So, although we continue to try to get back in the market, I'd say it's not in short term and not assumed in any of the guidance we've given. Which, at this point, given a June 30 year-end, only goes out another 3, 3.5 months or so.

Balaji Prasad: Understood. And on the question of swine again, a couple of years ago, we had multiple entities developing ASF vaccine and we had discussed that in detail. Do you have any projects, programs there? What kind of expectations should we have on this segment?

Damian Finio: I think we've talked about this on many of our calls, at least it's come up, about African swine fever and some of the development work that we're doing. We continue to partner with a developer in China. Again, similar to what I just mentioned about China, I would say progress has been slowed for all the same reasons I said before. So, we don't expect anything in the short term. Again, nothing in our guidance, but are still doing our best and maybe it would be something in more the medium term or 18 to 24 months is we'll know a little bit more, but it's not something that would be immediate.

Balaji Prasad: Got it. And you've also been making a couple of investments in, of course, companion animal business, that's a switch shift that you have been articulating and your vaccine facility, which is coming up in Quincy. So, take us through the various investments that's happening in the business right now.

Damian Finio: Yes. So, our strategic investments are implied in our guidance, and I think we said explicitly back in August, was planned to be about $37 million for the year. That was up $8 million over the prior year or about 25%. The split of that $37 million is roughly equal between companion animals, nutritional specialties and vaccines. I'll start with companion animals. So, companion animals, we've said it's more of a medium-term opportunity than a short-term. There are several projects in the mix --we have oral care for cats and dogs, pain management, and atopic dermatitis projects.

We also did a deal with Rejuvenate Bio, which I'll mention in a second, and then also a Lyme vaccine. Those first three; dermatitis, pain management, oral care, those are big markets, $1 billion to $2 billion markets. We'll often get the question; can you compete with the Zoetis or the Elanco's of the world in those categories? I mean for us, if you do the math, just use easy numbers, $2 billion market, even if we had a 5% share, that's $100 million of sales at decent margins, call it, 50%. That's $50 million.

Our Adjusted EBITDA guidance midpoint was, what, about $115 million. So, even a sliver of one of those large markets is meaningful for Phibro. I think that's important to keep in mind. What's the more near term of those projects and probably the most exciting one at the moment is a smaller one, which is the deal with Rejuvenate Bio. So, that is a product for mitral valve disease. The product profile that we're shooting for would make it better than what's on the market today. Mitral value disease is very prevalent. Eight percent of dogs in the U.S. show signs of mitral value disease. If we were to be successful and launched this product, it would be a onetime injection, and fairly costly.

But from what we understand, something that I joke, I have daughters, they both have -- one has dog and the other one wants a dog, neither of them wants children. So -- and they would spend anything on those pets. So, that's the market – it is changing, as you know, in companion animals. So, Rejuvenate Bio and Scout Bio are the two companies that lead the way in gene therapy for animal health. So, I think it's a good sign that we have a deal for one product with one of those two companies. Of course, the hope is, if we're successful, there'll be other products that would come down the pike, but let's start with that first one.

They've said, they being Rejuvenate Bio, that they will have their filing for a conditional approval with FDA before the end of this calendar year. That's about a $200 million market. We haven't disclosed anything more than what I've just said. But we're hopeful that that submission would occur before the end of the year, and that would be the nearest term of our companion animal pipeline.

Balaji Prasad: So that would kind of take us through a potential Q4 next year launch?

Damian Finio: Yes, depending on timing -- feedback and timing of feedback -- from the FDA. Now the other two categories; nutritional specialties and vaccines, again, a lot going on in both of those categories. So, nutritional specialties for us includes -- that's where our companion animal sales are for Rejensa, but it's also where our probiotics business is. We bought Osprey Biotechnics back in August 2019. That was a supplier of ours. We now own the company and have for several years. We continue to dig into that project and that process.

We've moved some of the technology into our existing facilities in Brazil. So, we continue to find opportunities for probiotics and for the work that they're doing in Osprey. I'm actually headed there tomorrow. So, a lot going on there and the investments are related to manufacturing and their technologies, etc.

On vaccines, we have facilities in the U.S., facilities in Israel. We've talked a lot about our facility in Sligo, Ireland. It was acquired a few years ago. We continue to invest there. We had our first sales from Sligo, which really opens up markets in the Middle East for us primarily, and we had sales in our last fiscal year. Ramp up at a vaccine facility is slow because the registrations are country by country. So, we continue to slowly ramp up the Sligo facility. And we're also opening up an autogenous facility in Brazil. And in fact, the soft opening ceremony is today. And that's where some of our management team is today, there for the soft opening in Brazil. So, that's exciting, too.

Balaji Prasad: The impact on the vaccine facility is commissioning and coming through, it's still going to slow, especially on the EBITDA side?

Damian Finio: Yes. I think that's correct. It's just the way that the vaccines work. Again, it's country by country. So, you have to register each country individually, wait to hear back and eventually you ramp up, but it's a slow ramp.

Balaji Prasad: Getting back to your companion animal pipeline and programs and get a sense of where you are currently with your atopic derm program, or your oral care program, as we speak?

Damian Finio: Yes. We have yet to disclose too much detail, I think, other than to say, medium term. So, -- and beyond that, we haven't said anything specific. I think as we get further along the development timeline and closer to launch, we'll share more information. But at this point, we've said medium term, and haven't really said anything beyond that for any of the projects.

Balaji Prasad: Fair enough. And with regard to the pain space, were you looking to license like in commercial product?

Damian Finio: Same deal. So, we licensed in the product that's in development, but it would also be a medium-term opportunity.

Balaji Prasad: Medium-term option?

Damian Finio: Yes, all of them are. With the exception of Rejuvenate Bio, which could be shorter term.

Balaji Prasad: Understood. And of course, I just want to get your thoughts around Alejandro Bernal joining the Board recently from PetDx. So, what's the strategy?

Damian Finio: Yes. So, Alejandro Bernal joined the Board in February. He is an industry veteran, I would say. He worked at Mars. He worked at Zoetis. He was most recently announced as the CEO and President of PetDx. So, he's got a long history in companion animals. He joined the Board in February. I think we're excited to have him. It's a fresh perspective. And I think it just further emphasizes our intent to grow our companion animal franchise

by including Alejandro on the Board. He joined our first board meeting in February, and is already making contributions, we're already seeing a difference, and we're excited to have him on the board.

Balaji Prasad: I don't think I've ever asked you this before, but any potential interest in diagnostics itself?

Damian Finio: I think our company has shown over the years, we're open to a lot of ideas. I think you know Jack and Dani. So, we're always open to ideas. I think specifically, we haven't talked about diagnostics. What we did say on our last call, is in companion animals at the moment, given our balance sheet and some other things, we feel like… let's focus on these five projects. If one was to drop out, maybe we'd pick another one up? And of course, we're always opportunistic. But as of right now, there's nothing specifically targeting a diagnostic opportunity. But we're open.

Balaji Prasad: Understood. Maybe just on the operating margin side. I think last year, we had multiple moving pieces between inflation and labor and everything else. So, what are you seeing on the ground now? And how are -- how is operating EBITDA?

Damian Finio: Yes. So, I think it was about 1.5 years ago, we started to raise prices. We've been pretty successful as evidenced by our growing top line sales. But over that same time, we've had modest growth on an adjusted EBITDA basis. If you zero in, I'd say gross margin is down a couple of percentage points. I'd say going into COVID, we were maybe at about 32%, 33% consolidated gross margin. It's closer to 30%, give or take now. There's a couple of points lost there that relate to all the things that we read about. So, higher labor costs, higher input costs and freight also plays a factor. So, for us, we manufacture in 17 sites. We sell in 80 countries. Some of our material, as you know, is big, bulky material, expensive to ship or slow and expensive to ship by freight or by boat, by barge.

With some of the issues with the shipping lanes from China to the U.S., etc., we've had to work through, pass-through, some surcharges, etc., and raise price where we can. But for the most part, with a bit of exception, I would say those prices, raises, were more to offset our increased costs than anything else.

We would hope, I should say, too, going forward, if we see the freight -- we are seeing some freight charges coming down and shipping lanes open. If our prices are sticky, which we assume they will be, we should start to see some margin improvement as the economy improves going forward. Again, we haven't given guidance past June 30, but our guidance we'll give for fiscal year 2024 would be in August, and we'll need to speak to some of those things, some of those dynamics, at that time.

Balaji Prasad: Sure. I really need to ask you still on that, but before we get there, Rejensa. Latest updates on it and at what point do you think it's acquired enough critical size? It's now been a couple of years that you had this product, but you've not had more on the nutritional supplement side, especially for CA. What's the strategy there? Is this going to be a sole product in the nutritional specialty side.

Damian Finio: All right. So, you're right, we've had Rejensa on the market for a couple of years, of course, things were slowed a bit with COVID and visits to the vet clinics, etc. We've seen

and been very happy with the growth of Rejensa. Our guidance this year -- we said explicitly that Rejensa sales would double this year versus last year. I would say, we'll come up a little bit short of that target, but still some really strong growth.

We sell that product through a distributor. We have an exclusive arrangement with one of the bigger name distributors who we have not disclosed, and the product continues to grow. What's interesting about that product and the approach we took, it's an OTC product, but it's only available at the vet. So, you can't find it on Chewy or Petco, etc. And it was a way for us to keep some of those profits and revenues at the vet and we start to build a relationship because, as you know, we're new to the space with the intent to grow the franchise. So, not saying that model will be sustainable if we launch these bigger products in bigger markets or not, and we'll make those decisions as those products come closer to commercial launch, but right now, we're happy with Rejensa's performance and the arrangement we have with the distributor.

Balaji Prasad: Great. Probably last question from me again. I know that you'll come out with the guidance in August. But as we look forward to the next 12 months, what are the big moving pieces between the -- both on the positive and on the negative side?

Damian Finio: Yes. I think it will be largely driven by the macro economy. Again, we sell in 80 countries. So, there's dynamics in each of the countries where we sell. But some of our bigger markets, Brazil, U.S., etc., we'll need to see. I think it will be whether or not we see some relief from freight charges, input costs, labor and we're able to keep our pricing. And if so, I would say our existing portfolio should grow year-over-year. And then incremental to that, it's other opportunities that we may be seeing some return on relating to these investments that we've made. I mentioned the facility opening in Brazil. So, there should be incremental sales from there in fiscal year 2024. Sligo should continue to ramp up, maybe something will occur with Rejuvenate Bio in our fiscal year 2024. So, we'll need to see some of these other investments hopefully start to get a payoff on top of our existing business growing and thus building operating leverage.

Balaji Prasad: Fantastic. We'll look forward to your next update then, Damian.

Damian Finio: All right.

Balaji Prasad: It was a pleasure having you here.

Damian Finio: Thank you very much for having us. Appreciate it.

Balaji Prasad: Thank you for joining us, and I wish you a productive day at the conference.

Damian Finio: All right. Thank you very much.