

Phibro Animal Health Corporation
(PAHC) Phibro Animal Health Corporation to Acquire Zoetis' MFAs Business
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Call Participants

EXECUTIVES

Glenn C. David
Chief Financial Officer

Larry L. Miller
Chief Operating Officer

ANALYSTS

Erin Wright
Morgan Stanley, Research Division

Michael Ryskin
BofA Securities, Research Division

Presentation

Operator

Thank you for standing by. My name is Julianne, and I will be your conference operator today.

At this time, I would like to welcome everyone to the Phibro Animal Health Corporation to acquire Zoetis MFAs Business Conference Call. [Operator Instructions]

Thank you. I would now like to turn the conference over to Glenn David, Chief Financial Officer. Please go ahead.

Glenn C. David

Chief Financial Officer

Good day, everyone, and thank you for joining us. My name is Glenn David, and I am the Chief Financial Officer of Phibro Animal Health. I'm delighted to have you join us today as we take you through this exciting announcement regarding our agreement to acquire Zoetis' Medicated Feed Additives and Certain Water-Soluble Products business.

I'm joined today by Larry Miller, our Chief Operating Officer. Due to religious commitments, Jack Bendheim is unable to join today's call, but he wanted to share the following message with our shareholders.

Over a long period of time, Zoetis has built a valuable, high-quality, and reliable source of Medicated Feed Additives around the globe. This investment will enhance, diversify, and broaden our portfolio globally and help us continue to deliver value to our customers and to our shareholders. We believe our cash generation will allow for continued investment into our higher-growth businesses of nutritional specialty, companion animals and vaccines. I am confident we have the right capabilities to integrate and strengthen the business. I look forward to collaborating with the Zoetis team and welcoming new colleagues to Phibro Animal Health to support this portfolio.

Larry and I will walk you through these slides, and we'll open the floor up for a question-and-answer session afterwards.

As a reminder, our discussion will be focused on this transaction, and we will not cover the operational parts of our business, including our operating results, which will be covered in our earnings call next week. Finally, Jack and Daniel Bendheim will be available for investor discussions later this week and will join our earnings call next week.

Before I continue, please take a moment to review our forward-looking statements. As you may have seen, we have entered into a definitive agreement to acquire Zoetis' MFA and Certain Water-Soluble Products business for \$350 million, subject to customary closing adjustments. We have long been familiar with the business and expect the transaction to bring Phibro among the ranks of the leading global animal health players. The transaction will bolster and diversify our revenue base, provide us with significant earnings accretion, and generate cash flows to support a rapid deleveraging profile. We expect this transaction to close in the second half of the calendar year.

I would like to highlight 3 primary factors driving the transaction. First, we will have an immediate boost to our scale. Our MFA segment today drives the core of our business. And with the increased scale will be a critical component to meet global protein demand. Given that we have extensive experience in MFAs, we feel that the Zoetis MFA and Certain Water-Soluble Products business is a natural fit. Our combined revenue base will be approximately \$1.4 billion, which provides us a more stable business with continued growth. Our revenue base will become more diversified allowing us to not be anchored or dependent on the performance of any single market or product.

Larry will walk you through some details through our strategic rationale in a moment.

Second, this transaction is financially compelling. We will have an immediate and significant boost to our adjusted EBITDA margin, which on a combined basis, we expect will be in the mid-teens. We also expect to have significant adjusted EPS accretion after the first 12 months, greater than \$0.60 per share. These factors build the case for strong value retention for our shareholders.

Finally, as we have always committed to our shareholders, we will allocate capital prudently to help drive the growth of our business. The purchase price paid here is reflective of our prudence and discipline, especially compared to precedent transactions of Animal Health deals. We are not using any equity in the purchase consideration, and we expect to bring our leverage below 3x by 2027 with our increased cash flows. Finally, our cash generation will allow for continued investment over time into our higher-growth businesses of Nutritional Specialties, Companion Animal and Vaccines.

With this, I'll pass it over to Larry to go over the strategic highlights of this transaction.

Larry L. Miller

Chief Operating Officer

Thank you, Glenn, and good morning to everyone. I'll start with why we feel expanding our MFA business makes sense for future growth and importantly, how it aligns with and build on Phibro's mission statement of healthy animals, healthy food, healthy world.

MFAs help improve the overall health and well-being of livestock by treating and controlling diseases. Healthy animals are more thrifty and therefore, able to produce more affordable food with less natural resource inputs. MFAs remain a critical component to meeting global protein demand and we expect this demand will continue to grow. We continue to see strong operating momentum in our business. Our Animal Health revenue has grown at approximately 9% and our MFA revenue has grown approximately 7% over the last year, well above the market growth rate.

Moving forward, Phibro's MFA business has historically accounted for roughly 40% of our total revenue. As a reminder, the MFA business is comprised not only of antimicrobials, but also anticoccidials, rumen health products and anthelmintics. We have extensive experience here and feel that Zoetis' MFA and Certain Water-Soluble Products business complements and expands our business, enabling us to provide more product options supported by a high level of service, which adds value for our livestock-producing customers.

In addition, through some new geographic territories, we expect to gain exposure to new customers to whom we may offer our additional Phibro products. We believe that the increased scale and operating leverage will help us generate additional investment capabilities in our faster-growing businesses of Nutrition Specialties, Companion Animals and Vaccines.

On the next slide, you can see the increased diversification and scale that the transaction adds for us. Our combined Animal Health business will now constitute approximately 80% of our pro forma total revenues with MFAs accounting for 60% of the overall revenues.

We will expand the poultry and swine components of our MFA business and significantly expand our presence in beef cattle in North America. In addition, we will be adding 6 fully staffed manufacturing plants across 3 continents that will significantly expand our reach. Although our overall revenue mix between U.S. and non -- and ex-U.S. remains similar, we will have an expanded footprint in China and establish a commercial base in the European Union, allowing us to scale and grow in these regions.

Additionally, we believe investment in the acquired brands and products can help us drive incremental growth and opportunity over time. We look forward to welcoming more than 300 new manufacturing and commercial colleagues in China, and we look forward to a seamless integration.

I'll now hand it back to Glenn to cover the financial benefits of this deal.

Glenn C. David
Chief Financial Officer

Thanks, Larry. Double clicking into what we covered earlier. Two compelling components of this deal financially are the immediate expansion and diversification of our revenue base and the immediate accretion and enhanced margin contribution. Our existing business, combined with Zoetis' MFA base creates an attractive profile.

I'll start with the expansion of our revenue base. As you can see, our revenue base immediately grows approximately 40% after completion of this transaction, taking our combined revenues to approximately \$1.4 billion. We expect our combined MFA business to grow at a low to mid-single-digit percent, providing a stable revenue base for us in the future.

The immediate accretion and margin contribution is one of the most attractive parts of this deal. Our current stand-alone adjusted EBITDA margin is roughly 11%. Based on the unaudited financials that Zoetis shared with us, we expect the adjusted EBITDA margin for Zoetis' MFA and Certain Water-Soluble Products business, including potential stand-alone costs under our ownership, to be roughly in the low 20% range on adjusted EBITDA. This will give the combined business an expected margin in the mid-teens. Because of this strong margin contribution, the acquisition is expected to be accretive after 12 months at the rate of greater than \$0.60 per share.

To dig a bit deeper on the transaction, we will be acquiring the business for \$350 million, subject to customary closing adjustments, and we will enter into a transition services agreement at close. After the transaction is completed, as per the SEC requirements, we will be filing an 8-K with the audited financial statements of the acquired business for the last 2 fiscal years and an unaudited financial statement for the most recent interim period. Related pro forma financial statements for the last fiscal year and the most recent unaudited interim period will also be provided. We have received committed financing from our lending partners and at closing, we expect to have a net leverage ratio in the range of 3.5x to 4x combined adjusted EBITDA.

Touching on our capital allocation again. We believe this transaction allows us to allocate our capital in a way that creates significant value for our shareholders. Our purchase price is prudent and disciplined, especially because the MFA business is already core to our current business model. Our cash generation will allow for continued investment into our higher-growth businesses of Nutritional Specialties, Companion Animal and Vaccines. In addition, we have no equity dilution from this deal, which is financed from debt and cash. We expect to rapidly deliver and are targeting net leverage below 3x by fiscal year 2027.

With that, I'll hand it back to Larry to close.

Larry L. Miller
Chief Operating Officer

To wrap up, we just want to reiterate why we feel this is a compelling transaction for Phibro and its shareholders. We will immediately boost our scale, the transaction is financially compelling, and our prudent capital allocation gives us the ability to build over time. We hope that you're as excited about this transaction as we are.

Now we'd like to open up the floor to questions about this transaction.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Erin Wright from Morgan Stanley.

Erin Wright

So, on the historical growth rate, can you comment on the historical growth rate of the Zoetis business in particular? And also, the mix in terms of medically important antibiotics across that MFA business?

Glenn C. David

Chief Financial Officer

Yes. Thanks for the question, Erin. So just in terms of the performance historically, what we've seen in '22 and '23 essentially was a flat level of revenue for the Zoetis MFA business when you look at '22 to '23. Prior to 2022, there were some declines, those are more particularly product related, some particular products facing generic competition. So, we are confident that the business has stabilized. And with the additional coverage, we'll be able to provide to support the growth in the future that we can get into more of a mid- to low single-digit range of growth. I'll let Larry comment on the medically important piece.

Larry L. Miller

Chief Operating Officer

And again, as we said, we believe that this is an opportunity for us to diversify our product base, both from a product segment standpoint as well as geographic.

Erin Wright

Okay. And then on the margin profile, so it's higher than your corporate average, but then slightly below or maybe in line kind of with your Animal Health margin profile, but arguably, I would have thought actually it would have been a little bit lower in terms of Medicinal Feed Additives segment in general. Can you describe a little bit more on that mix, especially in terms of the water-soluble business, I assume that that's falling into kind of poultry? Is that a little bit higher margin for you?

Glenn C. David

Chief Financial Officer

So, I think when you look at the margins, Erin, it's pretty similar to our existing MFA business, particularly at a gross margin level. One of the attractive areas of this deal, though, is that we are able to leverage a lot of the current infrastructure and scale that we have from the selling, general and administration perspective. Obviously, there are some additional costs that will have to support an additional \$400 million in revenue, but it will be less than what we currently have to support the existing business. So there definitely are operational efficiencies, utilizing the infrastructure that we already have across the globe.

Erin Wright

Okay. Great. And one last one, if I can. Just can you describe kind of how the deal came about and the rationale behind the deal? And I think it makes sense, but what -- were you just being opportunistic in terms of this coming up? And was it a competitive process?

Glenn David

Chief Financial Officer

Yes. As you know, many of these deals have many processes to them in a long time period. We just saw this as a deal that was very strategic for Phibro and one that will add significant both strategic and financial value to us. And we're very happy that we were able to sign last night and very looking forward to integrating the Zoetis colleagues into our business and to driving good performance moving forward.

Operator

[Operator Instructions] Our next question comes from Michael Ryskin from Bank of America Securities.

Michael Ryskin

BofA Securities, Research Division

Congrats on the deal. I want to follow up along some of the lines of Erin's question. Just in terms of the fit of the asset. And obviously, there's a strong strategic fit given your existing presence in MFA, that's pretty obvious. But you had historically over the last couple of years, increasingly shifted your focus into Nutritional Specialties, into Vaccine into the Companion Animal business. So, this seems to be sort of going in the other direction. I recognize that the asset is available, so it is what it is. But does this change your strategy longer term or sort of how do you see the business evolving over time?

Larry L. Miller

Chief Operating Officer

I'll take that. Thanks for the question. Actually, this really helps enable and drive some of those higher growth areas, which continue to be, as you mentioned, the areas that we see higher growth in, which are the Nutrition Specialty products, our Vaccines, and our Companion Animals. So, this, we believe, can help us accelerate and further invest in those strategic areas.

Michael Ryskin

BofA Securities, Research Division

Okay. And then in terms of the portfolio fit, you went through a lot of that in terms of the species mix and the geographic mix. But is there -- are there any assets here where you're going to refine the portfolio or sort of the trends from the duplicate assets? Just sort of like how to complement you are to portfolios?

Glenn C. David

Chief Financial Officer

Yes, Mike. So, the 2 portfolios are very complementary. It just enhances and builds our portfolio globally, so we're very excited about that fact. We'll have a broader portfolio to be able to provide to our customer base.

Larry L. Miller

Chief Operating Officer

Yes. We see that this is really a complement and an extension or expansion of our current products. And what we really liked about these products is that they have been well-proven, well-trusted products in the market.

Glenn C. David

Chief Financial Officer

And also, just to follow up on some of the points that Larry made in his prepared remarks, it also significantly enhances our presence in beef cattle in the U.S. as well as gives us another footprint in Europe to expand upon.

Operator

[Operator Instructions] We have no further questions. I'd like to turn the call back over to the presenters for closing remarks.

Glenn C. David

Chief Financial Officer

Well, again, we want to thank you all for taking time to join us today. As I mentioned earlier, we hope that you're as excited about this transaction as we are. And thank you again for taking time this morning, and we will talk to you next week. Have a great day.

Operator

This concludes today's conference call. You may now disconnect.

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