Phibro Animal Health Corporation

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Erin Wright: Okay, good afternoon, everybody. My name is Erin Wright. I cover life sciences, tools and diagnostics at Credit Suisse. We're happy to have Phibro Animal Health with us today. With them, we have CFO, Richard Johnson. Just as a reminder, Phibro is a leading manufacturer of livestock therapeutics across the animal health space where we cover a bunch of different companies.

I guess I wanted to kick off -- and this is a fireside chat, so feel free to reach out or raise your hand if you do have a question, or email me if you would also like to submit a question for me to ask. I'm happy to do so. I'll start off and kick it off. The most recent quarter, can you give us an overview of the more recent trends you're seeing and update on ASF and global dynamics across your different livestock segments?

Richard G. Johnson: Our most recent September quarter -- we're a June year-end, so it's the first quarter of our new fiscal year -- it was in line with our expectations. It was certainly a down quarter from where we were last year. It was what we had expected broadly both top line and bottom line. As expected, we saw our business in China basically have negligible sales after having a $40 million run rate for the full year last year. So that was a major factor in the reduction in the quarter and on the top line.

We also saw some encouraging signs in our nutritional specialty business as our dairy business was stable after having declined for several quarters sequentially. Our vaccine business also saw some encouraging signs. Our September quarter was essentially the last quarter where we had exited a distribution arrangement about a year ago, and so we still had a negative overlap there. So we reported a negative number, but putting aside that overlap, we saw about 5% growth in vaccines.

And on the bottom line, the profit reduction measured by adjusted EBITDA declined in proportion. Actually, it declined even more than the top line decline we had. Of course, due to the sales decline and we had some unfavorable mix which hurt our profit, and we had some manufacturing costs and a little bit of negative FX in the quarter which hurt our profits.

Didn't spend quite as much money as we had forecast we were going to spend on some of our strategic initiatives. So we'll be looking for that to ramp up for the remainder of our fiscal year. We reaffirmed our guidance for the full year, despite the relatively soft numbers in the September quarter. Still looking for sales to ramp as we move through the

year coming out of some new product introductions and also getting beyond some negative overlaps in certain areas.

We expect that gross profit anomaly not to be there to the same extent going forward, but on the other hand, we do expect some higher operating expenses going forward. But fundamentally, we reaffirmed our profit, which calls for just in the animal health segment about 3% sales growth for the full year, despite the fact that we were down in the first quarter. So, looking for sales to accelerate in our animal health business. And across the total company, looking for a ramp in profitability and adjusted EBITDA as we go through the rest of the year.

Erin Wright: Okay. Great. That's helpful. And then I think one of the things that people thought was particularly surprising in the most recent quarter was that you mentioned you did see some stabilization across dairy, or you were seeing some stabilization. I guess can you give us a little bit more color on what's driving this, what you think this -- will this stabilization continue? How this impacts OmniGen sales. And then also, this morning there was a Dean Foods processor that filed for bankruptcy in that segment. So I did want to ask can a -- yes, I guess to reiterate sort of the stabilization dynamic and what that necessarily means for you.

Richard G. Johnson: Right. I don't want to get too far ahead of the dairy story. Certainly, in market news, dairy prices have rebounded. And in particular, the dairy components that get traded on a global basis, which are milk powders, whether they're whole milk powders or skim milk powders or other similar sorts of derivatives, and those prices have come back nicely in about the last 6 months. They're not back up to the really very good days of, I don't know how long ago it was, 3, 4, 5 years ago, but they're back enough to make a difference for producers. That's number one.

Number two, we saw our OmniGen product Erin mentioned, it's a nutritional supplement. Helps keep a dairy cow healthy. Helps -- in a healthy cow it has the ability to fight off a lot of disease challenges, and therefore a herd of cows can produce more milk, which is really what the producer's looking for. We saw that product, the sales stabilize after having seen some decline for the last, say, couple of years. So that's been encouraging.

And then third, we're looking to launch a revamped version of OmniGen where that's scheduled to come out in January where we're going to add some different components to the product, offer the dairy producer more value and give him a more direct relationship between the product and his basic measurement, which is the amount of milk he gets. And we're still very positive and enthusiastic about that.

And then last is just anecdotally, our customers seem, with the rebound in prices, our customers seem a little more optimistic than they were. And in some of the ongoing consolidation, which that's been going on for decades but had really accelerated recently, that seems to be moving through also.

As far the bankruptcy of Dean Foods, I don't know a lot about the business. I think that's not really directly related to our business. That's, as I understand it, it's probably more directly related to just the sale of fluid milk in the United States. When you say dairy, you think of a jug of milk, but really what we're talking about are milk powders or cheeses, yogurts, a lot of other components that really is the whole big dairy industry.

Erin Wright: Okay. And part -- sorry, not to totally run on about dairy, but part of your strategy was going to pivot more towards larger scale, like 5,000-plus cow dairy farms that were

catering -- or as opposed to catering to some of the small dairy farms that you historically had. I guess how is that strategy playing out for you?

Richard G. Johnson: It's early days, but it seems to be working well. We've refocused our sales team, or a good chunk of our sales team, to focus on those larger dairies that Erin described. And I think the proof will be in the pudding when we re-launch OmniGen because this revamped product is really primarily going to be focused on those larger producers and give them that enhanced different value proposition.

Erin Wright: Okay, great. And then switching to China and African Swine Fever, can you parse out the impact that you're seeing, the headwinds. And then I think more importantly, too, is what could be some of the offsets that you see longer term and how long term are they, and how should we think about timing in some of those offsets?

Richard G. Johnson: Right. I think most everyone here is -- anyway, if you're not familiar, there's been this devastating disease present itself in China. It's been there for over a year now. It's probably -- there's something in the neighborhood or order of magnitude of half of the size of the herd in China is gone of the swine herd. And just to put it in perspective, prior to this disease, China produced and consumed more pork than the rest of the world combined.

So what this has done is created a very large supply hole in the protein needs for the people in China. And what Erin is referring to is that protein has to come from somewhere else. So it's coming from increased domestic production of poultry. There are little signs, but it's way too early to talk about it. People are talking or thinking about repopulating some of the swine production facilities and bringing that back.

And then the other major protein producing regions around the world, the United States, Brazil, Europe, are all producing more poultry and pork and a little -- to a certain extent beef, and that additional production is being shipped to China. So are we seeing a little bit more business in some of these other production areas? Yes, but it's still quite small and it's difficult to put your finger on just how much it might be.

Erin Wright: Okay. But you anticipate that that will ramp at some point.

Richard G. Johnson: I think it will continue to -- we'll continue to see some benefits. It's going to be slow. We're not going to see a sudden surge of demand for our products.

Erin Wright: And any update on your own potential vaccine for ASF?

Richard G. Johnson: We, like many other people, with the presence of this disease -- and it's a disease that's actually been around for a long time, but it's a very complicated virus. No one's ever come up with an effective vaccine against the virus. We've partnered up with some smart people with some very interesting technology. And we continue to be encouraged at the progress we're making in sorting through possibilities and alternatives and beginning to narrow down whether we might be able to find something that could be an effective vaccine against African Swine Fever. It's still too early to say whether we've got something or not. Perhaps in the next 12 months we'll be able to say we think we really have something and we're going to continue to spend development money. Or the other side of the coin could be is, well, it was a good try, but it doesn't look like it's going to work, and we would of course stop investing.

Any commercial product is still several years into the future. Because even if you do

come up with something, it's going to be -- it's going to take time to get it through all of the regulatory steps. Although we do believe that given the severity of the disease that the regulators would fast track anything that looked like it really had a good chance of helping.

And I would -- we put out -- and it's all speculation, and you can put whatever numbers on you want. But whoever, or if there's more than one, if there is a real viable, workable vaccine against African Swine Fever, it's going to be a substantial financial opportunity for whatever company or companies can come up with something that works. So you can do all of the math about the really large numbers. So, China used to raise 800 million pigs a year. Could you get $5 per pig for a vaccine or $2 or $1? It's, whatever the number is, it has the potential to be a very large potential commercial opportunity.

Erin Wright: Great. And switching species just a little bit. So, poultry. Can you speak a little bit about underlying demand trends across the poultry market? And then also just that subsegment of MFA and your exposure across MFA in the poultry segment.

Richard G. Johnson: I think the poultry industry, when I think about it, generally around the world, the poultry industry is doing fine. Their prices are good. In part, prices are supported by the increased demand coming out of China. Input costs are generally favorable. Most of the cost of raising a chicken is corn or soybeans, so those prices are still relatively benign. The second part of your question, Erin, was --

Erin Wright: Exposure within the MFA segment.

Richard G. Johnson: Exposure. So we have this, we talk about our sales in terms of product groups, and one of our bigger product groups is medicated feed additives, which means -- another way to think about it is they're regulated pharmaceuticals that are fed to the animal by mixing it in with feed. Within that category are antibiotics, which have gotten a lot of both regulatory and consumer pressure against those antibiotics.

We've seen our business on this category of antibiotics that the FDA calls medically important antibacterials, MIA. And we've seen that business of our business in the United States go from in excess of $40 million 5 years ago to being almost negligible today. We're in the single digits. So that's declined to pretty much where it is. Those same products in the rest of the world continue to have good demand, good acceptance.

The regulatory environment internationally is changing in a very orderly fashion to make the same changes that the United States, the FDA made 3, 4, 5 years ago where they did away with the growth promotion claims or registrations and went to only allowing the products to be used for therapeutic purposes. So that therapeutic means to prevent, control or treat a disease, and it also implies that a veterinarian is involved with supervising the use of the product.

And that is something that we and the industry can deal with generally without a major disruption to our business. It's really -- in the United States what's driven our sales down had been the consumer preferences and the packaging that I'm sure you all see when you go to the grocery store or you see the ads from the quick serve restaurants that say raised without antibiotics or no antibiotics ever or any variation of those phrases. That is a bit of a factor in the rest of the world or in the emerging markets. It's certainly a factor in Europe. We don't do really any MFA business in Europe. But it's not so much of a factor in the other emerging markets where we deal.

Erin Wright: Okay. Great. And then can you speak a little bit about your foray into the companion animal market? I guess, what are your next steps there in terms of investment and innovation? And then what do you need to kind of scale and readily compete in sort of the companion animal segment?

Richard G. Johnson: We've always been, up until now, we've always been exclusively focused on food animals, livestock. And one of the things over the last number of years that we found in our nutritional specialty category primarily was we were able to connect with outside people who had good product ideas or maybe good technology but not much of a way to bring the product to market. And we've had a lot of success with that in the food animal side.

We looked at that and we said we thought there was room to do something similar with companion animals. And so we've hired a few people who have significant market experience in the companion animal industry. Have gone out, talked with and in-licensed some interesting product technology that we then are test marketing for a startup or a foray into companion animals. That's a good word, foray.

So we're in test marketing right now. Our first product that we've been talking about is a canine joint health product. It's a nutritional supplement type of product. Test marketing we're working through the vet clinics, working through distribution. We're not going to build up a big organization, but we think there's a way that we can offer a differentiated product that brings something to the market and has value to the market. And we've been really encouraged with both the, kind of the initial acceptance, as well as some of the reorders and also the anecdotal stories about how people liked the product.

So, early days. The numbers in the scheme of things and the numbers inside of our numbers are still small and insignificant, but have the potential to develop into something. Too early to say absolutely that's where it's going, but we're encouraged.

Erin Wright: And is the focus primarily on the in-vet clinic dispensing as opposed to going to a Chewy.com or 1-800-PetMeds or more of a retail channel like Walmart?

Richard G. Johnson: We see the vet as a partner and a gatekeeper, and we think that's -- we've thought about and given some thought to various methods, but that seems to be the best way to go.

Erin Wright: Okay. And then you recently did an acquisition of Osprey. Can you speak a little bit about that opportunity and where the progress is in terms of integrating that asset?

Richard G. Johnson: Right. Yes, we bought a company at the beginning of August, so about 3 months ago I guess. And it is a producer of microbial products. So that means living organisms that are used for a number of different products. We've known them for several years. As we were developing a gut health or an intestinal health product for poultry, they were the owner of the strains of the microbes and made the product. And then as we got to know them more and more, it seemed to make a lot of sense that we would acquire the company, so that's what we did.

And we see a substantial opportunity in bringing this microbial, they're called direct fed microbials for animals. And it's essentially keeping the health of the intestinal tract up to its optimum level. And really in a way, all of these products are, although they're not direct substitutes, they are alternatives for the classic tried and true antibiotics that in markets like the United States, producers, for reasons of their customers, are no longer using those products. But they have the same health problems, and they have the same

challenges in raising their animal that they've always had. So they're looking for alternatives to keep that animal healthy and growing to its maximum potential as they're raising it.

Erin Wright: Okay, that's helpful. And then it's been a while since I've heard you talk about aquaculture. So I wanted to check in and see where that initiative is today, if there was any update.

Richard G. Johnson: Just that we about 5 or 6 years ago, we acquired a small aqua consulting business and really charged that team with evaluating our product portfolio and beginning to -- and moving some of our products into the aqua space. Aqua, which is -- it's the same industry as chickens or pigs or cows. You're raising a lot of animals together in close proximity to each other, and so you get certain disease challenges.

And because aqua as a farming industry is a relatively new industry, you don't have these older products that were approved for use in animals quite a while ago, and now the regulatory environment is changed, so it's much more difficult to get a product approved. So, we're focused more on the nutritional specialty portfolio, focused on vaccines to some extent. And if you've ever seen a fish being vaccinated, it's really pretty neat. Hard to think of, but in fact you do vaccinate fish one by one by one.

And it's moving along. It's moving slower than we'd like it to move. We still think there's a lot of potential there. And maybe in another year or two we'll be able to talk and give you really some more solid numbers around aqua.

Erin Wright: Okay. Well, that's exciting. And so I guess this is a bigger, broader question to kind of end with here. Can you just provide some color when we think -- when you think you can kind of get back to -- part of the strategy here was also to help diversify maybe away from a core MFA business in vaccines and nutritional specialties. When do you think those businesses could get back to a double digit or high-single digit, low-double digit kind of growth trajectory across those businesses like we saw previously? Or has anything changed in your longer term outlook across those segments?

Richard G. Johnson: Our long-term outlook remains consistent with what we've been talking about for a long time now. And even if we take our guidance and what that implies in terms of growth rate for the rest of the year, it will be the nutritional specialties and the vaccines growing at somewhere in that upper single digits or perhaps more range to really drive the overall sales growth that's going to get us to where we intend to be by the end of the year, as our guidance indicates. So I think our strategy is the same. Maintain that base MFA business, grow it at a slower rate, and then substantially faster growth in both nutritional specialties and in vaccines.

Erin Wright: And any update on Performance Products, divesting that business or just broadly deemphasizing that over time? Or what is the latest on Performance Products?

Richard G. Johnson: It's status is unchanged. So we'll, as we've said before, we will continue to rationalize the business as it makes sense when it makes sense, but no new news there.

Erin Wright: And mineral nutrition, are you still able to leverage some of those relationships across mineral nutrition and use that across your core animal health business? And is that still a positive, synergistic sort of relationship there?

Richard G. Johnson: Yes, we like the minerals business. It's a solid, good cash flow until recently where we've

run into some headwinds that we think all in all we're going to be able to work our way out of in terms of headwinds. In terms of profitability, that it's a valuable part of the company and it makes sense to continue to operate and keep minerals as part of the overall mix of the business.

Erin Wright: Okay. Great. I think we're out of time. Thank you so much. I appreciate your time today.