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Richard G. Johnson Phibro Animal Health Corporation - CFO

CONFERENCE CALL PARTICIPANTS

Balaji V. Prasad Barclays Bank PLC, Research Division - Director

PRESENTATION

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Good afternoon, everyone. Thank you for dialing in. My name is Balaji Prasad. I cover Specialty Pharma for Barclays. This is a continuation of our virtual healthcare conference and for the session now, we have with us today the senior management team of Phibro. We have Richard Johnson, CFO; and Dani -- Daniel Bendheim, Executive Vice President, Corporate Strategy. Also reminder that owing to the nature of this format, there will be no Q&A session at the end of this.

Richard and Dani, thank you for joining us. Would you like to start with an overview and then outlook of how you're seeing the business evolve, and we have a few questions that we can launch into post your overview. Thank you.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Right. Let me first give a brief overview, and I'll probably just summarize our numbers and our guidance that's out there for the year.

We are roughly $800 million, a little north of $800 million annual revenue company focused on the animal health industry-focused today on production animals. So that means poultry, swine, cattle, both dairy cattle, beef cattle and a small business in aqua. We're also experimenting or test marketing on the companion animal side. We're out there with a joint health supplement product for dogs, and that's in test market.

We expect EBITDA, I'll just use the middle of the range of the numbers I put out there. We expect EBITDA of about $105 million this year on slightly over $800 million of sales. That's down from last year as largely, we're seeing sales growth, and we're seeing gross profit improve, but we are investing off of our P&L for future growth. So we've got some strategic investments in our P&L, which have affected our comparisons year-over-year.

We've been a public company for about 6 years, about 50% of the float is with the public, 50% is held by the founding family. We see strong growth opportunities ahead. Certainly, on the production animal side, as all of the macro fundamentals are there, growth of the global middle class and growth of income around the world, driving increased demand for protein. And to fulfill that demand, you really need to do it by increasing your productivity and increasing your efficiency. And one of the ways you do that is by keeping your animals healthier as you're growing them. And that's what our value proposition is to our customers.

So with that, I'll turn it back to you, Balaji.

QUESTIONS AND ANSWERS

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Thank you, Richard. So maybe even before going into the business specifics, something which is on everyone's mind is COVID-19. Thought that's a good place to start. I mean 2019 was all about ASF and its impact that we saw across the industry. And now we have COVID-19 to worry about.

So can you start with an overview of how you see your business being impacted or not on the demand side? And I also received a fair amount of questions on the supply chain impact too? Any color there it would be helpful.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

I think to date, the impact on our business has been minimal. The question really is logistics around the world and everyone's supply chain and as you read the business press, everyone's supply chain has some products coming out of China. So we have -- we have generally good safety stock. So we don't see anything in the immediate future, but if this continues on for some time, those supply disruptions out of China of certain raw materials or in the case of our minerals business, a fair amount of our raw materials from the minerals business comes from China. So that's what we are seeing.

And then as we see other disruptions, the logistics. So for example, some countries are restricting or shutting down flights into the country that can have an effect on our ability to bring product in and it may impact our supply chain.

And on our customer side, where some customers are restricting access, that hasn't had a short-term impact. On the companion animal side, we are hearing that the vet clinic, when we sell this product to the vet clinic they don't want sales calls from the salespeople. And then we're also hearing anecdotally that traffic is down. So -- and all said, minimal effect to date. We'll have to see where it takes us as this develops. It's obviously a day-by-day development story.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Understood. Also, I read a couple of days ago, an article on a coronavirus related patent awarded to you last year around May 2019. Is there any color that you can throw on that?

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

Yes, this is Dani speaking. That was something in Seeking Alpha. But I think, actually, I think the guy was just trying to whatever make noise. As you know, there's tons of coronaviruses out there. And this is one that we addressed back in 2016 in swine. It has 0 impact on the COVID-19.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Fair enough. Understood. So as we now look at the business and look at the way your segments. So you addressed some of these in your opening remarks when you spoke about the food production, food protein demand. So starting with the (inaudible) segment. So following the last quarter improvement that we saw in MFAs. What are your current thoughts on the segment growth for this year, this calendar year and the next year? And maybe considering the confidence that you have in your breakeven to slightly positive estimates for FY '20?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

I'd say in our overall animal health sales, we're looking at sales growth year-over-year of $5 million to $15 million. Within that, more than all of the sales growth will come from our faster-growing product groups, the nutritional specialties and the vaccines, and that includes the acquisition we did early in our fiscal year.

On the MFA side, we will see -- we have been seeing, and we expect to continue to see growth in our MFA sales ex-China. On a total MFA product group basis, when we factor in the year-over-year decline out of China, as we called out in our initial guidance and have talked about, we will see the MFA sales numbers decline in our fiscal 2020 compared to the prior year. But we're seeing good MFA demand in other parts of the world, and by good, I mean that's in those low single-digit kind of numbers.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Sure. And Richard, when we last discussed the re-herding opportunity in China. You mentioned that you are going through a series of re-registrations. And so this kind of places you towards the end of the year for benefiting from any re-herding in China. So can you just take us through this? And maybe call out any specific products that you would like to highlight? And so we would assume that most of the impact will be felt in your FY '21 numbers?

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

Well, the impact this year we've obviously felt on the negative side. As far as the re-herding is concerned, we've definitely seen movements in that direction. But our belief is that until a vaccine is developed, we think it's going to be very difficult for them to bring back population to the same level as it was before. So it's an ongoing story, definitely not expecting it to be fully re-herd in the next calendar year.

As far as our plan, our plan was to have our first re-registrations by the end of this calendar year. As we have discussed with ASF, and now with the COVID-19, our ability to do some testing in China, which is required to get these re-registrations has been proven a little more difficult. So that might lag a little bit, but we're still looking to hopefully get our first re-registrations around the end of this calendar year, might flip a little bit into next year.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Understood. So I was planning to ask some questions on vaccines later on, but since we said that re-herding is contingent on ASF vaccine development. So let me just advance that question a bit ahead. So it's an interesting segment. We have seen multiple vaccines, news flows coming through from different industries. So we saw an announcement from -- announcements from Harbin Institute recently a couple of weeks ago, and following upon USDA's announcement in December. So while we await to a late spring update. Can you help us understand how your epitope-based vaccines are different from USDA's or versus Harbin's Institute's vaccines?

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

Okay. So we are not scientists, and we'll keep it at very high level. Both of those vaccines are attenuated vaccines, as you know.
And they very well may work. Obviously, the challenges for attenuated vaccines are both large-scale safety trials that they needed to work on as well as large scale manufacturing. And I'm sure the manufacturers or the people working and partnering in those situations are working on those issues. The fact of the matter is that all things being equal, countries will prefer an epitope-based vaccine to an attenuated vaccine. And that's because at the end of the day, if you want to be able to differentiate your herd as far as whether it's going to affect you or not affected, you cannot be using an attenuated vaccine because there's no way to differentiate whether the swine you're looking at, the pig you're looking at, is merely showing the vaccine or actually was infected. So for sure, for export countries, for country that exports swine that they, again, all things being equal they will prefer an epitope-based vaccine. We think if China ever wants to be able to declare that they're free of ASF, which is a challenge. They're going to need to adopt vaccines of the sort that we're looking at rather than an attenuated one.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Right. And so considering these differences, how do you expect development time lines will compare. I think USDA had recently said that they expect to be commercial in 1 to 2 years or in the near future, which we interpreted as 1 to 2 years. Is that a fair assumption? Or is it still too aggressive?

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

We think that's probably a little bit too aggressive, but this is a huge issue that I'm sure China will pull out all the stops to solve. But for sure, they're not going to be willing to do a short cut when it comes to safety. So the attenuated vaccines again, they'll have to do large commercial scale trials. We've heard stories, not necessarily to deal with ASF. But even within ASF the trials people have done where things look good in the lab, but when you get out to numbering in the thousands, it doesn't always present as well. So they have those hurdles to overcome. We have similar -- we're by no means ready to get into the market any time in the short term. So probably 1, 2 years is probably a little bit aggressive, but I think everyone is trying to get something out there as soon as possible.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Fair enough. Switching gears back towards the health side -- on the dairy side, so we've seen recent years data reports with trends which are pointing to an improvement on the dairy side, including pricing. So how does this resonate with what you're seeing from the segment? And can you also comment upon the factors that are driving it and how sustainable they are?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Yes. I think, we agree. We are seeing more optimism and that's being driven by better financial results in the dairy industry. There's been a lot of pain in the last few years as a lot of farms have really been forced out of business and the consolidation of the industry has accelerated over the last few years. The initial launch of our new reformulated product that is positioned much more directly to show value to the producer. We just did that launch a few weeks ago, and initial results have been very encouraging. We're seeing good receptivity.
First you have to sell it to your own sales force and our sales force is definitely sold on the product. And so they are out there talking to the customers, and that's going well. So we expect the reformulated product -- OmniGen Pro -- will reignite growth. We've seen a decline in this flagship product over the last roughly 3 years as the market was increasingly difficult. We expect that the reformulated product will reignite growth, and we'll be able to take back a lot of those sales that we've lost. And so we think this will be a very meaningful contributor to our results somewhat the rest of this fiscal year, which ends in June, and certainly in our next fiscal year.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Thank you, Richard. So on that reintroduction of this product, how large is it in sales currently? And if I were to think about the ability of this product to contribute to incremental growth over the next 2 to 3 years. How could it grow? Can you throw any numbers around it?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Yes. We don't -- we haven't disclosed individual product sales in this category. But this could certainly give us $5 million, $10 million, $15 million of sales growth next year over this year, something in that neighborhood.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Understood. So if this is currently being delivered or given to around 20% of cattle in the U.S. Is it a fair assumption to think that this could go up to 30% over the next 2 years?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Yes. That would be a very nice goal.

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

I think the 20% of current cattle, kind of was probably closer to our peak.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

20%, 25% was our peak, and we're probably a little under 20% today. Yes, getting back -- even getting back to 25% would be a very nice win for us.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Great. We'll look forward to updates on that. And Richard, you recently commented on consolidation in the dairy industry. Could you also -- and also about the drivers, which is helping this moment. Can you elaborate more on this? And how sustainable will this consolidation trend be? And what it means for you?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Yes. What's happening in the dairy industry is a continuation of what's been happening for a long time. But a dairy producer now just needs to be bigger and bigger to be economically viable. And that is good for us. Our business is -- we're a B2B, business-to-business company --and we offer a value proposition to our customer. And so when our customer is larger, more sophisticated and can understand and measure results, that's good for us. So we see it as a positive. We've had to reposition our sales force to spend much more of their time on the much larger dairies and shift from the medium- to smaller-sized dairies, that's going well. And so we see the market consolidation as a positive.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Understood. Coming down to your foray into pet care, something that we have discussed and you had indeed alluded to this in the past. So at what point of time would you make a decision when you think about the capital allocation priorities to expand your foray into this segment? And what formats would that expansion take?

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

Yes. So I think we're already looking. We're constantly looking. The way that we look at this is we have a blank slate. There is a lot of change happening in the U.S. pet care industry, a lot of change as far as distribution, as far as how customers, how pet owners receive their products. And in a certain way, we think coming in now is advantageous, and so far as we're not tied to any specific way of getting the product to either the vet or the customer or both. We're looking at a vast array of products and of opportunities. We've discussed, obviously, Dick alluded to Rejensa. We've previously announced a Lyme vaccine novel delivery that we licensed, that's still in the testing phase, and there's other things as well. We are looking at potentially bigger opportunities, but there's nothing that's imminent by any stretch at this stage, and we'll continue to look.

I think, overall, on capital deployment, we look at pet, and on the production animal side, we look at vaccines, abilities to grow in vaccines as well as the nutritional specialty space. The acquisition we made earlier this year, Osprey Biotechnics, which again, Dick alluded to, where we look at that and say it's a real platform on the microbial space for production animals and, frankly, as well as for pet industry to grow. And I would expect in the coming years, us looking to leverage that.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Got it. So on the business development priority, so after Osprey, can you also speak more about your appetite for small- to mid-sized acquisitions or even larger acquisitions? And if this is something that you would consider to establish a large presence on the pet care side at all?

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

Okay. I think we're looking at both. Typically, I'd say the typical down the fairway acquisition for us is probably a smaller size acquisition, the bolt-on.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

And it could be a business or it could be more individual products. If it's individual products, it's more -- it's probably earlier stage, in-licensing type of structure.

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

But we've looked at larger opportunities as well. Obviously, we don't have the synergies that some of our competitors do. So as the opportunity gets larger, the economics may be getting a little more difficult for us relative to our competitors who are able to look at cost savings, but we don't look at that. So we're out there. The bankers definitely know that.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Understood. So a couple more questions on the vaccine side and probably coming to the end of our time. Could you also speak about your pHi-Tech automated vaccine system, the advantages that you have with this over similar competitors on the vaccine side? And lastly, on your Irish facility. So are you still on target to July 2021 commissioning? And how should we think about your gross and operating margins in the outer years once this facility comes online?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Why don't you take pHi-Tech?

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

Okay. So pHi-Tech is a revolutionary delivery system -- right now for poultry. There's really no -- the competition that we're facing is really kind of manual injection. We're not competing against large animal health companies when it comes to this sort of technology. We're innovating here. And you're taking something that has typically been, call it, been spent pennies on. And we're turning into real dollars and what the integrators are seeing is that there's much more information, more data. They understand now what's happening in the field, and they have a much stronger sense of whether they've achieved herd immunity. You know which workers of yours are more efficient. It is worker safety that's involved here. There's a lot of things that our customers are very excited about. They're willing to take a category that they're spending next to nothing and start spending some real money. So that -- our competition is not another innovative solution, it's kind of the status quo. As far as Sligo is concerned...

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Right. We're still on track for that mid-2021 commercial launch, it will be the same poultry vaccine portfolio that we currently make in another vaccine production facility. It expands our capacity. It also will expand some market access due to various reasons. And to your summary question is what about operating margins. I think we feel we can grow the bottom line faster than we grow the top line as we move forward over the next 2 or 3 years. And that just inherently, will improve operating margins bit by bit.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Great. I think that's a good place to leave it at. Dani and Richard, thank you so much for your time. Great to hear your thoughts and we'll stay in touch. Thank you.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

All right. Thank you.

Daniel M. Bendheim - Phibro Animal Health Corporation - Executive VP of Corporate Strategy & Director

Thank you.

Balaji V. Prasad - Barclays Bank PLC, Research Division - Director

Have a good day.

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