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Phibro Animal Health Corp. (PAHC)

Q1 2021 Earnings Call

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Derik De Bruin BofA Merrill Lynch, Research Division - MD of Equity Research

Kevin Kedra G. Research, LLC - Research Analyst

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Phibro Animal Health Corporation Q1 2021 Conference Call. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Richard Johnson, Chief Financial Officer. Thank you. Please go ahead, sir.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Thank you, operator. Good morning, everyone, and thank you for joining us today, and welcome to the Phibro Animal Health earnings call for our first quarter ended September 30, 2020. On the call today are Jack Bendheim, our Chief Executive Officer; myself; and Damian Finio, our incoming Chief Financial Officer. We'll provide an overview of our quarterly results and our guidance for our December quarter and then we'll open the lines for your questions. Before we begin, let me remind you that the earnings press release and financial tables can be found on the investors section of our website at pahc.com. Today's presentation slides and a replay and transcript of the call will be available on the website later today. Our remarks today will include forward-looking statements, and actual results could differ materially from those projections. For a list and description of certain factors that could cause results to differ, I refer you to the forward-looking statements section in our earnings press release. Our remarks today will also include references to certain financial measures, which were not prepared in accordance with generally accepted accounting principles, or U.S. GAAP. I refer you to the non-GAAP financial information section. Reconciliations of these non-GAAP financial measures to the most directly comparable U.S. GAAP measures are included in the financial tables that accompany the earnings press release.

Now before we get into the numbers, let me just briefly remind everyone that we present our results on a GAAP basis and on an adjusted basis. Our adjusted results exclude acquisition-related items, unusual, nonoperational or nonrecurring items, other income and expense items as separately reported in the consolidated statement of operations and the income tax effects related to any pretax adjustments as well as unusual or nonrecurring income tax items.

And now here is Jack Bendheim with some introductory comments. Jack?

Jack Clifford Bendheim - Phibro Animal Health Corporation - Chairman, President & CEO

Thank you, Dick. Our first quarter saw a very nice bounce back in performance as we emerge from what we hope was the depths of the COVID crisis. Our Animal Health segment net sales grew 5% with similar growth across all product lines. We posted a stronger adjusted EBITDA than we had anticipated
as we saw a favorable product mix and restrained operating expense spending in the quarter. Beyond the numbers, I'm really excited about what is happening on daily basis at Phibro. Over the last few months, we have significantly strengthened our sales organization around the globe, in quality and in quantity, and the results are starting to show.

On the Nutritional specialty side, we are, for the first time, showing real growth in the European and Asian dairy sectors, where we have accelerated
penetration in these important regions. We continue to grow our market share in the U.S. Poultry segment as we provide valuable and often custom solutions to our customers.

On the vaccine side, as we launch and register our new products in major segments, we are pleased with vaccine penetration and our increasing market share in our key target markets. Globally, we have had 15 significant vaccine registrations approved in the last 12 months and our expectation over the next 3 years is for an additional 70 approvals.

On the MFA side, we know that the industry recognizes and appreciates Phibro's commitment to safety and to science and our willingness to take the necessary actions to keep products available for their use.

Finally, we continue to grow our Rejensa business even though we are encountering difficulties in accessing vet clinics due to COVID restrictions. We are committed to strengthening our pet business and look forward to sharing some additional color on our initiatives in the coming months.

As we look to our current quarter, we believe our momentum will continue. But our optimism is somewhat tempered by the fact that the world is
clearly dealing with a new wave of COVID and some economies are in the recession. We think protein demand in U.S. and Europe will remain relatively healthy, but we are seeing signs some developing countries are experiencing a more halting recovery.

I also want to make note that this is Dick Johnson's final investor call as CFO. Dick has been a valued partner and friend for more than 18 years. During his tenure Phibro has matured into the global business we see today. Much of what we have accomplished is due to his diligence and business understanding. On behalf of myself and the 1,700 employees in the Phibro family. I want to say thank you to Dick, and we wish you continued good health and enjoyment for years to come.

I also want to extend a warm welcome to Damian Finio, our incoming CFO. Damian has had a successful career in financial management, and he brings the skills and experience needed to play a key role in Phibro's success. I look forward to working with Damien as we address future opportunities.

With that, I would like to ask to Damian to say a few words, and then Dick will lead us through their quarterly numbers. I look forward to taking your questions at the end of the call. Damian?

Damian Finio - Phibro Animal Health Corporation – incoming Chief Financial Officer

Good morning, everyone. Thank you, Jack, for the introduction and for the opportunity to join Phibro. I'm excited and looking forward to assuming the role of Chief Financial Officer and humbled to be accepting the baton from someone with Dick's level of knowledge and experience. I also want to thank Dick for supporting my transition and thank the global Phibro team for the warm welcome.

Phibro Animal Health is a company with many opportunities. As CFO, I look forward to working with my colleagues to increase revenues and profitability through further geographic expansion and market penetration, while continuing to improve returns on investment. Working closely with my team, I intend to gain a better understanding of our business in order to identify opportunities to gain efficiencies, explore alternative tax strategies and strengthen internal controls. Lastly, I hope to have the opportunity to meet some of you, albeit virtually, in the not-too-distant future.

Now let me hand the call back over to Dick. Dick?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Well, thank you, Jack, and thank you, Damian. So first, let's review the results for our first quarter ended in September. Our consolidated sales were $195 million for the quarter. That was an increase of $5.5 million or 3% compared to the same quarter a year ago. The sales increase was driven by the Animal Health segment as we saw increased demand and volume growth across the product portfolio, primarily in international. Mineral Nutrition net sales declined, while Performance Products net sales were about comparable to the prior year.

Our September results reflected a partial recovery from the reduced demand we saw in our June 2020 quarter, which was more affected by the pandemic. On a reported basis, net income of $12.3 million increased approximately $10 million over the prior year, driven by increased gross profit, with a partial offset from higher operating expenses and foreign currency gains in the current year. Diluted earnings per share was $0.30 per share for the current quarter, an increase of $0.24 per share, reflecting the increased net income.

Now let's discuss adjusted results on the following page. And looking at selected line items from the P&L, I'll discuss net sales in more detail at the individual segment level. But it's important to note that in total, adjusted gross profit increased $6.2 million or
10% when compared to the year. That improvement in adjusted gross profit was much stronger than the sales growth and reflected favorable product mix as well as favorable production costs and plus a somewhat unfavorable mix in our quarter a year ago.

Looking at adjusted gross profit by segment, Animal Health increased due to sales growth, favorable product mix and favorable production costs, which were primarily driven by favorable foreign currency movements. Mineral Nutrition gross profit declined due to unfavorable production costs and Performance Products gross profit increased as a result of the favorable product mix and production costs.

Overall, our adjusted SG&A or operating expenses increased $1.6 million or 4%. In the Animal Health segment, incremental professional fees that we incurred to support the continued safe use of carbadox and higher costs associated with new products were partially offset by the favorable effects of foreign currency movements and timing of marketing spending. Corporate SG&A increased due to the increased cost of strategic initiatives. Costs in other parts of our business, that is Mineral Nutrition and Performance Products, were comparable to the prior year.

At the income tax line, the effective tax rate on an adjusted basis was 31% in the current quarter compared to 28% from the prior year. And that all resulted in adjusted diluted EPS of $0.27 per share, an increase of $0.08 per share or 42%, consistent with the growth in net income.

Now looking more closely at the Animal Health business. We saw net sales of $128 million, and that was an increase of $6.5 million or 5% compared to the same period last year.

In the MFAs and other category, net sales of approximately $79 million increased almost $4 million or 5%, driven by increased international demand for poultry products coupled with favorable timing of certain customer orders.

In the nutritional specialty products category, net sales of $32.6 million grew better than $2 million or 7% year-over-year. During the quarter, we experienced international growth in dairy products, while domestic sales were roughly comparable to the prior year.

In the vaccine area, net sales were $17 million, an increase of close to $1 million or 4%, driven by international demand for our poultry vaccines.

That all resulted in adjusted EBITDA for the segment of $30 million for the quarter, an increase of $5 million or 20% over the prior year. The overall sales
growth and related gross profit increases were partially offset by increased SG&A spending.

And then looking at our other segments. Mineral Nutrition net sales were slightly over $51 million for the quarter, and that was a decrease of approximately $1 million compared to the prior year, or 2%. We did see volume growth, but the volume growth was more than offset by lower average
selling prices. Just as a reminder, the lower average selling prices are generally correlated with the movement of underlying raw material costs. We saw a decline in gross profit due to unfavorable production costs and as a result, adjusted EBITDA was $3 million, down $400,000

compared with the same quarter last year, basically attributable to the decline in gross profit. In the Performance Products segment, net sales were about $15 million and roughly comparable to the prior year. We saw increased sales of personal care product ingredients, but those sales were partially offset by reduced sales of copper-based products. While overall sales were comparable, we saw higher gross profit that drove about a $1 million increase in adjusted EBITDA. Gross profit increase was due to favorable product mix as well as production costs. And in our corporate area, expenses that we don't allocate to our business segments. Corporate expenses of roughly $11 million increased about $1 million over the prior year as we continue to invest in strategic initiatives for future growth.

Looking at capitalization, our gross leverage ratio of debt to trailing-12 EBITDA was 3.7x at September 30, 2020. We had $92 million of cash and short-term investments on the balance sheet at quarter end. And for the September quarter, we used $6 million of cash before financing, excluding the changes in short-term investments. And finally, we did pay and we'll pay another routine quarterly dividend. We paid one in September and have
declared another routine dividend to be paid in December of $0.12 a share, which in the aggregate, is about $4.9 million.

And now let me turn to our guidance for our December quarter. We continue to forecast only near term expectations, given the uncertainty of the future course of the pandemic and the ongoing difficult conditions in the industry. The animal production industry continues to recover from the effects of the pandemic. We believe industry conditions will continue to normalize as we progress through our fiscal year, and the industry gradually will return to typical operating levels.

Our expected financial results for the December quarter, for the 3 months ending December. Our net sales of approximately $205 million, resulting in net income of approximately $9 million, which then would be diluted earnings per share of $0.23 per share. And on an adjusted basis, adjusted EBITDA of $26 million, and that would result in adjusted diluted EPS of $0.28 per share.

We are encouraged by the improving trends in our business. Compared to our September quarter just ended and that we're talking about today, our expected December quarterly results, including net sales, adjusted EBITDA and adjusted diluted EPS are expected to increase quarter-over-quarter.

However, compared to the same period last year, our expected December quarterly results are lower than a year ago as our business continues to gradually recover from the effects of the pandemic. Most P&L lines will be below the year ago numbers as we've shown in the charts and in our press release. So that's the conclusion of our prepared remarks.

And operator, if you would then please open the line for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from David Westenberg.

Unidentified Analyst

This is John on for Dave. First, can you talk about how we should think about the African Swine Fever vaccine? Is this still a meaningful market? And are there any time lines that we should think about?

Jack Clifford Bendheim - Phibro Animal Health Corporation - Chairman, President & CEO

So thank you for the question. So African swine fever remains a major threat to growing pigs. As of this discussion, there are no successful African Swine Fever vaccines. So it's a significant market and a significant opportunity, and we continue to spend money on developing a vaccine for African Swine Fever.

Unidentified Analyst

Got it. And could you also please talk about COVID-19 in the developing markets, like even in the event of COVID-19 breakout, will those markets still stay resilient?

Jack Clifford Bendheim - Phibro Animal Health Corporation - Chairman, President & CEO

So I think what we're seeing -- what we all see in our own lives with COVID-19, so in most of the developed parts of the world, take the U.S. that we know. So the markets have adjusted, right? We're eating less in restaurants, but we most likely are eating better or more at home. So the protein market in the United States, pretty much, it is back to normal, back to where it was pre-COVID. I would say, similarly, in Europe. I think where we're seeing where we're seeing effect -- still negative effect is the economic uncertainties or damage caused by COVID-19 around the developing world.

So in countries where the economies have really suffered, typically in the Central America or the Far East, people have less money to spend. And when they have less money to spend, they're going to cut back on more expensive food. So that is -- that continues. And as we referred to it earlier, as
we see the second wave or third wave of COVID, it's really setting back development or sort of managing the results of the virus in many parts of the world.

Operator

Our next question comes from Kevin Kedra from G. Research.

Kevin Kedra - G. Research, LLC - Research Analyst

Thanks, Dick, and I wish you well on your retirement, and I appreciate all the work you've done with Phibro over the years and look forward to working with Damian going forward. So first, you mentioned some favorable timing benefiting the MFA business. I was just wondering if you put any sort of sizing around that and whether that was something we should think about as pull forward from fiscal Q2 or kind of more of a one-off type event?

And then secondly, you mentioned your pet strategy. You've kind of -- you mentioned that you may have more things to talk about
going forward. But can you at least give us a sense of -- if you're looking at that as kind of a purely external opportunity for expansion through business development or are there things that you're working on in-house that will allow you to get a stronger footprint in that market?

Jack Clifford Bendheim - Phibro Animal Health Corporation - Chairman, President & CEO

So let me take companion animals first. I think as we most likely discuss on these calls, we find ourselves in a unique position in the companion animal business. The unique position is that we're not in the business. I mean compared to all of our competitors who are heavily in that business with large sales forces and big R&D staff, and we're not. But what we find, and we've seen it in an increasing basis is that people come to us with new ideas because there's very few places to go.

So one result of that was Rejensa. I think it's moving successfully. We're hitting our targets, albeit not by getting into more clinics because as Dick said earlier, we're having problems getting into new clinics because of COVID. But the reorder level is higher than we had expected. And we're

starting to work and starting to invest in new products and new opportunities that we're seeing. I mentioned that we'll discuss it further maybe in the months ahead, but there are many opportunities for us to take products and that have been developed on the outside and bring it to market.

And that's a very exciting opportunity for us. It's hard to quantify yet, especially when in only one market one product, but this is a real opportunity for Phibro.

As far as the MFAs, a lot of it has to do with timing, a lot of it has to do with different products around the world, but that business is continuing. We're shifting some of the antibiotics, I would say, almost 100% into therapeutics. That's been a major shift for us. But the demand in the animals remain challenged by bacteria, and one of the best ways to solve that problem through MFAs or through antibacterials.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Yes. And on the timing question you had, Kevin. It wasn't a huge number, maybe a couple of million dollars. We called it out just because it did affect the comps a little bit. It's baked into what we told you we expected for our December quarter.

Operator

(Operator Instructions) The next question comes from Derik De Bruin from Bank of America.

Derik De Bruin - BofA Merrill Lynch, Research Division - MD of Equity Research

In for Mike Ryskin today. A couple of points. Can you talk a little bit about the SG&A spend? Obviously, you're expanding the sales force going with that. Can you talk a little bit more about operating expenses and how we see that playing out?

Jack Clifford Bendheim - Phibro Animal Health Corporation - Chairman, President & CEO

Well, I think as -- again, we've said it for a couple of quarters, notwithstanding the fact that the industries we have been selling into have been challenged, and we've faced a bunch of different hits with swine fever in China and market disruptions. We continue to work on developing various products and various product lines. And that will all sort of -- there are no products really being sold, it all sort of hits in the bucket of SG&A. So it's not only expansion of sales force and expansion of technical ability, it's investing in developing a range of products.

And as we are proven that with the vaccine device, to DFMs through Omnigen Pro, et cetera, et cetera, and that's the increase in SG&A.

Derik De Bruin - BofA Merrill Lynch, Research Division - MD of Equity Research

Got it. I and sort of how are you looking at FX trends for the December quarter?

Jack Clifford Bendheim - Phibro Animal Health Corporation - Chairman, President & CEO

Dick?

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Yes. I'd say we're looking at them to be roughly where they've been in recent months, not a lot of turbulence, but nothing -- no major changes from the current status.

Derik De Bruin - BofA Merrill Lynch, Research Division - MD of Equity Research

And could you talk about the pace of recovery by species? I mean, anything dramatically different in poultry versus cattle and dairy?

Jack Clifford Bendheim - Phibro Animal Health Corporation - Chairman, President & CEO

So let's just talk about the U.S. So I would say the poultry industry has sort of returned to pre-COVID level. I think pretty much the dairy industry has
also returned. I mean the swine industry still has some bottlenecks, mainly -- there was one big plant from Smithfield. They're still not operating at full capacity. It's operating, from what we hear, at 70, 80% capacity. So that's still causing some disruptions in the North Carolina area. But in the rest of the country, people have learned to manage with COVID and have brought the slaughter rates back again to where they were pre COVID.

Derik De Bruin - BofA Merrill Lynch, Research Division - MD of Equity Research

Got it. And I guess -- and was there any inventory build by any customers this quarter? And you saw some inventory draw down last quarter?

Jack Clifford Bendheim - Phibro Animal Health Corporation - Chairman, President & CEO

No. I think when COVID first hit back in March, and there was a lot of disruptions in transportation. People tried to put in more inventory, weren't sure what was going to happen with shipping, et cetera, et cetera. I think now people have been managing fairly well in these last few months, the last many months. So we're not seeing any inventory increases out of the normal.

Operator

(Operator Instructions)

There are no further questions at this time. I will now return the call to our presenters for final comments.

Richard G. Johnson - Phibro Animal Health Corporation - CFO

Well, excellent. Thank you very much, and thank you to everyone for your kind words, either on the call today or notes I've received. It's been a real pleasure working for Phibro and I wish you all the best as we move forward, and I thank everyone very much. So we will talk to you again in 90 days, and we'll talk about our December results. So thank you very much. And this is the end of the call. Thank you. Bye now.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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