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Phibro Animal Health Corp. (PAHC)

Q4 2021 Earnings Call

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PRESENTATION

Operator

Thank you for standing by, and welcome to the Phibro Animal Health Corporation Q4 2021 Conference Call. (Operator Instructions)

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

Damian Finio - Phibro Animal Health Corporation - CFO

Thank you, Rebecca. Good morning, and welcome to the Phibro Animal Health Corporation earnings call for our fourth quarter and year ended June 30, 2021. My name is Damian Finio, and I'm the Chief Financial Officer of Phibro Animal Health Corporation. I'm joined on today's call by Jack Bendheim, Phibro's Chairman, President and Chief Executive Officer; and Daniel Bendheim, Director and Executive Vice President of Corporate Strategy. On today's call, we will cover financial performance for the fourth quarter and our full fiscal year 2021 as well as guidance for our fiscal year ending June 30, 2022. At the conclusion of our opening remarks, we will open the line for questions.

I'd like to remind you that we are providing a simultaneous webcast of this call on our website, pahc.com. Also, on the Investors section of our website, you will find copies of the earnings press release and annual report on Form 10-K filed with the SEC yesterday as well as the transcript and slides presented on this call. 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 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 in our earnings press release for a discussion of these measures. 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. We present our results on a GAAP basis and on an adjusted basis. Our adjusted results exclude acquisition-related items, unusual, non-operational or nonrecurring items, including stock-based compensation and restructuring costs, other income, expense is separately reported in the consolidated statements of operations, including foreign currency gains and losses. And lastly, income tax effects related to pretax adjustments and unusual or nonrecurring income tax items.

Now let me introduce our Chairman, President and Chief Executive Officer, Jack Bendheim, to share his opening remarks, which will include his perspective on the fourth quarter, full year financial performance and guidance for our fiscal year 2022. Jack?

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

Thank you, Damian, and hello, everyone. I am pleased to announce that we ended our fiscal year strong, posting our fourth consecutive quarter of net sales growth and financial results ahead of our previously communicated projections.

Net sales for the quarter were up 19% versus a year ago, while full year sales were up 4%. Adjusted EBITDA for the quarter was up 13%, while full year adjusted EBITDA was up 6%. I would be proud of these numbers under any circumstances, but as we all know too well, the year ended June 30, 2021 was one filled with unprecedented challenges for our industry.

Quarantines, lockdowns and political unrest throughout the world drove input prices higher, prompted significant shipping delays and labor shortages, which required all of us to work that much harder and be that much more innovative. Our employees really stepped up, and I want to acknowledge their significant efforts, which enabled our organization to not only survive but grow during these turbulent times.

Our efforts to build a companion animal franchise are progressing. Sales of our canine growth joint care product, Rejensa, continued to grow, in fact, doubling again in the second half of the year. Our plan going forward is to continue working with our exclusive distribution partner while at the same time expanding our direct sales force in order to service veterinary clinics with the intent to double sales of Rejensa again in our upcoming fiscal year. And behind Rejensa, we completed a quarter of steady progress on our pet product development pipeline, specifically in terms of our dermacare and oral care product. We are optimistic these products will propel our growth in the mid- to long term.

We made significant efforts to better streamline our business and financial processes to strengthen our internal control framework. Although we've been in business since 1946, we went public in 2014. After running our business as a privately held company for new 70 years, coupled with the diversity and complexity of our product offering and geographic spread of our facilities, gaining compliance under the Sarbanes-Oxley Act of 2002 presented some challenges to our organization. But as you'll read in our annual form on Form 10-K filed yesterday with the SEC, our material weaknesses have been fully remediated, and we are now fully in compliance with the SOX Act.

Now let me share a few thoughts on the current state of the business and what we plan to deliver on our fiscal year ahead. Since the beginning of the global pandemic, our perspective and approach to managing the challenges it presented have not waivered. We continue to sell our products in over 80 countries across all species of feed animals. It's the diversity of our portfolio that enabled us to keep our business stable and on a path of modest growth. The most challenging conditions we face in the business are in those countries where the economies are struggling. We expect this variability by country to continue. In aggregate, we remain confident that the diversity of our portfolio will keep Phibro on a course of growth while we continue making investments in our future.

For our fiscal year 2022, we are projecting net sales in the range of $840 million to $870 million, which reflects growth of approximately 1% to 4% and adjusted EBITDA of $110 million to $114 million, reflecting about 2% to 6% growth. I'm excited that, despite our increased spend on future projects, we are in a position to lever our organization to see greater bottom line margin expansion.

Overall, it was a great quarter and a solid year all around. We are projecting top and bottom line growth next year despite the continued challenges of the pandemic.

Now let me hand the call back to Damian to go through these items in more detail. Damian?

Damian Finio - Phibro Animal Health Corporation - CFO

Thanks, Jack. Let me start with our consolidated financial performance for the fourth quarter ended June 30, 2021, versus the same quarter 1 year ago. Now keep in mind that quarter ending June 30, 2020, was the first full quarter impacted by the effects of COVID-19. Phibro, like most others in our industry, were navigating through a time when consumer demands were shifting and there were disruptions in the supply chain, ranging anywhere from labor shortages to shipping delays. And consequently, we posted lower-than-expected top and bottom-line performance. That said, on a consolidated basis, our fourth quarter financial performance was significantly ahead of the prior period.

Net sales increased 19%, driven by improvements across all 3 of our business segments, namely Animal Health, Mineral Nutrition and Performance Products. GAAP-based net income and diluted earnings per share were up 203% and 200% versus the same quarter a year ago. Although a portion of this significant improvement was attributable to higher sales and gross profit, it was also driven by a material swing in our provision for income taxes.

In the prior quarter, our financial results included unanticipated adjustments relating to federal Global Intangible Low-taxed Income tax expense, often referred to as the GILTI tax, coupled with incremental reserves needed to cover uncertain international tax positions. These tax-related adjustments recorded in the prior quarter were unfavorable to net income and earnings per share. Our current quarter results include similar tax-related adjustments. However, these more recent tax-related adjustments were favorable to net income and earnings per share, thus causing the large swing between the prior quarter and current quarter provision for income taxes.

After making our standard adjustments to GAAP results, including acquisition-related items, foreign currency movements and one-offs, such as the tax-related adjustments I just described, fourth quarter adjusted EBITDA, adjusted net income and adjusted diluted EPS were up 13%, 89% and 88%, respectively.

Turning to Slide 5, looking at the same financial metrics, but now for the full year. On a consolidated basis, our full year financial performance improved over the prior year. Net sales increased 4%, driven by stronger net sales performance for each of our 3 business segments. GAAP-based net income and diluted EPS for the full year were up considerably versus the prior year. Consistent with what drove the fourth quarter variance, the year-over-year variance was driven by sales and gross profit improvement as well as the delta between the tax-related adjustments I mentioned previously, offset partially by increases in SG&A costs on strategic investments and interest expense. Now let's dig a bit deeper in the fourth quarter and full year financial performance for each of our business segments.

On Slide 6, I'll start with fourth quarter financial performance for our largest segment, Animal Health, which is comprised of MFAs and other, Nutritional Specialties and Vaccines. Net sales of our Animal Health segment increased 20% versus the same quarter prior year. The increase in our Animal Health segment net sales is comprised of 3 components: first, the 26% increase in MFAs and other versus the prior quarter, driven by stronger demand across geographies and species; second, 18% growth in nutritional specialties, driven by strong domestic and international growth in dairy products; and third, the 1% improvement in vaccine net sales, driven primarily by growth in North America and Asia Pacific, offset partially by lower demand in Eastern Europe due to continuing economic challenges. In terms of profitability, Animal Health adjusted EBITDA was $29.5 million, which was consistent with the same quarter prior year as higher gross profits were offset by increases in SG&A costs.

Now on Slide 7, looking at full year financial performance of our Animal Health segment. Net sales for the full year increased 4% versus the prior year. The increase in Animal Health full year net sales was driven by a 2% increase in MFAs and other versus the prior year, primarily due to domestic growth in swine coupled with increased international sales in poultry. 10% growth in Nutritional Specialties, driven by domestic and international growth in dairy products, partially offset by lower demand in domestic poultry. And lastly, the 3% decline in vaccine net sales as domestic volume growth and increased demand in our Asia Pacific region was more than offset by challenging economic conditions in Eastern Europe.

In terms of profitability, Animal Health adjusted EBITDA was $124 million, up 1% in comparison to the prior year, driven by increased gross profit, offset partially by higher SG&A costs.

Moving on to fourth quarter financial performance for our other segments on Slide 8. Mineral Nutrition net sales for the fourth quarter were $56.8 million an increase of 14% versus the same quarter prior year, driven by favorable product pricing correlated with the movement of the underlying raw material costs. Mineral Nutrition adjusted EBITDA was $4.7 million, an increase of 34%, driven by increased gross profit on favorable customer and product mix, and the adjusted EBITDA margin for the quarter was 8.2%, an improvement of 130 basis points versus a year ago.

Our Performance Products segment continued to perform well, finishing the year strong. Net sales of $16.7 million for the three months ended June 30, 2021, reflects an increase of 23% over the same quarter prior year, driven by strong demand for copper-based products and favorable product pricing correlated with the movement of the underlying raw material costs. The increased gross profit drove $2.3 million of adjusted EBITDA for the quarter, a 216% increase versus prior year and an adjusted EBITDA margin of 13.6%, also an improvement from 1 year ago.

Lastly, corporate expenses decreased 4% versus the same quarter prior year due to savings and SG&A costs, driven by lower professional fees, partially offset by incremental investments in our future and an increase in employee performance-based incentives.

Now looking at full year financial performance for these segments on Slide 9. Mineral Nutrition net sales for the full year were $220.6 million, an increase of 3% versus the prior year, driven by favorable product pricing correlated with the movement of the underlying raw material costs.

Mineral Nutrition adjusted EBITDA was $17.1 million, an increase of 17% driven by increased gross profit on favorable product mix. Adjusted EBITDA margin for the quarter was 7.8%, an improvement of 100 basis points versus a year ago.

Our Performance Products segment had a great year. Net sales of $67.1 million for fiscal year 2021 reflects an increase of 14% over the prior year, driven by stronger demand and increased volume of copper-based products sold. The increased gross profit drove $9.4 million of adjusted EBITDA for the quarter, a 108% increase over the prior year and an adjusted EBITDA margin of 14.1%, an improvement of 640 basis points.

Lastly, corporate expenses increased 6% versus prior year, driven by incremental investments in our future, employee performance-based incentives, professional fees and IT-related expenses offset partially by lower travel due to COVID-19-related restrictions.

Turning to key capitalization-related metrics on Slide 10. Our business provided nearly $30 million of cash before financing activities for the full year. Our gross leverage ratio, which is calculated by dividing total debt of $393 million by trailing 12-month adjusted EBITDA of $108 million has been stable and sits at 3.6x at year-end. In terms of liquidity, we had $245 million available at year-end. This includes cash and short-term investments of $93 million and $152 million of unused and available revolving credit, reflective of the incremental credit secured when we amended our loan agreement on April 22, 2021. Now please note, the accessibility of available revolving credit is subject to leverage ratio limitations, which are outlined in the loan agreement. And lastly, consistent with the past several quarters, we announced a quarterly dividend of $0.12 per share or $4.9 million. That concludes our perspective on both fourth quarter and full year financial performance.

So, let's turn our attention to fiscal year 2022 financial guidance on Slide 11. For fiscal year 2022, despite the lingering uncertainties and country-by-country variability relating to COVID-19, we are projecting net sales in the range of $840 million to $870 million, which reflects a growth rate of approximately 1% to 4%. These projections assume growth for each of our 3 business segments but driven primarily by Animal Health. We are projecting adjusted EBITDA in the range of $110 million to $114 million, which reflects a growth rate of 2% to 6% despite an approximate $20 million increase in SG&A, about half of which is earmarked for planned incremental fiscal year 2022 spend on future investments. Future investments include research and development projects as well as other strategic initiatives.

Net income and diluted earnings per share are projected to decline 14% to 17% in comparison to fiscal year 2021 due primarily to the favorable one-off tax items recorded in the fourth quarter of fiscal year 2021, which our fiscal year 2022 guidance assumes will not be repeated. This leads to an adjusted net income in the range of $50.7 million to $53.3 million and a projected adjusted diluted earnings per share in the range of $1.25 to $1.32, both of which reflect an improvement of up to 4% at the high end of the range or a decline of 1% at the low end of the range. Net income and earnings per share guidance, both on a GAAP and adjusted basis implies a return to a more normalized effective tax rate ranging from 29% to 31%.

Just to give you a bit more color on what's driving our net sales growth projections for our Animal Health segment, keeping in mind that COVID-19 variants remain a risk, let me share 3 assumptions. One, we will drive growth in nutritional specialties by expanding our existing portfolio and further leveraging our 2019 acquisition of Osprey. This will enable us to penetrate the microbials market and identify opportunities to better integrate Osprey's capabilities into the broader Phibro business.

Two, our plan is to drive growth in our vaccines business by bringing new products to the market and expanding our sales efforts into new markets, replacing distributor sales models with direct sales strategies where possible and seeking opportunities to recover in those geographies facing economic challenges that hampered our efforts in fiscal year 2021.

And three, we intend to maintain our position in the Medicated Feed Additives global market. Our guidance assumes an increase in operating expenses of about $20 million or 10% year-over-year. Roughly half of the increase relates to planned incremental spending on future investments, which include, but are not limited to, efforts to progress our pipeline of companion animal products, develop a vaccine for African swine fever, the ongoing registration of products in new markets and the continued build-out of our vaccine facility in Sligo, Ireland. We expect our first product registration for the Sligo facility to be issued towards the end of our fiscal year 2022.

Lastly, our plans include an approximate $8 million or 30% increase in capital expenditures, part of which relates to carryover projects from our last fiscal year, while the remainder relates primarily to further investments to increase our vaccine manufacturing capacity. And consistent with prior years, with the exception of last year, which was impacted by COVID, due to the seasonality of our portfolio, we expect a decline in our upcoming first quarter top and bottom line financial performance relative to the fourth quarter of the prior fiscal year.

So in summary, our fiscal year 2022 financial guidance is as follows: Net sales of approximately $840 million to $870 million; net income of approximately $45 million to $47 million; diluted earnings per share of approximately $1.11 to $1.16; adjusted EBITDA of approximately $110 million to $114 million; adjusted net income of approximately $50.7 million to $53.3 million; and lastly, adjusted diluted EPS of approximately $1.25 to $1.32.

That concludes our opening remarks. Rebecca, could you please open the line for questions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Katie Tryhane with Credit Suisse.

Katie Anne Tryhane - Crédit Suisse AG, Research Division - Research Analyst

Can you just maybe expand a little bit further about some of the demand trends across species, including poultry, swine and dairy domestically, and how to think about those or what's embedded in your guidance for fiscal year 2022?

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

Thanks for the question. As we look towards our next fiscal year, we are still seeing sort of a renewed world of COVID. I mean our initial thoughts towards the end of our fiscal year 2021, was that this thing was sort of in hand pretty much. But we've seen what's going on with the Delta strain and it's increased our concern and definitely what we see in the business environment around the world.

In the U.S., interestingly enough, we're sitting with the highest population of dairy cows than we have since 1994. So, it's about 9.4 million dairy cows where -- historically, in many years, we kept talking around 9.0 million, 9.1 million.

We're seeing the poultry business being strong. Export demand being good and again talking domestically. And again, the same thing for the swine business. All of our customers in United States are making money. Around the world, it's a mixed bag. Damian mentioned the COVID-related economic problems in Eastern Europe, also same thing in South America. So it's -- our outlook has been really sort of tempered a bit by the pandemic, but we see continuing strong underlying demand for the business, and that's really the basis for these numbers.

Katie Anne Tryhane - Crédit Suisse AG, Research Division - Research Analyst

Okay. Got it. That's great. And then maybe on Rejensa, I know you mentioned that sales doubled, but can you help us understand, I mean, how has that product trended relative to your internal expectations? And perhaps maybe what have been some key learnings spend as you've entered the companion animal market?

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

It's Dani speaking. So, I think Rejensa has largely met our expectations for the past year. Truthfully pre-pandemic, we were going at a faster clip as access to the vet was limited and has remained somewhat limited. Our growth slowed relative to our initial expectations, but it's been consistently growing throughout the last 12 months. And as we discussed in our guidance, we expect it to double again in the next 12 months.

As far as our learnings, it's probably hard to draw lessons from the current time period. But clearly, getting access to the vet is the challenge, and there's multiple ways to do it, and we're still figuring out for ourselves the best way.

Right now, we're working with an exclusive distributor, and we're happy and pleased with the access to distributors for the most part. But we are also, at the same time, adjusting and increasing the number of our direct sales reps who are working with our distributor, and that will be a trend that will continue. And truthfully, it sets us up the years to come, with spending on the product portfolio, we will have a larger footprint on the ground to sell those products.

Operator

(Operator Instructions) Your next question comes from the line of Michael Ryskin with Bank of America.

Michael Leonidovich Ryskin - BofA Securities, Research Division - Associate

I want to follow up a little bit on sort of the outlook in Animal Health. Could you give us a little bit more insight into your expectations for next year between MFAs and other between Nutritional Specialties and Vaccines? Is it safe to assume that Nutritional Specialties, Vaccines are back to that historical sort of high single-digit, maybe 10% range, and MFAs and other is more of a low single-digit 2% to 3% result next year, just sort of putting all the pieces together?

Damian Finio - Phibro Animal Health Corporation - CFO

Let me start, Michael. So as I mentioned, on a consolidated basis, our sales growth next year ranges from 1% to 4%, which I would say reflects general market growth in the animal protein industry globally .

I also mentioned that it's Animal Health driving those growth numbers. So within our Animal Health segment, we have MFA and other, Nutritional Specialties and Vaccines. We see the majority of the growth coming from the nutritional specialty and vaccine product lines. Nutritional Specialties, we expect to be fueled with some of the items mentioned - our acquisition of Osprey and some other products recently launched. And in Vaccines, we hope to recover in some of those markets where we saw economic challenges in 2021 and by launching some new products and expanding the products into new markets as well.

Michael Leonidovich Ryskin - BofA Securities, Research Division - Associate

Okay. Okay. That's helpful. And then on the gross margin line, you saw some nice gains this quarter. I think a lot of that was probably an impact of the underlying commodity pricing in Mineral Nutrition and in Performance Products. Do you anticipate gross margin to sort of continue along that trajectory next year? Could you give us any sense on sort of your assumptions around COGS, also keeping in mind inflationary pressures, everything else going on in the broader economy?

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

As we put out these numbers, as I was sort of saying earlier, the challenges we face -- generally, we feel gross margins should improve. The unknowns are the commodity price increases we're seeing around the world. The usual situation was shipping and freight costs in some way is tripling, quadrupling and what impact that will have, and our ability to pass that on, we will do it, but it's going to be a struggle.

So, in a normal year, I would say the answer is yes. The margins will increase. We would see the 10% or greater percent in sales growth in vaccines and in nutritionals and the lower growth in the MFAs. But it's still an upside down market out there.

And we still have not had the ability in many countries to sit in front of the customer. Things are still going a bit of long distance. So the information is slower. But overall, underlying growth is there. And we see it returning to trend whether it will completely return in this year fiscal year, I'm not sure, but definitely returning.

Operator

And at this time, there are no further questions.

Damian Finio - Phibro Animal Health Corporation - CFO

All right. Thank you, Rebecca. Thank you again to our employees for delivering such a strong financial performance in fiscal year 2021. And thank you everybody on today's call for your time, attention, questions, and interest in Phibro Animal Health Corporation. Please enjoy these last day of the summer and let's all be diligent about keeping ourselves and one another safe. Thank you, and have a great rest of your day.

Operator

Thank you for participating. This concludes today's conference call. You may now disconnect.

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