

# Phibro Animal Health Corp.

(PAHC) Q2 2022 Earnings Call

February 10, 2022

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10-February 2022

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## CORPORATE PARTICIPANTS

Damian Finio Phibro Animal Health Corporation - CFO

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

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

## CONFERENCE CALL PARTICIPANTS

Erin Elizabeth Wilson Wright Morgan Stanley, Research Division - Equity Analyst

Michael Leonidovich Ryskin BofA Securities, Research Division - Director in Equity Research & Research Analyst

## PRESENTATION

Operator

Good morning. My name is Shantel, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Phibro Animal Health Corporation Second Quarter 2022 Conference Call. (Operator Instructions)

Damian Finio, CFO, you may begin your conference.

Damian Finio - Phibro Animal Health Corporation - CFO

Thank you, Shantel. Good morning, and welcome to the Phibro Animal Health Corporation Earnings Call for the quarter ended December 31, 2021, which is the second quarter of our fiscal year 2022. My name is Damian Finio, and I'm the Chief Financial Officer of Phibro Animal Health Corporation. I'm joined on this call today 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'll cover financial performance for our second quarter as well as a revised financial guidance for our fiscal year ending June 30, 2022. At the conclusion of our opening remarks, we will open the lines 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 the second quarter Form 10-Q filed with the SEC yesterday as well as the transcript and slides discussed and 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, nonoperational or nonrecurring items, including stock-based compensation and restructuring costs. Other income and expenses as separately reported in consolidated statements of operations, including foreign currency gains or losses net. And lastly, income tax effects related to pretax adjustments and unusual or nonrecurring income tax items.

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Now let me introduce our Chairman, President and Chief Executive Officer, Jack Bendheim, to share his opening remarks, which will include his perspective on Phibro's second quarter financial performance and a revised financial guidance for our fiscal year 2022. Jack?

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

Thank you, Damian, and good morning, everyone.

We had a strong second quarter. In fact, we posted \$233 million of net sales, the highest single quarter of sales in the company's history. This was an 8% increase over last quarter and a 13% increase over the same quarter of the prior year.

As we discussed on our last call, in light of the rising cost to do business over the course of the last few months, we have taken stronger steps to raise prices and pass-through incremental freight costs. This is reflected in our performance this last quarter, where in our core Animal Health segment, we saw our margin improve each month over the previous month, and we expect it to continue to play out positively over the balance of fiscal year.

Notwithstanding our pricing actions, we saw continued strong demand for our products globally, and we expect this trend to also continue for the balance of this fiscal year.

Our largest segment, Animal Health, posted sales growth of 11% over the same quarter of prior year, driven by continued strong growth in our vaccine product line, but also a 12% growth in the MFAs and other. And Mineral Nutrition seems to perform well, posting a net sales increase over the prior quarter of 23%.

Strong top line sales drove adjusted EBITDA of \$29.1 million, reflecting a 2% improvement over the same quarter period last year. More importantly, this equates to a second quarter adjusted EBITDA margin of 12.5%, which is a 200 basis point improvement versus last quarter and just 40 basis points shy of our fiscal year 2021 adjusted EBITDA margin of 12.9%.

Given our first half performance and outlook for the remaining of the fiscal year, we are raising full year net sales guidance for a second time. We're now projecting net sales for the year of \$890 million to \$920 million. We are maintaining our adjusted EBITDA guidance of \$110 million to \$114 million and raising our guidance on adjusted net income and adjusted diluted EPS by about 5%, driven by the favorable change in our projected adjusted effective tax rate.

Lastly, I've said it before and unfortunately need to say it again, COVID-19 variants remain a risk. The Omicron variant has created scheduling challenges with the higher-than-normal number of employees having to quarantine. We seem to be through the worst of it and we remain optimistic that Phibro will continue to navigate the situation successfully as we've done in the past.

Now let me ask Damian to review our financial results, and then we will come back to answer your questions.

Damian Finio - Phibro Animal Health Corporation - CFO

Thanks, Jack. I'll start with consolidated financial performance on Slide 4 and then cover segment level performance, key balance sheet metrics and conclude with a review of our revised financial guidance for the full fiscal year 2022.

The Consolidated net sales for the quarter ended December 31, 2021, were \$232.7 million, reflecting a \$26.6 million or 13% increase over the same quarter 1 year ago. This increase was driven by improvements in our largest segments, Animal Health and Mineral Nutrition, offset slightly by a \$0.6 million sales decline in our Performance Products segment.

GAAP-based net income and diluted earnings per share increased 36% and 34%, respectively, versus the same quarter a year ago. The net income increase was driven by stronger volumes and selling prices, partially offset by increases in raw material costs and unfavorable product mix as well as a \$4.8 million increase in foreign currency gains, offset by a \$2.8 million increase in income tax expense reported below operating income.

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Although it was good to see a foreign currency gain this quarter, volatility in foreign currency exchange rates continues. For Phibro, the impact is primarily driven by the effect of translating intercompany balances to the U.S. dollar for reporting purposes at the end of the reported period.

After making our standard adjustments to GAAP results, including acquisition-related items, foreign currency movements and one-offs, second quarter adjusted EBITDA improved 2% over the same quarter prior year. The adjusted EBITDA improvements were driven by higher gross profit in our Animal Health and Mineral Nutrition segments, offset by higher SG&A and a decline in the profitability of our Performance Products segment.

Adjusted net income and adjusted diluted earnings per share improved 9%, driven by higher gross profit from an increase in volumes and average selling prices partially offset by increased SG&A due to the intentional incremental spend on strategic investments.

Moving to segment level financial performance on Slide 5. I'll start with second quarter financial performance for our largest segment, Animal Health, which includes 3 product lines, namely MFAs and other, nutritional specialties and vaccines. Net sales of our Animal Health segment were \$150.9 million, which represents an increase of \$14.7 million or 11% versus the same quarter prior year.

Within the Animal Health segment, we reported a \$10.1 million or 12% increase in MFAs and other versus the same quarter prior year, driven by stronger demand in North and South America, reflecting continued recovery from the effects of the pandemic. Processing aids used by producers of ethanol, distillers corn oil and distillers grain products contributed \$3.5 million of the \$10.1 million increase.

We also had a \$0.9 million or 3% growth in nutritional specialties, driven by increased selling prices and volumes as well as increased revenues of our companion animal product, Rejensa. And lastly, a very strong \$3.6 million or 20% improvement in vaccine net sales, driven by increased domestic and international volumes.

In terms of profitability for the Animal Health segment, adjusted EBITDA was \$33.7 million, a modest increase of 1% over the same quarter prior year, driven by higher gross profit and offset partially by an increase in SG&A expenses.

Moving on to second quarter financial performance for our other business segments on Slide 6, starting with Mineral Nutrition. Net sales for the first quarter were \$66.7 million, an increase of \$12.5 million or 23% versus the same quarter prior year, driven by higher average selling prices of trace minerals correlated with the movement of the underlying raw material costs.

Mineral Nutrition adjusted EBITDA was \$5.5 million, an increase of \$1.3 million or 32% and reflects an improvement in adjusted EBITDA margin of 60 basis points, driven by increased gross profit derived from the higher average selling prices.

Looking at our Performance Products segment. Net sales of \$15.1 million for the 3 months ended December 31, 2021, reflect a decline of 4% from the same quarter prior year as a result of lower average selling prices and lower volumes, primarily related to shipping delays in copper-based products, partially offset by higher sales of personal care product ingredients.

Adjusted EBITDA was \$1.3 million, a decrease of \$0.9 million, driven by higher material and production costs. Lastly, corporate adjusted EBITDA declined 2% or said differently, corporate expenses increased 2%. As I've mentioned on previous calls, this is intentional and expected as the change is driven by the incremental increase in strategic investments.

Turning to key capitalization-related metrics on Slide 7. Free cash flow for the 12-month period ending December 31, 2021, comprised of \$44 million of operating cash flow less \$30 million of capital expenditures, was \$14 million.

Our gross leverage ratio calculated by dividing total debt of \$401 million by trailing 12-month adjusted EBITDA of \$107 million was 3.8x at the end of the second quarter, which is consistent with the end of the prior quarter.

In terms of liquidity, we had \$235 million available at December 31, 2021. This includes cash and short-term investments of \$95 million and \$140 million of unused and available revolving credit.

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As a reminder, the accessibility of available revolving credit is subject to leverage ratio limitations outlined in the loan agreement.

And lastly, consistent with the past several quarters, we paid a quarterly dividend of \$0.12 per share or \$4.9 million in aggregate.

That concludes my opening remarks on the second quarter financial performance. In summary and to further reinforce what Jack stated earlier on the call, we posted strong second quarter financial performance, driven by the highest sales reported in a single quarter since our inception.

This is encouraging evidence of the strong demand for our products and the beginning of the positive impacts resulting from actions we've taken to adjust price and pass through incremental freight costs. We anticipate further margin improvement through our fiscal year-end June 30 because of these actions.

Before I close, however, I would like to share how we're thinking about the second half of our fiscal year and our second raise to the full year guidance. Please turn to Slide 8.

As Jack mentioned earlier, our adjusted EBITDA margin for the second quarter reflected a 200 basis point increase from the first quarter, and it was just 40 basis points shy of what we realized in fiscal year 2021. Given the top line growth we've realized and what we project, coupled with the improvements in adjusted EBITDA margins realized and expected to continue, we are raising full year sales guidance by \$30 million on both the low and high end of the range.

Said another way, from our last guide of \$860 million to \$890 million, up to our revised guidance of \$890 million to \$920 million. This represents an increase of about 3% from our prior guidance for the full fiscal year.

In terms of adjusted EBITDA, with \$52 million reported in the first half, we are maintaining our adjusted EBITDA guidance of \$110 million to \$114 million for the full year, which implies a projected adjusted EBITDA in the range of \$58 million to \$62 million in the second half of our fiscal year 2022.

From an adjusted EBITDA margin perspective, the \$58 million to \$62 million of projected second half adjusted EBITDA reflects an improvement over the first half, bringing margins roughly back in line or above what the business delivered in the prior two fiscal years.

Lastly, we are raising guidance on adjusted net income and adjusted diluted earnings per share, given a favorable change to our projected adjusted effective tax rate, driven by a shift in jurisdictional mix of taxable earnings. Given what I mentioned earlier about the positive impacts resulting from actions we've taken and our projected strong second half performance, we are confident that the current momentum of the business can deliver this revised guidance.

So in summary, our revised fiscal year 2022 guidance is as follows: net sales of \$890 million to \$920 million, which is an increase from the \$860 million to \$890 million last communicated; adjusted EBITDA of \$110 million to \$114 million, which, as I said, was unchanged from previous guidance; adjusted net income of \$52.8 million to \$56.4 million, which is an increase from the \$50.7 million to \$53.3 million, last communicated; adjusted diluted earnings per share of \$1.30 to \$1.39, which is an increase from the \$1.25 to \$1.32 in our last guidance; and an adjusted effective tax rate of 26% to 27%, which is an improvement from the 29% to 31% assumed in our prior guidance for the full fiscal year.

Overall, a strong second quarter, very solid first half, and we are projecting an even stronger second half to close out the full year.

That concludes Jack and my opening remarks. Shantel, if you could please open the lines for questions.

## QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Erin Wright with Morgan Stanley.

Erin Elizabeth Wilson Wright - Morgan Stanley, Research Division - Equity Analyst

Can you speak to the magnitude of the price increases you were able to take in the quarter? What's embedded in your expectations for the balance of the year? And are you seeing any pushback? Or what's the feedback from a customer perspective? And how does the strategy or your strategy compared to your competitors out there?

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

Let me take the second half first, Erin. I think I saw this morning something that inflation was up 7%. So we're living in a time where everyone is seeing higher prices. And so the pushback on price increases are less than it would be in a normal time.

Everyone's seeing it in wherever they're going. And so we've been able to increase our prices. It's -- I would say, it's not over because if inflation continues and our costs go up, we will have to and we will raise prices again. But to the exact amount, we're not going to talk about.

Erin Elizabeth Wilson Wright - Morgan Stanley, Research Division - Equity Analyst

Okay. And then excluding the pricing dynamics from a volume perspective, how are trends and demand trends progressing here with macro dynamics hopefully subsiding? If you could speak to that across species groups globally and which species groups may be better positioned over the next 12 months?

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

That's a great broad question. We are seeing strong demand in most business segments and in pretty much all markets. I mean, some of the markets that are still being hit with COVID, clearly, demand has not come back as rapidly as in other markets. But in the major markets we deal with in North America, South America and the Far East, we are seeing demand increase across all species.

Erin Elizabeth Wilson Wright - Morgan Stanley, Research Division - Equity Analyst

Okay. And just one quick one, if I could sneak it in. The \$3.5 million benefit to the MFA category, is that something that continues here or was embedded in expectations for the balance of the year?

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

And is that specifically talking about the sales for ethanol?

Erin Elizabeth Wilson Wright - Morgan Stanley, Research Division - Equity Analyst

Yes, yes.

Daniel Bendheim - Executive VP of Corporate Strategy & Director So, ethanol sales are products or coproducts that produce ethanol processing aid products that we sell throughout animal health, that's an ongoing business. And that's a business that has continued to strengthen year-over-year and it's an international business for us and one that we continue to see great horizons for.

Operator

(Operator Instructions) Our next question comes from Michael Ryskin with Bank of America.

Michael Leonidovich Ryskin - BofA Securities, Research Division - Director in Equity Research & Research Analyst

Jack, I want to ask first on some recent news we've seen in the space. The bird flu the avian flu outbreaks in the United States, I think just yesterday, it was detected in a commercial port for the first time in a couple of years. We've gotten a lot of questions on this. And given you have relatively high poultry exposure, I'm just wondering if you could characterize the risk? Obviously, still very early, but sort of walk us through the various scenarios and how you think that play out over the rest of the year?

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

So avian influenza is a big risk to the poultry industry. So -- and the response to it, I mean how it affects us, really depends on the country. The U.S. is always well prepared for any outbreaks because we have really good biosecurity. We have good protocols of what you do when you detect it, and what you do to sort of clean out the area around it to minimize what will happen.

Some other countries in the world are not as good. So it is out there. It so far has not had a big impact on the business.

Michael Leonidovich Ryskin - BofA Securities, Research Division - Director in Equity Research & Research Analyst

Okay. Okay. And then a follow-up question on Mecadox. Last month, you noted that there's going to be a public hearing with the FDA in mid-March. Obviously, Mecadox has been sort of an issue for a number of years now. Can you talk about any recent dialogue with the agency sort of what are your expectations? And what's your outlook going into the hearing?

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

I think the dialogue is the fact that the agency published this public hearing to focus on areas that we're quite comfortable with focusing on - areas of looking for the safety of this product, which has been on the market, as we know, for 50 years, which is used by over 90% of the feed producers in the United States, in nurseries, and is an extremely important product.

The other sort of interesting thing is the use of Mecadox or carbadox allows the producer to use a lot less antibiotics - that is important for humans. So we're sort of in an interesting dynamic where there are some people in the agency who feel, "Hey, let's get this product off the market, it's been around for 50 years."

But the agency and people in this country and the consumers have spent so much time and so much effort to try to reduce the amount of, call it, human antibiotics that are used in animals, and that's a dash. So, we're appreciative of the agency sort of opening up and looking for this public hearing. And -- but as you know, we never know where the government goes.

Michael Leonidovich Ryskin - BofA Securities, Research Division - Director in Equity Research & Research Analyst

Okay. Great. And if I could squeeze in one last one, just a follow-up to something Erin just asked earlier. I want to make sure I get it right. On the price increases in the past, you've sort of been careful to call out that a lot of it is freight surcharges and therefore, somewhat temporary in nature.

Is it still safe to assume that -- assuming at some point in the future inflation normalizes a little bit that those price increases are going to be rolled back and we're going to go back to sort of a historical pricing?

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

So we've been -- as we said often in the past, we produce the majority of products we sell. And we've been sort of hit with a range of price increases. Everyone knows and reads about the shortage of labor.

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We've seen labor price increases. We've seen raw material price increases. And those are things that we pass along and that will not get rolled back. We've also seen, and what you read, great stories about the shortage of truck drivers in the United States and freight increases.

So in our industry, in many industries, it's not abnormal to see some turn to a freight surcharge, which as long as those costs are up, you easily can pass those costs on as everyone is seeing them. So yes, if prices of trucking goes back down, then yes, the prices will go back down, but our costs will go down too. The main thing on a price increase is to cover your increased costs that don't go away, and we've done both.

Operator

There are no further questions at this time. Damian, I turn the call back over to you.

Damian Finio - Phibro Animal Health Corporation - CFO

Great. Thank you, Shantel, and thank you, everybody, who joined today's call. As always, we appreciate your time, attention, questions and interest in Phibro Animal Health Corporation. As always, feel free to reach out to Jack, Dani or myself directly or via the Investors section of our website, should you have any further questions. Have a great rest of your day, and please continue to stay safe.

Operator

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

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