Phibro Animal Health Corporation
(PAHC) Q1 FY2024 Earnings Call
November 9, 2023

Correct Transcript

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Q1 FY2024 Earnings Call

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Call Participants

EXECUTIVES

Richard G. Johnson
Interim Chief Financial Officer

Jack Clifford Bendheim
Chairman, President & CEO

Daniel M. Bendheim
Executive VP of Corporate Strategy & Director

ANALYSTS

Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

Linda H Bolduc
Morgan Stanley, Research Division

Michael Leonidovich Ryskin
BofA Securities, Research Division

Mikaela Lee Franceschina
Barclays Bank PLC, Research Division

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Presentation

Operator

Hello, and thank you for standing by. My name is Regina, and I will be your conference operator today. At this time, I would like to welcome everyone to the Phibro Animal Health Corporation FY 2024 Earnings Conference Call. [Operator Instructions]

I would now like to turn the conference over to Dick Johnson, Chief Financial Officer. Please go ahead.

Richard G. Johnson
Interim Chief Financial Officer

Well, thank you, Regina, and good morning to everyone, and welcome to Phibro's earnings call for our fiscal first quarter ended September 30. My name is Dick Johnson. I'm the Chief Financial Officer of Phibro Animal Health Corporation. I'm joined today on the call by Jack Bendheim, Phibro's Chairman, President, and Chief Executive Officer; and also, by Daniel Bendheim, Director, and Executive Vice President of Corporate Strategy.

Today, we'll cover financial performance for our first quarter and provide an update on our financial guidance for our full fiscal year ending June 2024. At the conclusion of our opening remarks, we'll open the lines for your questions.

I'd like to remind you that we're providing a simultaneous webcast of this call on our website, pahc.com, and also on the Investors section of our website. Later today, you will find copies of the earnings press release and the first quarter Form 10-Q filed with the SEC yesterday as well as the slides and transcript from our presentation this morning.

Turning to Slide 2, just the standard disclaimers. 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; other income or expenses separately reported in the consolidated statement of operations, primarily foreign currency gains and losses; and the income tax effects related to any of those pretax adjustments plus any unusual or nonrecurring income tax items.

Now let me introduce our Chairman, President and Chief Executive Officer, Jack Bendheim, to share his perspective on Phibro's first quarter financial performance and the outlook for our fiscal year 2024. Jack?

Jack Clifford Bendheim
Chairman, President & CEO

Thank you, Dick. Good morning, everyone, and thank you for joining us today.

Our first quarter had some strong positives despite the overall disappointing results. Our core Animal Health business grew sales at a healthy 4%. And I was especially pleased to see that some of the measures we have taken to counteract margin erosion helped the Animal Health EBITDA grow at an even faster rate of 6%. We saw growth across all 3 product categories in Animal Health, led by 14% growth in vaccines. We are seeing increased uptake of our vaccines across multiple regions, but especially in

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South America where we have launched several new commercial vaccines, as well as have opened a new autogenous vaccine facility in Brazil.

We are continuing to invest behind our successes. We're looking to introduce additional vaccines in the Americas and have just recorded our first sales of a new line of nutritional specialty products for U.S. poultry producers. We see vaccines and nutritional specialties as double-digit annual opportunities for the short and medium term, and we are making the necessary investments to enable us to achieve our targets. We are also continuing to support our other initiatives such as companion animal. But considering the challenging macro environment, we are targeting ways to curtail or delay some of the spend.

As mentioned, we are in a challenging macro environment. Our Mineral Nutritional business has seen revenue drop and margins drop even more as we have recently been on the wrong side of commodity price movements and some inventory positions. While we anticipate our margins returning to more historical levels as we progress through the fiscal year, volumes could take longer to recover.

Similarly, we see weaknesses in some of the other end markets, including dairy in the U.S. and China and our feedlot businesses in Latin America. Finally, the horrific terrorist attacks in Israel a month ago and the subsequent war have increased the costs relating to our operations in Israel. We have confidence in our ability to meet our supply commitments to customers. For all these reasons, we have decided to lower our guidance for the remainder of this fiscal year, as Dick will go into in greater detail at the end of his presentation.

Before I hand it back to Dick, I want to touch on the FDA's most recent action relating to Mecadox. The FDA has been targeting Mecadox for close to a decade. Mecadox is a very important product for swine producers to help keep baby piglets healthy during the critical early period of their lives. It's been safely sold in the United States for over 50 years and continues to be available and to be used. We will continue to support this product and defend our customers' ability to use it. We are extremely confident in its safety and efficacy.

With that, I look forward to hearing your questions following Dick's review of our financials.

Richard G. Johnson
Interim Chief Financial Officer

Thanks, Jack. Well, let me start with the consolidated financial performance on Slide 4, then move on to segment-level performance and other factors, and I'll conclude with a review of our updated financial guidance.

Our consolidated net sales for the quarter ending September were about $231 million, reflecting a decrease of $1 million or 1% compared with the same quarter a year ago. As Jack mentioned, the Animal Health segment saw a nice increase, while both Mineral Nutrition and Performance Products decreased from the year earlier.

GAAP-based net income and diluted earnings per share decreased, driven in part by higher SG&A expenses and notably by a $10.4 million charge for pension settlement cost. We also saw increased interest expense due primarily to higher rates, some increased foreign exchange losses, all of which were partially offset by reduced income tax provision.

Our first quarter adjusted EBITDA was $18.7 million. That was a decrease of $3.5 million. Within that, Animal Health increased $1.5 million due to sales growth and favorable gross margins, which was partially offset by higher spending and SG&A. Mineral Nutrition decreased $2.4 million at the EBITDA line due to lower sales and higher costs.

Performance Products dropped about $1 million compared to last year at the EBITDA line due to lower sales driving gross profit down. And finally, corporate expenses increased $1.6 million year-over-year due to increased strategic investments, some of which was timing and also higher employee-related costs.

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At the adjusted net income and adjusted diluted EPS lines, we saw adjusted EPS of $0.14. That was down 1/3 from a year earlier, driven primarily by higher SG&A expenses. Just as a reminder, the large one-off pension charge is not included in adjusted net income but driven by other SG&A spending and higher interest expense, partially offset by reduced income taxes.

So now if we move to segment-level financial performance, our first quarter performance of our largest segment, Animal Health. Animal Health segment posted $160 million of sales for the quarter. That was an increase of close to $6 million or 4%. And within that sales increase, we saw, as Jack pointed out, a better than $3 million increase or 14% growth in vaccine net sales. The increase was driven primarily by poultry product introductions in Latin America and also growth in the U.S. swine sector, but there was some offset -- a partial offset due to timing of deliveries in other international regions.

In nutritional specialties, we saw a growth of about $1 million or 3%. And there, it was driven by increased volumes in poultry products, primarily in the U.S. domestic market. And finally, MFAs and other increased about $1 million or 1%, and that increase was driven by increased sales of processing aids used in the ethanol fermentation industry.

In terms of profitability for the segment, Animal Health adjusted EBITDA was $28.5 million, up 6% from the same quarter a year earlier and a 30-basis point improvement in adjusted EBITDA margin due to the improved gross profit in the segment.

Moving on to first quarter financial performance in our other business segments on Slide 6 and starting with Mineral Nutrition. Net sales were $56 million, down about $3.5 million or 6% versus the same quarter last year. There were declines -- the sales declined due to lower average selling prices and reduced volumes due to a drop in demand. And Mineral Nutrition adjusted EBITDA dropped even more strongly at $2 million. It was a 46% decline year-on-year, driven by the sales decline and higher costs.

Looking at Performance Products, net sales were about $15 million for the quarter, down about $3 million or 18%. And this was driven primarily by lower demand for ingredients used in personal care products, and that reduced sales drove a decline in adjusted EBITDA of about $1.4 million, a large percentage decline on a relatively small base. And corporate expenses were up 13%, driven by strategic investments and employee-related costs.

Turning to key capitalization-related metrics. Our free cash flow for the 12-month period ending September was a positive $4 million. That's first time in some time that we've seen a trailing 12-month positive free cash flow. So that's good news and reflects a lot of work and progress we're making in managing our working capital and our cash flows.

And it was comprised overall of, over that 12-month period, $40 million from operating activities, less $36 million of capital expenditures. We ended the quarter with a gross leverage ratio of 4.4x. That's a simple math of $484 million of total debt divided by $109 million of trailing adjusted EBITDA.

Looking at the dividends, consistent with our history, we've paid a quarterly dividend during the quarter of $0.12 a share, which is about $4.9 million in the aggregate. And as a reminder, $300 million of our debt is not exposed to rising interest rates because we fixed the variable portion of our interest rate to a fixed rate of 61 basis points plus the margin adder. The remainder of our debt is subject to floating interest rates, which are now determined by SOFR, which is the replacement for LIBOR. We also are seeing some partial offset from higher interest income earned on our short-term investments.

And now let's look at our updated guidance. So, if we look at those boxes on the right-hand side, we show you the new updated guidance. Just call out a couple of lines. Sales now expected to be between $980 million and $1.020 billion; and adjusted EBITDA, between $106 million and $112 million. And you see the other numbers that are driven by those 2 key metrics.

The updated guidance reflects reduced expectations for the fiscal year compared with our previous guidance. We see difficult fundamentals in certain parts of our business, including international beef feedlots, the U.S. and China dairy sectors and the pace of recovery in the Mineral Nutrition and Performance Products segments, plus the cost of manufacturing disruptions and inefficiencies due to the

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current conflict in Israel. I would note that we expect our December quarter to be roughly similar to or less than last year, reflecting some of the issues described above.

So, in closing, this is a challenging environment from various perspectives, but we remain confident in the demand for our products around the world and the longer-term opportunities ahead of us.
And with that, operator, if you would please open the line for questions. Thank you.

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Question and Answer

Operator

[Operator Instructions] Our first question will come from the line of Balaji Prasad with Barclays.

Mikaela Lee Franceschina
Barclays Bank PLC, Research Division

This is Mikaela on for Balaji. Just wanted to dig in a bit more around the FDA's recent notice for carbadox and the potential implications for Mecadox. As you mentioned, it seems you provided a great deal of safety data to the FDA in prior instances. So just wondering what your next steps here will look like.

Jack Clifford Bendheim
Chairman, President & CEO

Can't fully go through what our next steps are. But as I've said earlier and I think we said in our press release, this product has been on the market for 50 years. It's safe and an effective product. And we have sort of been [battling] the FDA. They don't like this product because it has some carcinogenic products in it. But by law, as long as there's no leftover carcinogenic products in the meat, it's safe to use.

And we've proven that, and we've seen some of that, and we've tested it up on the FDA with us over these last 50 years. So, there might be some mindset changes in the FDA, but this product is used by most of the hog producers in the United States. And again, it's safe and effective.

Mikaela Lee Franceschina
Barclays Bank PLC, Research Division

Great. And just one follow-up. Can you just remind us of how Rejensa has been tracking?

Daniel M. Bendheim
Executive VP of Corporate Strategy & Director

I'll take that. This is Dani. So Rejensa continues on sales out to grow nicely. It's not immune to the kind of slowdown we've seen in the vet channel throughout the industry. So, the pace has slowed a little bit, but overall, we continue to be happy with its growth and it's getting planned.

Operator

Your next question comes from the line of Michael Ryskin with Bank of America.

Michael Leonidovich Ryskin
BofA Securities, Research Division

And Dick, welcome back. It's been a while. I want to ask first on some of your comments regarding further outlook for fiscal year '24. You specifically called out OUS, international beef feedlots. Just wondering if you could expand a little bit on what's going on there. We often hear about U.S. beef feedlots and herd contraction and some of the pressures there, but not as much discussion as what's happening internationally. So, any color could be really helpful.

Jack Clifford Bendheim
Chairman, President & CEO

I mean the color is around our business in Latin America, where -- which is generally it's the higher cost of grain, which has put pressure and turned some of these businesses and some of the production of beef into loss businesses. So, we've seen drop in volume and fewer cows on the feedlot, which translates for us into fewer products sold.

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We see corn prices starting to drop. They were in the 7s, and now they're down into the 6s. USDA is projecting higher -- get higher production of corn in the United States. So, the prices have dropped further, and we see that business should turn around. And that's basically been the driver.

Michael Leonidovich Ryskin
BofA Securities, Research Division

Okay. So, it sounds like it's primarily macro-driven and tied to input costs, especially feed costs. And hopefully, that will be relatively quick to turn around. Is that the right interpretation?

Jack Clifford Bendheim
Chairman, President & CEO

Exactly. I mean that's what we're seeing, and that's what we're seeing also in the dairy business.

Michael Leonidovich Ryskin
BofA Securities, Research Division

Okay. Great. No, dairy was actually going to be another one of my questions. So then if I could ask on the vaccine strength. I mean that's been a really good business for you for a while now, but you really emphasized that this quarter that vaccines, especially in LatAm, was doing really well. Is that any particular product introduction that should be called out? Or is it a broad portfolio effect? I know you guys did an acquisition a couple of years ago where you brought in some novel vaccine technology. Is that what we're seeing the benefits of? If you could just dive into the vaccine strength, that would be great.

Jack Clifford Bendheim
Chairman, President & CEO

So, it's a few products that we have developed. I mean the novel technology that we've been using is the TAbic or the -- our ability to tabletize a vaccine, which makes it easier to use in the field. And the combination of both those things, we're seeing growth in the market. I mean you always remember that you also need to see the virus, and we are seeing the virus in these markets. So, the virus is spreading. And with the virus spreading, we have a very effective product, and the vaccine follows.

Michael Leonidovich Ryskin
BofA Securities, Research Division

Okay. Great. If I can squeeze in one last one. Some comments again on your -- I think you mentioned you want to control cost or control the spend just a little bit in companion -- in the companion business. Could you expand on that? Is that new product development? Is that anything -- any promotions or sales efforts tied to Rejensa? Just kind of like where are you pulling back a little bit in that part of the business?

Daniel M. Bendheim
Executive VP of Corporate Strategy & Director

Yes, I'll take that, Dani again. So, it deals with our pipeline. I think we have strong stage gates throughout. And when a product misses a stage gate, we kind of look at it again. One of our products in our pipeline, dealing with one of our oral care products. We have 2 oral care products in the pipeline, one for dog, one for cats. In the dog product, we decided to slow down on our spend there because it doesn't -- we're really looking at the opportunity in light of the results we're getting. So, we are curtailing our spend in that respect.

Operator

Your next question will go from the line of Brian Wright with ROTH MKM.

Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

Two real quick questions. Just was trying to get a little more understanding the detail about the pension settlement and that -- I've read the 10-Q, but just trying to understand what exactly happened there?

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Richard G. Johnson
Interim Chief Financial Officer

Sure. So, I think first, let me say that for the corporation, this was a noncash event. In other words, we funded -- we put money into the pension plan years ago. So, this was a transaction that happens inside the pension plan, and it's something that many, many corporations have been doing. We essentially got an insurance company to irrevocably assume the liability for paying those future benefits for a group of people that are in the pension plan.

And so basically, on a present value basis, the insurance company took over the -- the precise number is there, but it was $24 million. The insurance company took over a $24 million present value of a liability. And the pension plan took $24 million of its assets and paid the insurance company to take over that liability. So -- and then from there on, you get into some accounting recognition rules where we had to recognize this $10 million charge, but again, a noncash item to the corporation, to Phibro.

Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

Okay. So that's still off the books. As far as the insurance company has that obligation, there's no counterparty risk impact that's being recorded here in that $10 million charge.

Richard G. Johnson
Interim Chief Financial Officer

No, there's no counterparty risk. In the insurance company, we were very careful to only consider transferring this liability to very highly rated insurance companies. So, this is -- I forget how the rating system works, but this is a very highly rated, very financially stable insurance company who has irrevocably assumed the obligation to pay these benefits over time in the future.

Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

Okay. And then just one detail on the follow-up. Of that -- of the gross debt, how much is characterized as first lien?

Richard G. Johnson
Interim Chief Financial Officer

Fundamentally all of it. It's -- with the exception of a small -- I think it's around $11 million -- the remainder of the gross debt is all within one credit facility. It's broken into various pieces. There's a revolver piece and a term loan piece, but it's all supported by the same collateral package.

Operator

Your next question will come from the line of Erin Wright with Morgan Stanley.

Linda H Bolduc
Morgan Stanley, Research Division

This is Linda Bolduc on for Erin Wright. So, we have 2 questions. Can you speak to the dynamics you're seeing across the core MFA business? And how are you thinking about the dynamics for the balance of this year?

Jack Clifford Bendheim
Chairman, President & CEO

Just can you repeat the first question?

Linda H Bolduc
Morgan Stanley, Research Division

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Yes, yes. Can you please speak to the dynamic of the MFA business? And how are you thinking about the dynamics for the balance of the year there?

Jack Clifford Bendheim
Chairman, President & CEO

Sorry, you cut out on the -- your question is something about the dynamics of the MFA sector. And what was the rest of the question?

Linda H Bolduc
Morgan Stanley, Research Division

And how you're thinking about dynamics for the balance of this year?

Jack Clifford Bendheim
Chairman, President & CEO

So, the MFA business, which translates to mean medically feed additives, is a very, very big category. In other words, any product that is -- that has registrations is -- comes into that category. And it's -- we don't know exactly. I would say, worldwide, it's a $3 billion to $4 billion business and shared by a few producers and a few generic producers, and it's a very strong business. It's the most efficient way to get products into the animal, whether it's a chicken, a pig, or a cow.

And we've seen, depending on disease pressures, but we've seen that to be always a steady business. And we see that growing in line with what we've always talked about, population and economic growth. That's been our history with this product, and that's how we see it going forward.

Linda H Bolduc
Morgan Stanley, Research Division

That's helpful. And one quick follow-up. On Performance Products, can you remind us of any key drivers there in your overall commitment to that business?

Richard G. Johnson
Interim Chief Financial Officer

Our key products are -- there's a couple of smaller segments within -- or kind of businesses within that segment. One of the important categories is we represent end-market ingredients for personal care products. So importantly, some ingredients for -- that would sell to toothpaste manufacturers, ingredients that go into shampoos, other products like that.

And then our -- the second piece of that business is copper-based products, where that's a legacy business that Phibro has had for a long time. We have said that the business is opportunistic. It's not core. It's a relatively small part of the company. It's cash flow positive. It's not something that is terribly distracting. So up until this point, we've retained the business.

Operator

With that, I'll hand the call back to Dick Johnson for any closing remarks.

Richard G. Johnson
Interim Chief Financial Officer

Well, it's nice to be back on the phone with folks and enjoyed the Q&A this morning. We thank you for your time and your interest in Phibro, and we'll talk to you again on our next earnings call. So, everybody, have a nice day, and hope you're doing well. Take care. Bye now.

Operator
That will conclude today's call, and we thank you all for joining. You may now disconnect.

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