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Phibro Animal Health Corporation (PAHC)

Q2 2024 Earnings Call
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Call Participants

EXECUTIVES

Daniel M. Bendheim
Executive VP of Corporate Strategy & Director

Jack Clifford Bendheim
Chairman, President & CEO

Richard G. Johnson
Interim Chief Financial Officer

Glenn David
Incoming Chief Financial Officer

ANALYSTS

Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

Michael Leonidovich Ryskin
BofA Securities, Research Division

Erin Elizabeth Wilson Wright
Morgan Stanley, Research Division

Mikaela Lee Franceshina
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 Second Quarter Investor 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

Thank you, Regina, and welcome to the Phibro Animal Health Corporation Earnings Call for our fiscal second quarter ended December 31, 2023. As we said, my name is Dick Johnson, I'm the Interim Chief Financial Officer of Phibro Animal Health. I'm joined today by Jack Bendheim, Phibro's Chairman, President and Chief Executive Officer; by Dani Bendheim, Director and Executive Vice President of Corporate Strategy; and also, by Glenn David, the incoming Chief Financial Officer.

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

I'd like to remind you that we're providing a simultaneous webcast of this call on our website, pahc.com, and on the Investors section of our website, you'll find copies of the earnings press release and second quarter Form 10-Q as well as, later today, the transcript and slides that we're discussing on our call this morning.

Turning to Slide 2. Our remarks today will include our standard 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 on 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, which would include things like stock-based compensation and in this most recent quarter, a Brazil employment taxes item. Also, other income and expense as separately reported in the P&L including foreign currency losses and also income taxes related to any of those pretax income adjustments and any other unusual or nonrecurring income tax items.

So, with that out of the way, let me introduce our Chairman, President and Chief Executive Officer, Jack Bendheim, to share his opening remarks. Jack?

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Jack Clifford Bendheim
Chairman, President & CEO

Thank you, Dick, and thank you to everyone joining us this morning. Our second quarter showed the resilience of our business and was a positive step-up compared with our first quarter. Our core Animal Health business grew net sales at a healthy 6%, and I was especially pleased to see that adjusted EBITDA also grew at 6%, led by high-value new product introductions in our vaccine product line. A strong 31% increase in net sales of vaccines led the way for Animal Health. We are seeing the uptake of our vaccines across various regions, especially in South America, we have launched new commercial vaccines and have the added benefit of a new autogenous vaccine facility in Brazil.

Looking ahead, we expect continuing growth in the Animal Health business in the second half of the year. We also expect to see significant improvement in our Mineral Nutrition and Performance Products businesses as we work through inventory imbalances and as we see a rebound in demand. We have affirmed our guidance for net sales, adjusted EBITDA and adjusted diluted EPS, as Dick will go into in greater detail at the end of his presentation.

We are continuing to invest behind our successes. We're looking to introduce additional vaccines in the Americas and have just had our first sales of a new line of nutritional specialty products for poultry here in the United States. We see Vaccines, Nutritional Specialties and Companion Animal as continued growth opportunities, and we're making the necessary investments to enable us to achieve our targets.

I'm also pleased to welcome Glenn David to Phibro as Chief Financial Officer, as we recently announced. Glenn brings over 30 years of experience in commercial and financial leadership roles, including a wealth of knowledge in the animal health industry. He brings the capability needed to contribute to Phibro's future success and to bring value to our shareholders.

I look forward to having your questions following Dick's review of our financials. But before I hand it back to him, I want to express my gratitude to Dick for agreeing to step in as interim CFO. As a company, we do not miss a beat, thanks to Dick's quick return to action, and I'm thrilled that Dick will continue to be available to assist Glenn and assist Phibro as a whole. Dick?

Richard G. Johnson
Interim Chief Financial Officer

Thanks, Jack. So let me start with the consolidated financial performance on Slide 4, and then we'll move on to segment level performance and some other information. Consolidated net sales for the quarter were just under $250 million, and that was an increase of $5.3 million or 2% over the same quarter of a year ago. The Animal Health segment grew 6%, while both Mineral Nutrition and Performance Products saw sales decline.

GAAP net income and GAAP diluted EPS decreased driven by a substantial increase in foreign exchange losses, mostly from a major devaluation in the Argentina peso, also driven by higher operating expenses that we refer to as selling, general and administrative expenses, and that included a $4.2 million charge for a Brazil employment tax issue. And third, increased interest expense driven by higher variable interest rates. Income taxes were a partial offset as they decreased $2.6 million.

After making our standard adjustments to GAAP results, including the items I named earlier, overall adjusted EBITDA decreased $1.5 million compared to the year earlier. Animal Health adjusted EBITDA improved by $2.2 million or 6% driven by gross profit from increased sales but partially offset by higher operating expenses.

Mineral Nutrition decreased almost $1 million driven by unfavorable inventory cost and a slight decline in volumes. Performance Products decreased $1.5 million year-over-year due to lower product demand and unfavorable product mix. And finally, we spent more in our corporate expenses. We spent $1.3 million more than last year, which was driven by a planned increase in strategic investments. Adjusted net income and adjusted diluted EPS declined 2%, respectively, reflecting the changes in adjusted EBITDA and the higher interest expense due to the higher variable interest rates. The effective income tax rate improved, and it was a partial offset to the negatives.

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Now looking at Slide 5 and moving to segment-level financial performance. Let's first look at Animal Health. The Animal Health segment posted sales of about $173 million. That was an increase of over $9 million or 6% over the prior year. And within that Animal Health segment, we saw sales increase, especially in vaccines, as vaccine sales grew $7 million, a healthy 31% increase driven by product launches in poultry products introduced into Latin America, plus we saw an increase in domestic demand.

In our MFAs and other category, net sales grew $4.8 million or 5% due to demand in various international regions and continuing growth in demand for our processing aids used in the ethanol fermentation industry. Nutritional specialties net sales declined in the quarter by $2.4 million or about 6%, mostly due to reduced demand from the domestic dairy business. All of that drove Animal Health adjusted EBITDA of about $39 million, also a 6% increase as the higher gross profit from increased sales was partially offset by increased SG&A.

Now moving to the other business segments on Slide 6, starting with Mineral Nutrition. Net sales for the quarter were $61 million, a slight decrease from last year due to a decline in average selling prices and some reduction in sales volume. Mineral Nutrition adjusted EBITDA was $3.5 million, reflecting a year-on-year decrease of $900,000 as we worked through some unfavorable inventory positions.

Looking at our Performance Products segment, net sales of $15.5 million for the 3 months reflect a $3.7 million or a 19% decline driven by reduced demand for personal care product ingredients and for industrial chemicals. Adjusted EBITDA was $800,000 for the quarter, a decline of $1.5 million compared to the prior year, largely reflecting reduced sales, and also reflecting unfavorable product mix.

Corporate expenses increased $1.3 million driven by the planned increased strategic investments.

Now if we turn to the capitalization-related metrics on Page 7, we saw positive free cash flow. And for the trailing 12 months, we now have generated positive free cash flow of $37 million, which is comprised of $74 million from operating cash flows and then invested $37 million in capital expenditures. And as a result, we ended December with cash and cash equivalents and short-term investments with $92 million on the balance sheet at the end of the quarter. Our gross leverage ratio was 4.4x at the end of the quarter based on $476 million of total debt and $108 million of trailing 12-month adjusted EBITDA.

Consistent with our history, we paid a quarterly dividend of $0.12 a share or $4.9 million in the aggregate. And as a reminder, $300 million of our debt is at a fixed rate of 61 basis points plus an applicable margin of 1.75%. The remaining amount of our debt, or $176 million, is subject to variable interest rates, although offset somewhat by interest earned on our excess cash and short-term investments.

Now looking at our guidance for the full year, we have affirmed our guidance for net sales, for adjusted EBITDA and for adjusted diluted EPS. So, no changes to those measures. We have updated our guidance for the GAAP measures to reflect recent developments, which would include that Brazil employment taxes issue, additional foreign currency losses, again, mostly coming out of an Argentina devaluation and then some other smaller items and the related income tax effects of those things.

So, in closing, we are optimistic as we enter the second half of our fiscal year. We're confident of the demand for our products around the world and look forward to seeing continued improvement in our business as we move forward.

And with that, operator, let's 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 Erin Wright with Morgan Stanley.

Erin Elizabeth Wilson Wright
Morgan Stanley, Research Division

Can you give us an update on just underlying demand trends and how you're thinking about fundamentals in some of the key livestock categories for you like poultry and dairy? And what are you expecting over the next 6 to 12 months across those categories?

Jack Clifford Bendheim
Chairman, President & CEO

Erin, short question, long answer. So, we are seeing around the world positive trends, I mean the underlying -- the 2 underlying things combined have sort of come back to historic positions. One is demand has returned. I mean the effect of COVID, I think we're finally seeing coming to an end in terms of imbalances in inventory and cost of inventory, people sort of returning to -- whether it's to restaurants or schools, et cetera, et cetera.

So, the normal buyers have returned or are returning to the market. At the same time, the most important ingredient in raising animals is cost of feed, and we see the decline in both the cost of soybeans and corn, which has returned profitability pretty much across the board. I mean, there's still some outliers, which will take some time like the dairy industry in the states. But even that, the trend is in the right direction.

So -- and that's one of the reasons I said, we're positive. We're seeing good sales in all regions, increasing sales.

We're seeing price increases holding. So again, it is the reason we're optimistic.

Erin Elizabeth Wilson Wright
Morgan Stanley, Research Division

Okay. And then adjusted EBITDA margin was strong in Animal Health. Is that just a function of the mix dynamic with the strength in the vaccines or what drove that? And you mentioned price, is that going to go -- kind of quantify what you're realizing in terms of price, did you take another price increase at the beginning of the year in terms of your Animal Health business?

Richard G. Johnson
Interim Chief Financial Officer

Yes. It's all those things, Erin. Certainly, we're seeing favorable product mix. Within Animal Health, vaccines, in general, have the highest margins. So, as we grow that part of our business, we're getting that favorable benefit, and that's allowing us to continue to build the business with -- by making very targeted expense investments in people mostly in certain markets, but we're able to offset that expense increment. So that's why the improvement. And I think as we grow going forward, it's reasonable to expect the kind of bottom-line growth at least equal in percentage terms to the top line growth.

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Erin Elizabeth Wilson Wright
Morgan Stanley, Research Division

Okay. That's helpful. And then just if I could sneak one more in here. There was a recent deal on the tape for Elanco's aquaculture business to Merck. And Merck is already larger in that space, obviously, but does this change anything from a competitive standpoint for you? How big is -- or what's your commitment to your aquaculture business? Or how big is that now?

Jack Clifford Bendheim
Chairman, President & CEO

So, we are committed, but it's a small business. So, the movement of the products from Elanco to Merck will have no effect on our business.

Operator

Your next question comes from the line of Balaji Prasad with Barclays.

Mikaela Lee Franceschina
Barclays Bank PLC, Research Division

This is Mikaela on for Balaji. Just two for me. Can you first just remind us of how Rejensa has been tracking? And following up on the previous question, I guess, could you just talk a little bit more specifically about geographies and species that are standing out and the outlook for the rest of the year?

Daniel M. Bendheim
Executive VP of Corporate Strategy & Director

It's Daniel. I'll take the Rejensa question. We actually did not call out this year's specific guidance with regard to Rejensa in our annual. So, it's part of the Nutritional Specialties. It continues to grow nicely, double-digit growth. But other than that, for competitive reasons, we don't call out more specifics.

Jack Clifford Bendheim
Chairman, President & CEO

And...

Richard G. Johnson
Interim Chief Financial Officer

Species and geographies.

Jack Clifford Bendheim
Chairman, President & CEO

Species and geographies. In general, poultry accelerates always across the world for economic, for religious reasons. And we're seeing that in most of the geographies we're in. For ourselves, we are increasingly focused on the cattle business. So, cattle are forming a more important part of our business, but still a small relative ex U.S. anyway, and it's dairy relative to the United States.

Operator

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

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Michael Leonidovich Ryskin
BofA Securities, Research Division

This is Wolf on for Mike. I was wondering, beyond the hit to the P&L, are you seeing any changes in customer behavior related to the drop in the Argentina peso? Do you have any expectation for how the impact to operations could play out based on the [indiscernible] history in the country?

Richard G. Johnson
Interim Chief Financial Officer

Well, the good news is Argentina has many decades of experience with economic chaos. So those folks know how to -- they know how to manage their business whether their currency is up, down, or sideways. And so, I think we have not seen any change in customer behavior since the devaluation, which was the middle of December. I think our customers and the industry in Argentina view this as a very positive step toward fiscal sanity and normality in Argentina. So, I think we took some pain there, but we're all hopeful that it's going to be that the gain is going to be worth pain as the business goes forward. Argentina is an agricultural powerhouse. And there's a lot of opportunity there, and we like the market.

Michael Leonidovich Ryskin
BofA Securities, Research Division

Got it. That makes sense. And then hopping across the world. Can you give us an update on your operations in Israel, and maybe a ballpark for the headwind you're facing as the war drags on? And has it changed at all since Red Sea shipping has become more of an issue?

Jack Clifford Bendheim
Chairman, President & CEO

So, you can just read the papers, it's not the easiest time to be operating in Israel. We have been successful operating our facilities and meeting our shipping commitments. Clearly, it's been more expensive as some of our people have been called up. But overall, we've slogged through this, and hopeful that this comes to end soon and then things will return to normalcy.

Operator

[Operator Instructions] And your next question will come from the line of Brian Wright with ROTH MKM.

Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

Can you help us get a feel for how much of the vaccine growth year-over-year is from the autogenous vaccine?

Jack Clifford Bendheim

Chairman, President & CEO

We don't break it out. So again, for some competitive reasons. Overall, the autogenous business is small compared to the regular vaccine business. It is -- the name for autogenous is custom vaccine. And I don't know if you understand what happens but -- maybe we spoken in the past, literally, we go to farms, and we take blood samples. If they're not -- basically, if things are not responding well to normal vaccines, the regular vaccines, we developed a custom vaccine for that farm that will respond to the viruses they're seeing to the bacteria they're seeing, we create a custom-made vaccine. It's much more expensive, but it's more effective, and we go back and sell it. So, it's a retail effectively. It's a retail way. It's farm-to-farm as opposed to the wholesale way. If I have a vaccine that can cover half the country.

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Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

When you're talking about the poultry product introductions in Latin America, that's not the custom vaccine for the poultry.

Richard G. Johnson
Interim Chief Financial Officer

Correct.

Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

Okay. And then can you just remind us on the seasonality of the vaccine business?

Jack Clifford Bendheim
Chairman, President & CEO

So overall, there's no seasons. You're talking about viruses. You're not talking about bacterial infections. So, it's year-round.

Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

Great. Okay. Perfect. And then lastly if I could -- just with the [changing] going on as CFO. Is there kind of -- are you conditioning the role changing any -- at all from what it has been in the past?

Richard G. Johnson
Interim Chief Financial Officer

And so, I'm not. On the other hand, I'm sure, as you see yourself in the banks], every individual has their own way of doing things. So -- and Glenn's in the room, he can answer that. But I surely expect, like I said, we are all standing on the shoulder of the giants. So, everyone will make their changes and all the changes together make for a better job.

Brian Michael Wright
ROTH MKM Partners, LLC, Research Division

Great. And then if I can ask one last one since you did take one in the room. And this might be a little early, but just early thoughts, Glenn, as far as like your top priorities as you come in?

Glenn David

Incoming Chief Financial Officer

Thanks. First, really excited to be here in joining Phibro. Obviously, I have a real passion for the industry and glad to join one of the key players in the industry again. And have been really impressed with the management team so far. And it's really just 2- or 3-days in. So really no ongoing hypotheses yet, but really look forward to working with the team, getting to understand Phibro in more detail and then looking to work with the team to really drive profitable growth moving forward. So more to come. And really look forward to working with the analysts and communicating with you over the next weeks and months.

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Operator

We have no further questions at this time. I'll turn the call back to Dick Johnson for any closing remarks.

Richard G. Johnson
Interim Chief Financial Officer

All right. Well, let me add my welcome to Glenn and wish him well. And as Jack said, we'll keep working together. I'll be available for questions as needed.

And with that, I wish everyone well. Thank you very much for joining us today and take care and talk to you next time. Bye now.

Operator
That concludes today's conference call. Thank you all for joining. You may now disconnect.

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