

Phibro Animal Health Corporation
(PAHC) Q3 2024 Earnings Call
May 9, 2024

9-May 2024

Phibro Animal Health Corporation (PAHC)
Q3 2024 Earnings Call

Call Participants

EXECUTIVES

Glenn C. David

Chief Financial Officer

Jack Clifford Bendheim

Chairman, President & CEO

Larry L. Miller

Chief Operating Officer

Daniel M. Bendheim

*Executive VP of Corporate Strategy
& Director*

ANALYSTS

Balaji V. Prasad

*Barclays Bank PLC, Research
Division*

Erin Elizabeth Wilson Wright

Morgan Stanley, Research Division

Navann Ty Dietschi

*BNP Paribas Exane, Research
Division*

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 Third Quarter Investor Conference Call. [Operator Instructions]

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

Glenn C. David

Chief Financial Officer

Thank you, Regina, and good day, everyone, and welcome to the Phibro Animal Health Corporation Earnings Call for our fiscal third quarter ended March 31, 2024. My name is Glenn David, and I am the Chief Financial Officer. I'm joined on today's call by Jack Bendheim, Phibro's Chairman, President, and Chief Executive Officer; Daniel Bendheim, Director, and Executive Vice President of Corporate Strategy; and Larry Miller, our Chief Operating Officer.

Today, we will cover our financial performance for the third quarter and provide an update on financial guidance for our fiscal year ending June 30, 2024. At the conclusion of our remarks, we will open the line for your questions. I would 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 third quarter Form 10-Q 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 these 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. Reconciliation of these non-GAAP financial measures to the most directly comparable U.S. GAAP measures are included in the financial tables that accompany the 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 Brazil employment taxes. Other income expenses as separately reported in the consolidated statement of operations, including foreign currency losses, gains net and income taxes related to pretax income 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.

Jack Clifford Bendheim

Chairman, President & CEO

Thank you, Glenn, and thank you to everyone joining us this morning. We had a very strong third quarter performance, led by our Animal Health division, which delivered double-digit top line growth. Within Animal Health, our Vaccines segment achieved 26% growth, and we delivered an exceptional 16% growth in our MFA and other segment. This translated to an overall growth of 9% in adjusted EBITDA.

As I'm sure you can all imagine, it has been a busy few months for all of us here at Phibro, and I am glad to reflect that this growth was achieved while at the same time my team was heavily involved in the process that led to our announcement last week of our signed agreement to purchase Zoetis Medicated Feed Additive portfolio. We are excited to onboard new colleagues and products of Phibro, and we are very confident that we have the operational strength and focus to ensure a smooth transition. This acquisition will also serve to enhance, diversify, and broaden Phibro species and product offerings, and

we are confident in our ability to maximize the opportunity related to this portfolio. We anticipate this transaction will lead to strong earnings accretion and debt pay down and will also serve as the engine that will continue to power our investments in the faster-growing Vaccines, Nutritional Specialties and Companion Animal product segments, where we continue to see and invest in both short and long-term opportunities.

Looking ahead, we expect continuing growth in the Animal Health business as we close out our fiscal year. We also expect to see continued improvements in our Mineral Nutrition and Performance Products businesses as we work through inventory imbalances and now see a rebound in demand. We have affirmed our guidance for net sales, adjusted EBITDA and adjusted diluted EPS, and then will go into greater detail in this presentation.

I look forward to hearing your questions following Glenn's review of our financials.

Glenn C. David

Chief Financial Officer

Thanks, Jack. I'm also really excited about the strong results in the quarter. Total company sales for the quarter grew 7%, and our adjusted EBITDA and our adjusted net income grew 9%. As Jack mentioned, our Animal Health sales grew 10% with Vaccines growth of 26%, MFA growth of 16%, offset by declines in our Nutritional Specialties.

In the quarter, our Mineral Nutrition segment grew 2%, offset by a decline in our performance products. The performance of both Mineral Nutrition and Performance Products improved in Q3 versus the first half of the year as we expected. On a fiscal year-to-date basis, we have seen revenue growth of 3% and adjusted EBITDA growth of negative 3%. Year-to-date performance is led by Animal Health with 7% growth in revenue with Vaccines sales growth of 23%, our MFA business at 7% and declines in Nutritional Specialties. Growth in Animal Health is partially offset by declines in both the Mineral Nutrition and Performance Products segments.

As we spoke last week, we are also excited about the acquisition of the Zoetis MFA business. These products are a strong strategic fit with our existing Phibro core competencies and capabilities, and we expect to deliver a rapid deleveraging profile and significant adjusted EBITDA accretion. As discussed, we expect this transaction to close in the second half of calendar year 2024. For guidance, we are affirming our guidance on net sales, adjusted EBITDA, and adjusted EPS. We have updated our GAAP net income and diluted EPS to reflect onetime costs related to the Zoetis MFA acquisition.

I'll start with consolidated financial performance on Slide 4, then cover segment level performance, capitalization metrics and conclude with a review of our affirmed or updated financial guidance for the full fiscal year 2024. Consolidated net sales for the quarter ended March 31, 2024, were \$263.2 million, reflecting an increase of \$17.6 million or a 7% increase over the same quarter 1 year ago. The Animal Health segment grew 10%, while Mineral Nutrition grew at 2% and the Performance Products segment declined.

GAAP net income and diluted EPS decreased driven by increased SG&A due to higher employee-related costs, higher interest expense and higher foreign currency losses, partially offset by favorable gross profit as a result of higher product demand in the Animal Health segment. Income tax expense also decreased by \$0.5 million. After making our standard adjustments to GAAP results, third quarter adjusted EBITDA increased \$2.3 million. Animal Health improved by \$2.3 million or 7% due to gross profit from increased sales, partially offset by higher SG&A.

Mineral Nutrition increased \$0.8 million, driven by higher gross profit. Performance Products adjusted EBITDA remained relatively the same. Corporate expenses increased \$0.7 million, driven by increased employee-related costs. Adjusted net income and adjusted diluted EPS both increased 9%. Increased gross profit driven by sales growth was partially offset by higher adjusted SG&A and higher adjusted interest expense, with a partial benefit from the reduced adjusted provision for income taxes.

Moving to segment level financial performance on Slide 5. We'll cover the third quarter performance of our largest segment, Animal Health. The Animal Health segment posted \$181.3 million net sales for

the quarter, an increase of \$16.9 million or 10% versus the same quarter prior year. Within the Animal Health segment, we reported MFA and other net sales growth of \$15 million or 16% due to demand in both domestic and international regions. Vaccine net sales growth of \$6.7 million, a healthy 26% increase driven by product launches in Latin America, plus an increase in domestic demand. Nutritional Specialties net sales declined \$4.8 million or 11%, mostly due to lower demand for microbial and dairy products. Animal Health adjusted EBITDA was \$36.5 million, a 7% increase due to higher gross profit from increased sales, partially offset by higher SG&A.

Moving on to the third quarter financial performance for our other business segment on Slide 6. Starting with Mineral Nutrition. Net sales for the quarter were \$64.2 million, an increase of \$1.3 million due to increased sales volume, partially offset by decreased average selling price. Mineral Nutrition adjusted EBITDA was \$4.7 million, reflecting a year-on-year increase of \$0.8 million, driven by higher gross profit.

Looking at our Performance Products segment. Net sales of \$17.7 million for the 3 months ended March 31, 2024, reflects a decrease of \$0.7 million or 4%, driven by decreased demand for personal care product ingredients and industrial chemicals. Adjusted EBITDA was \$2.4 million and declined 2% versus the same quarter prior year. Corporate expenses increased \$0.7 million, driven by increased employee-related costs.

Now turning to key capitalization-related metrics on Slide 7. We saw [\$40] million of positive free cash flow for the 12 months ended March 31, 2024. We generated \$79 million of operating cash flow and invested \$39 million in capital expenditures. Cash and cash equivalents and short-term investments were \$99 million at the end of the quarter. Our gross leverage ratio was 4.4x at the end of the third quarter based on \$487 million of total debt and \$110 million of trailing 12-month adjusted EBITDA. Our net leverage ratio was 3.5x at the end of the third quarter based on \$388 million of total debt and \$110 million of trailing 12-month adjusted EBITDA.

Turning to dividends. Consistent with our history, we paid a quarterly dividend of \$0.12 per share or \$4.9 million in aggregate. As a reminder, \$300 million of our debt is at a fixed rate of 0.61% plus the applicable margin. The remaining \$187 million of total debt is subject to variable interest rates although offset somewhat by interest income earned on short-term investments.

Let's turn to Slide 8, which lays out our updated guidance for the fiscal year ending June 30, 2024. We have affirmed our guidance for net sales, adjusted EBITDA and adjusted diluted EPS. We have updated our guidance for GAAP net income and GAAP diluted EPS. The updated guidance includes onetime costs related to the integration of Zoetis products. This is reflected in our GAAP guidance but are excluded from adjusted measures. Our affirmed or updated fiscal year 2024 financial guidance is shown in the table. Comparisons are to the prior fiscal year and year-over-year percentages are calculated using the midpoint of the guidance ranges.

Net sales of \$980 million to \$1.02 billion with growth of 2%. Net income of \$7 million to \$12 million. Diluted EPS of \$0.17 to \$0.30. Adjusted EBITDA of \$106 million to \$112 million, a decline of 3%. Adjusted net income of \$42 million to \$47 million, a decline of 9%. Adjusted diluted EPS of \$1.04 to \$1.16, a decline of 9%. And our adjusted effective tax rate range of 28% to 30%.

In closing, we are optimistic as we enter the final quarter of our fiscal year. We are confident in demand of our products around the world and look forward to seeing continued improvement in our business as we move forward. And we are very excited about the pending Zoetis MFA acquisition. With that, Regina, could you please open the line for questions?

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

So, on the MFA side of the business, what drove some of the strength, I guess, even on the comp? And does this continue? And whether there are any kind of onetime dynamics we should be thinking about? And how do we think about kind of the normalized underlying growth rate for the MFA business now? And then once you fold in Zoetis, their MFA portfolio, kind of what is the underlying growth look like for that MFA other segment.

Larry L. Miller

Chief Operating Officer

Thanks for the questions. This is Larry. I'll address the first part of your question having to do with what drove the growth. And it is really strong growth in our Animal Health segment, as Glenn stated, very strong growth in our Medicated Feed Additives and in our vaccines in particular. And so those were the key growth drivers. We experienced that growth geographically in North America and also in South America. Those were the highest-growing areas of our business.

Glenn C. David

Chief Financial Officer

Yes. Erin, just to add some context to it? So, we said the MFAs grew 16% in the quarter, which is obviously above the run rate that we would expect. There were some onetime dynamics in the quarter with some larger customers based on the timing of their purchases as well as some strong performance in other? We call it MFA and other, there was some strong performance in the other category as well, which is related to our EPG group. On a year-to-date basis, though, we have seen 7% growth in our MFA business. So, a strong performance throughout the year as well. And related to the terms of when we are able to integrate the Zoetis MFA products, we do expect those products after we bring them onto our hands to get to a growth rate probably in that low single -- middle digit range.

Erin Elizabeth Wilson Wright

Morgan Stanley, Research Division

Okay. And then as we think about the \$0.60 accretion from the Zoetis deal and -- and that's obviously a notable accretion number. So, what's the jumping-off point? I think consensus EPS is at about \$1.25 for 2025 or your -- your fiscal 2025. So, is that the right ballpark that we should be at from a jumping-off point? Are there other dynamics we should be modeling out for the underlying business in 2025?

Glenn C. David

Chief Financial Officer

Yes, Erin, obviously, for our own guidance for 2025, we'll be providing that on our next call as we update guidance. In terms of the \$0.60 accretion that we referenced on the call last week that we do see in the first 12 months of acquiring the business. So, depending on the timing of close, whether we have a full fiscal year or not that might impact the \$0.60. But I do also want to mention that we do see that accretion growing over time as we continue to pay down debt and lower our interest expense related to the deal.

Operator

Your next question will come from the line of Navann Ty with BNP Paribas.

Navann Ty Dietschi

BNP Paribas Exane, Research Division

I wanted to ask if you could discuss the Companion Animal pipeline and your capital allocation after the Zoetis acquisition.

Daniel M. Bendheim

Executive VP of Corporate Strategy & Director

It's Dani Bendheim. Thanks for the question. No real new update on the Companion Animal pipeline. We continue to make progress. Nothing in the short term to announce. But we do see that overall, this acquisition of the MFA -- or the Zoetis MFA business as furthering our ability -- along with deleveraging but furthering our ability to invest in Companion Animal. There's no shortage of pipeline ideas brought to us. And to date, I think we've been fairly judicious, and we'll continue to be judicious, but this will definitely allow us to ramp up our first within Companion Animal.

Glenn C. David

Chief Financial Officer

Yes. And so, the second part of your question related to capital allocation. Obviously, the first priority will continue to be to invest in our business. And as Dani mentioned, areas such as Companion Animal, Vaccines, Nutritional Specialties as well will be the key areas to focus. Second, obviously, we'll always continue to look for opportunities outside. But obviously, this is a large deal for us with the Zoetis MFA acquisition. So, I expect those to be small in nature. And then we'll look to continue to deliver over time. And I think we've committed that we will get to a net leverage ratio below 3 before the end of fiscal year 2027. And then we'll continue to return capital to our shareholders in the form of our dividend. We remain committed to the dividend. We are in the process of refinancing all of our debt to support this deal. There may be some covenants related to the dividend, but our projections show us well below those covenants, and we understand the importance of the dividend to our shareholders and plan to maintain them.

Operator

Our next question will come from the line of Balaji Prasad with Barclays.

Balaji V. Prasad

Barclays Bank PLC, Research Division

Two from me. Getting back to the deal, can you help me understand what this means to you incrementally in terms of your focus on Companion Animal and the appetite for potential business development deals of the site? Second, could you also comment on the shift in the veterinary feed directives on the change from no antibiotics ever to no human antibiotics? And what does this mean to you in terms of market opportunity opening up?

Daniel M. Bendheim

Executive VP of Corporate Strategy & Director

Dani, again, I'll take the first question. Again, I think as was stated in the opening comments, we view this as the opportunity to invest even stronger or even more in Companion Animals, in Nutritional Specialties and Vaccines. This will be -- we anticipate a lot of cash being generated from the combined business. And we recognize that the larger growth opportunities are in those areas that I just highlighted. So, I do anticipate -- or we do anticipate that we will redouble our efforts and continue to invest in those areas.

Larry L. Miller

Chief Operating Officer

It's Larry. On the second part of your question, the Zoetis MFA business actually has a significant weighting of products that are not considered medically important for human medicine by the World Health Organization. These include ionophores, no products in this class are used in human medicine. Anticoccidials, no products in this class are used in human medicine. And the bacitracin's are regarded -- are not regarded as medically important. Therefore, the combined Zoetis MFA and Phibro portfolios of Medicated Feed Additives, Nutrition Specialties and Vaccines offer several choices to livestock producers, including those who produce an antibiotic-free and/or no antibiotics use in human medicine.

As to your question about the poultry industry and some of the changes we've seen there, however it refers to the reintroduction of ionophores, which again are not medically important antimicrobials. They are used to control coccidiosis and other enteric diseases. Phibro does not currently have ionophores in the U.S. So, we really haven't seen impact on our business. However, the Zoetis MFA business does contain ionophores, which will allow us to serve customers with the -- with products in this -- in this class.

Operator

And that will conclude our question-and-answer session. I'll hand the call back to Glenn David for any closing remarks.

Glenn C. David

Chief Financial Officer

Thank you, Regina, and thank you, everyone, for listening in to today's call. We really appreciate your time, attention, interest, and support of Phibro Animal Health Corporation. Thanks again.

Operator

Thank you all for joining. That will conclude our call today, and you may now disconnect.

Copyright © 2024 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness, or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE

OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special, or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

© 2024 S&P Global Market Intelligence.