

November 12, 2014

**Phibro Animal Health Corporation (PAHC)**

Q1 September 2014 Earnings Call

## CORPORATE PARTICIPANTS

**Jack Bendheim** *Phibro Animal Health Corporation - CEO*

**Richard Johnson** *Phibro Animal Health Corporation - CFO*

## CONFERENCE CALL PARTICIPANTS

**Louise Chen** *Guggenheim Securities - Analyst*

**Erin Wilson** *BofA Merrill Lynch - Analyst*

**Mohammed Sajjalal**, *Barclays - Analyst*

## MANAGEMENT DISCUSSION SECTION

### Operator

Good day, ladies and gentlemen, and welcome to the Phibro first quarter results conference call.

As a reminder, this conference is being recorded. I would now like to turn the conference over to Richard Johnson, Chief Financial Officer. Sir, you may begin.

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**Richard Johnson** - *Phibro Animal Health Corporation - CFO*

Thank you operator. Good morning, everyone. Welcome to the Phibro Animal Health Corp earnings call for our September 2014 fiscal first quarter.

With me today is Jack Bendheim, our Chief Executive Officer, and together we will provide an overview of our quarterly results and also updated guidance for our fiscal year 2015, and then we'll open the lines for your questions.

Before we begin, let me remind you that the earnings press release and financial tables can be found on the Investor Section of our website at PAHC.com. We're also providing a simultaneous webcast of this morning's call which can be accessed on the website as well. Today's presentation slides and a replay and transcript of the call will also be available on the website later today.

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 today will also include references to certain financial measures which were not prepared in accordance with generally accepted accounting principles, or US 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 US GAAP measures are included in the financial tables that accompany the earnings press release. With that, I'll turn it over to Jack Bendheim for some introductory comments. Jack?

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**Jack Bendheim** - *Phibro Animal Health Corporation - CEO*

Thank you and good morning, and this morning, a very short introduction. Thank you for joining. It was a very good quarter. We saw growth across all segments of our animal health and mineral nutrition business.

The business we are in provides importantly to enable our customers to produce safe, healthy, and affordable animal protein. It is one that we are dedicated to growing as we see the overall market growth around the world, and I want to take this opportunity to thank all of our customers, suppliers, and employees for their dedication and loyalty.



Now, we'll kick this back to Dick.

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**Richard Johnson** - *Phibro Animal Health Corporation - CFO*

Thanks, Jack. Briefly on page 4, as Jack said, it was a strong quarter for us led by our animal health segment. In addition, our mineral nutrition segment had a very nice quarter.

Unusually, and we've laid it out in fairly clear detail, also in the quarter we had a total of \$6 million of licensing revenue from milestone achievements from the licensing of our proprietary vaccine delivery technology. That \$6 million included the accelerated receipt of \$4 million that we had originally expected in fiscal 2016, but the milestone was achieved earlier than expected.

Turning to page 5 and looking at overall consolidated results, consolidated sales were up 16% driven by that sales growth in animal health and mineral nutrition performance. Product sales overall were stable. If we set aside the licensing revenues, we had 12% sales growth.

Down at the bottom line, adjusted EBITDA was up 41%, as that licensing revenue drops all the way through. It shows up in gross profit, and it shows up in EBITDA in the same amounts. Without the licensing revenue, our EBITDA growth was 13% in the quarter. Overall, we had an adjusted diluted EPS of \$0.51 in the quarter.

Going back briefly and looking at the middle of the income statement, gross profit was up almost \$11 million, 22%. As I said, that \$6 million is included in the gross profit and in the increase, and SG&A overall was up about \$2 million or 6%. One other comment on EPS, the prior-year comparative number is a pro forma number that has been adjusted to show the pro forma effects of our IPO and refinancing, so that it's on a like-to-like basis.

Looking at page 6 and drilling down on the animal health segment, within animal health we talk about three product groups. Within that, sales of our MFA and other business grew about \$3 million in the quarter or 4%. Nutritionals grew over \$5 million or 38%, and vaccines grew almost \$8 million, \$6 million of that being the licensing revenue. Vaccine growth, ex the licensing, was still a 20% growth rate.

Across all of those products groups, the revenue increase was largely driven by volume growth. There were selected pricing actions in the growth. In MFAs and other, we saw the growth principally in our international markets, notably Latin America and Asia Pacific.

Nutritional specialties, that category is predominantly products that we sell to the dairy industry in both the United States and in Europe. Vaccines, across most of our markets, we saw good growth.

At the EBITDA line, that sales growth translated to \$32.5 million of EBITDA, \$8 million of growth over the prior year, or 35%, it was 10% growth, ex the licensing. It was really that sales and volume growth dropping down through with continued operating expense investment more or less matching the sales growth.

Looking at other segments on page 7, mineral nutrition, about \$55 million of sales in the quarter, \$9 million of growth, 20%. That sales growth was primarily volume driven, and we also saw some margin improvement on increased demand, so that margin in the quarter was better than 6%, up \$1 million over last year and about a 40% overall increase. Performance products, as I've said, roughly stable, both top line and bottom line, and corporate, \$6.5 million of spending in the quarter, up \$400,000, largely still incurring those run rate increases as we now have some public company costs.

Looking at page 8, capitalization and capital allocation, on the leverage front, gross leverage was 2.9 times, \$289 million of debt with trailing EBITDA of just under \$100 million. We closed the quarter with \$20 million of cash on the books.

We had a good cash flow quarter, generated about \$13 million of cash flow before financing, in other words, operating minus investing activities. Then of that \$13 million, we funded the \$3.9 million payment of a quarterly dividend, and in addition just under \$1 million of scheduled debt reduction.



Looking forward, we have declared the next quarterly dividend, same amount, \$0.10 per share, payable in late December.

Looking at our guidance for next year, we've updated our guidance to add the accelerated receipt of the \$4 million licensing revenue and profit that we previously expected in our following fiscal. Net sales and EBITDA and the equivalent effect in earnings per share, both the bottom end and the top end of the guidance have been increased by that \$4 million. Just to remind everyone, we now have it in our guidance a total of \$8 million of licensing revenue and profit in the current fiscal year.

With that, that concludes my prepared remarks. Operator, let's open it up for questions, please.

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## QUESTIONS AND ANSWERS

### Operator

Louise Chen, Guggenheim Securities.

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### Louise Chen - Guggenheim Securities - Analyst

Thanks for taking my questions. I had a few. The first question I had was on your volume growth. It's been quite robust. I'm curious what is driving that? Is that international expansion? Is it overall market growth? Is a market share gains? I'm just curious if you can give us a more color there.

Secondly, do have any update on the antibiotic labeling changes? I know you were working on that. Then lastly just on the animal health industry in general, it looks like there's been talk of consolidation and just curious how you look at M&A. Are you more interested in bolt-on deals? Would you consider something more transformational?

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### Richard Johnson - Phibro Animal Health Corporation - CFO

Let me take that first part on volume, Louise. I would say our volume growth is coming across all species. The animal numbers have not increased that much, so we're really getting better penetration on our products, whether it's penetration into the dairy market, penetration into some of the growth initiatives that we've talked about in the past for some of our MFAs. The animal numbers are probably inching up slightly, but I think we're seeing growth more on some of our focused initiatives rather than just riding the rising tide.

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### Jack Bendheim - Phibro Animal Health Corporation - CEO

It's Jack. Beyond that, besides what we look at it, and what affects our business, besides the number of animals, it's also the weight of animals. What we're seeing around the world, as well, is larger animals because of better nutrition, because corn and soy bean is cheaper, so it pays to grow an animal a bit larger than in the past. The bigger the animal, the more it eats, the more it needs our ingredients.

We're seeing a combination of, as Dick said, penetration as we increase our sales forces. We're seeing some growth in animals and some restoration in some markets around the world, especially where there was drought or where there was diseases, and finally, the over all increase in the weight of the animals.



Finally to the issue on label changes, we continue to work in the United States with the FDA and with our regulatory development teams on building towards compliance with what's called 209, 213, and we see no change in the timeframe. We expect all these things to be implemented sometime towards the end of 2015 calendar, maybe early 2016. We're on target, hopefully, to achieve our goal.

Finally, on overall industry trends, it seems we read the announcements in yesterday's (inaudible). There seems to be a lot of excitement. We continue, as we've said in the past, to look for bolt-on acquisitions.

We are seeing some possibilities, nothing that we're at a stage to want to announce. But this business overall is growing around the world. It's a business, as I said earlier, that basically affords people to eat healthier and better. As the world economy recovers from 2008, 2009, we are seeing growth around the world. That portends well for our organic business as well as some potential acquisitions.

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**Operator**

Erin Wilson, Bank of America.

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**Erin Wilson - BofA Merrill Lynch - Analyst**

On the MFA and other business, it was a little bit lower than what we had expected, or at least somewhat of a deceleration. How should we think about the quarterly progression of that segment?

For the second question, again, on the animal health industry consolidation, there was a bid out there from Cargill for Nutreco. Do you see any pressure from potential consolidation of some of your customers at all? Thanks.

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**Jack Bendheim - Phibro Animal Health Corporation - CEO**

For the first one, the MFAs at the end of the day are involved with treating disease in animals, and it's not like looking at same-store sales. The animal diseases ebb and flow around the world depending on various conditions.

We were satisfied with the growth this quarter. We looked at our business again across species and across products, and we deliver to them. I don't think it portends anything for the next quarter up or down. We're seeing still strong demand of all of our products across all platforms and in all markets.

The consolidation, specifically the interest in Nutreco, I don't think what we're seeing around the world will affect our business. At the end of the day, and I think I've said it often in the past, our ultimate customer is the single animal, and whether that's a chicken, a pig, a cow, as we grow into fish, and those animals need to be fed. They need to be treated, and they need to be supplemented.

We are fairly agnostic who delivers, who does that. In other words, a larger Nutreco, a smaller Nutreco, a larger Cargill, et cetera, I don't think it really affects our business at all.

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**Erin Wilson - BofA Merrill Lynch - Analyst**

Quickly on the tax rate, what's been anticipated or embedded in your guidance at this point? Can you give us also an update on China?

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**Richard Johnson - Phibro Animal Health Corporation - CFO**

Taxes, our guidance for the year was \$10 million to \$12 million of cash income taxes, and that's still our guidance. We haven't change that, so that's what's embedded in those EPS numbers. China?



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**Jack Bendheim** - *Phibro Animal Health Corporation - CEO*

Specifically in China, what we've spoken in the past was on our nutritional specialties. We're waiting to receive some licenses which we have now received, and we've recently signed on with an important distributor to begin to market our specialty products in China. So far, no business yet, but the milestone of getting that registration was achieved, and we're starting up that business.

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**Operator**

Mohammed Sajanlal, Barclays.

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**Mohammed Sajanlal**, *Barclays*

This is Mohammed in for Doug Tsao. I'm just curious about the decline in performance products business. Are there any plans to divest that business?

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**Jack Bendheim** - *Phibro Animal Health Corporation - CEO*

We stated often, Mohammed, and thank you for asking the question, this is a business that we call our legacy business. Some of these products date back. It's generational for us, and we continue to look for opportunities really to return the best value to shareholders.

Right now the best value is to continue to operate those businesses, but they're not core. As you can tell from Dick's presentation and from the time that I've spent on it on this call, what we think about every day is our animal health and mineral nutrition business, and then whatever time is left over, we spend on the performance products.

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**Operator**

I'm showing no further questions at this time. I'd like to turn the conference back over to Richard Johnson for closing remarks.

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**Richard Johnson** - *Phibro Animal Health Corporation - CFO*

All right, everyone. Thank you for listening in. We look forward to talking again in about another 90 days. In the meantime, hope you're all well, and enjoy the Thanksgiving holiday. Good-bye now.

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**Operator**

Ladies and gentlemen, this concludes today's conference. Thanks for your participation. Have a wonderful day.

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