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Phibro Animal Health Corporation (PAHC)

Q1 September 2015 Earnings Call



CORPORATE PARTICIPANTS

Richard Johnson *Phibro Animal Health Corporation - CFO*

Jack Bendheim *Phibro Animal Health Corporation - CEO*

CONFERENCE CALL PARTICIPANTS

Brandon Firth *Guggenheim Securities - Analyst*

Erin Wilson *BofA Merrill Lynch - Analyst*

Unidentified Participant *Analyst*

Kevin Kedra *Gabelli & Company - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Phibro Animal Health Corporation's first-quarter financial results conference call.

(Operator Instructions)

I would now like to introduce your first speaker for today, Richard Johnson, CFO of Phibro Animal Health Corporation. You have the floor, sir.

Richard Johnson - Phibro Animal Health Corporation - CFO

Thank you, Operator. Good morning, everyone, welcome to the Phibro Animal Health earnings call for our September 2015 FY first quarter. On the call today are Jack Bendheim, our Chief Executive Officer; and myself, Richard Johnson, Chief Financial Officer. We'll provide an overview of our quarterly results and then we'll open up the lines for your questions.

Before we begin, let me remind you that the earnings press release and the financial tables can be found on the Investors 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 to 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 descriptions of certain factors that could cause results to differ, I refer you to the forward-looking statements sections 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. Reconciliations of these non-GAAP financial measures to the most directly comparable US GAAP measures are included in the financial tables that accompany the earnings release.

So with that, I will turn it over to Jack for some introductory remarks. Jack?

Jack Bendheim - Phibro Animal Health Corporation - CEO

Thanks, Dick, and thank you all for joining us on this call. I am pleased to report that we have started out our new FY with a strong first quarter. Our animal health customers experienced a choppy quarter with numerous challenges including currency and profitability especially in the dairy markets.

Despite the challenging conditions, our Animal Health Group was able to deliver an impressive 8% sales growth and 19% adjusted EBITDA growth. These results have given us further confidence in our decisions to continue investing and growing out our dedicated sales team in certain key markets.

I am also pleased with progress we have made in expanding production capacity needed to supply our growing customer base. We believe we have developed a very scalable infrastructure in many markets.



So while we continue to emphasize our organic growth, we are also actively looking for acquisitions across the animal health business that would further leverage our capabilities.

Now I'll turn it back to Dick for some further color on our first quarter and I look forward to taking your questions after his presentation.

Richard Johnson - Phibro Animal Health Corporation - CFO

Thanks Jack. Before we start, just a note that all of the comparisons here in this presentation today are comparing against the 2014 numbers that excludes \$6 million of milestone revenues and income that we received last year related to the licensing of some of our proprietary vaccine delivery technology. For a better understanding of the underlying trends we have presented the comparisons with last year to exclude those milestone payments.

So now looking at our consolidated results, first on the top line consolidated sales of \$187 million grew about \$6 million, or 3%. That growth was driven entirely by our Animal Health Group with almost \$9 million of sales growth or 8% over last year.

Our mineral nutrition business saw good volume growth also but the revenues were affected by lower commodity pricing. As a result, our reported revenues were down 2% year over year. Our small performance products business saw about a \$2 million sales decline from last year on volume decreases.

So that \$6 million of sales growth translated into about \$6 million of gross profit growth, or 11%, as we increased our gross-profit ratio to better than 32% of sales. That increase was driven by volumes and mix. It was driven by improved operating efficiencies on our manufacturing facilities where we're seeing the benefit of some of our capital expenditures. It was also seen in favorable cost to goods driven by those larger volumes and also favorable currencies in some of our international manufacturing plants.

At the same time we have continued to invest in our operating expenses, building out our selling, marketing and development effort. We increased across the entire Company SG&A of approximately \$3 million or 9%. Almost all of that increase was in our animal health segment. Put that all together, we get down to an adjusted EBITDA of \$27.7 million, about a \$3 million increase over last year or 13%, driving that EBITDA ratio, our operating margin ratio, to 14.8% of sales.

On an adjusted diluted EPS basis, \$0.44 compared to \$0.33 last year. Again, that comparison excludes the milestone revenues from last year, an \$0.08 or 22% increase over last year. That improvement was driven by the growth in adjusted EBITDA and income taxes that, on a dollar basis, were about flat with last year which meant that they were a lower effective rate than last year. Our tax rate in the quarter was about 11.5%.

Turning to the animal health segment, within that 8% sales growth or, again, about \$9 million, MFAs and other, the biggest part of that segment, grew \$4.7 million or 6%, as we saw strong demand for our products across a number of international markets. Nutritional specialties with our focus in dairy and primarily in the US but also in Europe and some other international markets. In addition, an introduction of a poultry product to the US market.

Nutritional specialties grew almost \$3 million or 15% in the quarter. And vaccines was better than \$12 million of sales in the quarter, grew \$1.3 million or 12% over last year. So \$120 million in total sales for the animal health segment and \$9 million of sales growth. Out of that \$9 million of sales growth, we saw adjusted EBITDA increase \$5 million to \$31.5 million this year, or better than 26% operating ratio, a 240 basis point improvement, driven by that gross profit growth of things I called out on the previous page, volumes, product mix, favorable manufacturing costs and offset in part by continued investment in growing our business and increasing operating expenses.

Looking at the other segments, mineral nutrition, \$54.5 million of sales, down \$1 million, or 2% from last year. Within that we did see volume growth, still strong demand in that business, but commodity pricing resulted in lower sales revenue. The operating margin was down slightly on sales mix plus a small unfavorable SG&A comparison year over year. It's still a healthy operating margin at 5.8% of sales for this lower-margin business.

Performance products, \$12.5 million of sales, reduced volumes on reduced industrial demand and EBITDA just above breakeven. Corporate staying at about the same run rate. We've been seeing \$7 million for the quarter, nothing major to call out there.

Then looking at our capitalization and capital allocation, our leverage ratio was 2.9 times at September, as we had totaled debt of \$307 million. That includes being drawn on our revolver of roughly \$20 million. And on a trailing-12 basis our EBITDA was \$107 million. Ended the quarter with \$32 million of cash on hand. We used about \$10 million of net cash before financing activities in the quarter and that really represented investment in our business growth.



We saw increases in receivables, inventories and just typical timing of pay down of some payables for things like annual incentive compensation and some other payments. CapEx is in line with our higher guidance for this year; we spent about \$8 million of CapEx in the quarter. And just our typical dividend, no change there, \$3.9 million paid in September, the same level of dividend declared to be paid in December at \$0.10 a share.

So those are the highlights of our numbers for the quarter. Operator, if you will open it up and we'll have some question and answers. Thank you.

QUESTION AND ANSWER

Operator

(Operator Instructions)

Louise Chen, Guggenheim.

Brandon Folkes - Guggenheim Securities - Analyst

Hi, it's Brandon Folkes on for Louise. You have an aquaculture business. Could you give us some color around how big it is today and what is the growth potential for that business?

And then what products are you focused on growing right now? Is it anything you can talk about in your pipeline even if it's a more broad discussion? Thank you.

Jack Bendheim - Phibro Animal Health Corporation - CEO

Thanks for the question. It's going to be a very broad discussion. As you remember, we just launched our efforts in aqua within the last two years.

What we're concentrating on right now is reviewing and testing our current offerings - some of the products we own and control have IP on - and seeing how these products can be used in what species and what markets. So we're ongoing in that and we will be launching some products earlier in the coming calendar year.

We are also looking to get into the vaccine market where we're doing current tests at our Israeli manufacturing site to see exactly which vaccines and which diseases we think we can bring some value to the market to. And finally we are, as we said earlier, looking in the possibility of various acquisitions to grow in that sector. So it's a long answer to a question which is currently our sales are de minimus, but we hope over the ensuing quarters and years for this to become a significant contributor to the Company.

Brandon Folkes - Guggenheim Securities - Analyst

Great, thanks so much.

Operator

Erin Wilson, BofA Merrill Lynch.

Erin Wilson - BofA Merrill Lynch - Analyst

Great, thanks. Are you essentially reiterating your guidance for the year? And what does that incorporate as far as fundamental underlying utilization trends? Also, how should we think about the tax rate going forward?

Richard Johnson - Phibro Animal Health Corporation - CFO

Yes, we have not made any changes or updates to our guidance, Erin, so it stands as we put it out there before. I think the tax rate on a full-year basis was around -- just one moment -- probably around 17%. So, yes, this first quarter was low. The guidance we gave for the year gets us to a tax rate of around 17%. Again, that earlier guidance we gave still stands.



Erin Wilson - BofA Merrill Lynch - Analyst

Okay. And can you speak to what that new poultry product is on the nutritional specialty side? And what that could potentially add and where you have launched the product?

Jack Bendheim - Phibro Animal Health Corporation - CEO

I don't think we go through real break-outs on products. We are all seeing the effect and we applaud the most judicious use of antibiotics. Many of our customers are trying to control the various bacterial diseases with non-antibiotics.

This is a line of products that we have launched. We've been testing it -- we have had it in the market already for about a year on some tests. We've been developing it for the last four years. We think it's pretty unique.

As you said, it's for the poultry market and it helps control various pests and bacteria that will enhance the health and safety of the chickens. We're seeing a nice uptick in that business and we expect that to grow further.

Erin Wilson - BofA Merrill Lynch - Analyst

Okay. And then generally speaking, can you speak about the health of the poultry market, particularly in the US as some of these changes have evolved and the utilization of antibiotics? But also fundamentally speaking, overall demand trends?

Jack Bendheim - Phibro Animal Health Corporation - CEO

I would say right now the poultry business in the United States is quite healthy. Everyone is -- including in some sort of scared anticipation of the avian influenza time period to hit. So far, as best we can tell, it has not hit the US as we start getting into the winter months yet.

Overall I think the effect of the strong dollar is hurting our export market so it's causing some lower prices here because it's harder to export poultry. But our customers are still benefiting by lower feed prices and from a fairly strong domestic market. I think the overall industry is quite healthy and will continue hopefully continue to be so.

Erin Wilson - BofA Merrill Lynch - Analyst

Okay, that's great, thank you.

Operator

David Risinger, Morgan Stanley.

Unidentified Participant Analyst

Hi, this is [Anisa] on for Dave. Thank you very much for taking the questions. I have two questions. First, could you please comment on the outlook for herd sizes in 2016 relative to last year, including what percentage increase you expect? And secondly, could you provide more colors on the outlook for the December quarter related to last year? Thank you.



Richard Johnson - Phibro Animal Health Corporation - CFO

Let me take the second part first. That is, we give annual guidance and don't really focus on quarterly numbers. So if you'd go back and take a look at our guidance, we say that we expect each of our quarters to be similar to our annual guidance in terms of growth, et cetera, with more strength in the second half of our fiscal year. So that's as detailed as we have gotten on quarterly numbers.

On your question on herd size, I didn't quite catch all of the question. Could you repeat that, please?

Unidentified Participant Analyst

Yes, sure. So we were wondering if you could provide some comment on the outlook for the herd sizes in 2016 relative to 2015. What are you expecting? Whether you think the herd sizes will increase or in what percentage of increase are you expecting?

Jack Bendheim - Phibro Animal Health Corporation - CEO

As you know from our business, other than our dairy cattle, our beef business is not the busiest segment. But we watch the overall market, and this year we are seeing increases in herd sizes, if you're talking about the United States. We are seeing increases in herd sizes in all the places they should be. We expect people who sell products for those markets will see increased sales this year.

Unidentified Participant Analyst

Okay, thank you.

Operator

Kevin Kedra, Gabelli.

Kevin Kedra - Gabelli & Company - Analyst

Thanks for taking the questions. First, wondering if you could give more detail geographically on where you are seeing the most strength for the MFA business. Then on the aquaculture business, recently saw a competitor go out and buy a company for what looked like a relatively rich multiple amount, eight to nine times trailing sales.

Wondering if, when you look at some of the inorganic opportunities out there in aquaculture, is that the kind of multiple or valuation that you are seeing out there? Or are there some less expensive assets that you might be able to pursue?

Jack Bendheim - Phibro Animal Health Corporation - CEO

First of all, on the breakdown of antibiotics, we're seeing strength in most of the international markets. Our strategy has been, and we have stated this for the last couple of years, of growing this business into the cattle areas in many markets. The results, or returns, to the growers are phenomenal, over 10 to 1.

So we're concentrating on countries that raise a lot of cattle, whether it's Australia, or whether it's Brazil, Mexico, where we have the registrations and we have the permissions and the approval to do it. So those we're seeing a lot of growth. We're also seeing growth in our poultry and swine segments around the world, and that remains strong.

We never comment about competitors pricing in terms of acquisitions. We think it was a brilliant acquisition that Zoetis did. We think we're worth at least that. But I think our financial ability would restrain us from competing in those kind of markets.



Operator

(Operator Instructions)

That is all the questioners that we have in the queue at this time so I'd like to turn the call back over to management for closing remarks.

Jack Bendheim - Phibro Animal Health Corporation - CEO

Before Dick closes, it's Jack. I want to pass on a note that I received yesterday from the National Turkey Federation, because of the avian influenza last year there's less fresh turkeys in the market and more frozen meat. So for all of you thinking of deep frying, they recommend that you allow nearly a week to safely defrost a 20-pound turkey. So be safe, be careful, have a great holiday season, and I'll turn it over to Dick.

Richard Johnson - Phibro Animal Health Corporation - CFO

So there you have it, ladies and gentlemen. We are always interested in healthy animals, healthy food, healthy world and healthy people. So we'll leave it at that, talk to you next quarter. Bye now.

Operator

Ladies and gentlemen, thank you again for your participation in today's conference. This now concludes the program and you may all disconnect your telephone lines at this time. Everyone have a great day.

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