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Phibro Animal Health Corporation (PAHC)

Q3 2014 Earnings Call

Corporate Participants

Jack Bendheim
Chairman, President, Chief Executive Officer

Richard Johnson
Chief Financial Officer

Daniel Bendheim
Executive Vice President, Corporate Strategy

MANAGEMENT DISCUSSION SECTION

Mr. Richard Johnson
Chief Financial Officer

Well, good morning everyone and welcome to Phibro Animal Health Corporation's Third Quarter, March 2014, conference call. I'm on the cautionary statements on page two. Before we discuss our third quarter results, I'd like to remind everyone that the company will be making statements about its future results and expectations, which constitute forward-looking statements within the meanings of the Private Securities Litigation Reform Act. Such statements are based on current expectations and the current economic environment and are inherently subject to economic, competition and other uncertainties and contingencies beyond the control of management. You should be cautioned that these statements are not guarantees of future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements. Important assumptions and other important factors that could cause actual results to differ materially from those in the forward-looking statements are specified in our earnings release and the registration statement on Form S-1 filed with the SEC in connection with our initial public offering. If you did not receive a copy of the press release, it's available on our website at investors.pahc.com. And we're also providing slides to accompany this morning's conference call, which can be accessed on our website as well. Also, certain non-GAAP financial measures will be discussed on this call and these measures are reconciled to the GAAP numbers in our press release and/or in our quarterly report on Form 10-Q, which is also available on our website. So, with that let me introduce the people from the company on the call today. Turning to page three, Jack Bendheim, Chairman, President and Chief Executive Officer, myself, this is Richard Johnson. I'm the Chief Financial Officer. And, Daniel Bendheim, Executive Vice President of Corporate Strategy. And with that, let me turn it over to Jack for some introductory comments. Jack?

Mr. Jack Bendheim
Chairman, President, Chief Executive Officer

Thank you, Dick. And thank you to all of you for joining us on this call today, which is our first as a listed company. The last few months have been a very exciting time at Phibro Animal Health. It was a pleasure to meet with so many of you in the investing community during our recent IPO road show and to have the chance to introduce Phibro and to explain what I believe is so unique about our company. And if you recall, one of the strengths I highlighted was the strength of our overall team. And this is underscored by the strong operational performance we've turned in for our fiscal third quarter despite all the distractions inherent in going public. So, I'd like to begin by recognizing and thanking all of my colleagues for their efforts in general and specifically over the last few months. Phibro Animal Health is singularly focused on helping our customers raise healthy and productive animals to meet the growing demand for worldwide protein. And that focus has allowed us to drive initiatives resulting in significantly higher than industry growth. Our consolidated sales were $173 million, led by our animal health division, which delivered 15 percent growth as compared to our third quarter last year. And that growth was seen across the medicated feed, nutritional and vaccine product groups. This revenue growth and accompanying margin expansion led to a consolidated adjusted EBITDA of $22 million, a year-over-year improvement of 16 percent and a proforma adjusted EPS of $0.36, 28 percent greater than last year. And this bottom line strength was delivered despite the fact that we continue to spend on sales and marketing and development dollars that we are investing for the growth we expect in the quarters and the years to come. While Dick will discuss more fully our fourth quarter guidance a little bit later, we continue to feel very good about animal health growth initiatives and believe that we have strong operating momentum as we look to close out what, for us, has been an extremely exciting fiscal 2014. While we have nothing imminent to report, we remain on the lookout for tuck-in acquisitions that can further leverage the growth, the strong teams and market positions we have built to serve our industry. And now I'll turn it back to Dick to walk through our Q3 numbers and to provide Q4 guidance.

Mr. Richard Johnson
Chief Financial Officer

Thanks, Jack, and good morning again, everyone. Turning to our quarter results for the March quarter on page five. And if we just look at the chart on the right about in the middle of the chart, net sales $173 million, up 7 percent over the same quarter last year. As we've seen in a number of quarters recently, the animal health segment is leading that growth with almost $108 million of sales, 15 percent sales growth. And we'll get into more color on the segments in the next couple of slides. So, I won't say anything more here. Gross profit, 30.5 percent for the quarter, better than a 200-basis point expansion over the same quarter last year, 15 percent improvement in gross profit. As Jack just mentioned, SG&A $35.5 million, grew 14 percent. Most of that SG&A growth is in our animal health segment as we put sales, marketing and development spending behind our growth initiatives. We also had some increased corporate spending as we're beginning to see the cost of public company start to come into our P&L. So, as a result at the adjusted EBITDA line, $22.4 million of EBITDA, up $3 million or 16 percent over last year and quarter-over-quarter a 110 point basis point expansion with operating margins of 13 percent of sales. When we drop that EBITDA down all the way to net income and EPS and we've presented here a proforma EPS, which shows the impact of our recent IPO and our refinancing as if it had happened at the beginning of the period. So, in other words, we're showing on a proforma basis the lower interest expense and we're also showing the greater number of shares outstanding that gives pro-forma adjusted diluted EPS of $0.36 for the quarter, up 28 percent over last year. So, now let's turn to page six in the animal health segment. Again, first looking at the table on the right hand side of the page, MFA's, the largest part of this segment, $81 million of sales, had very nice growth in the quarter of 12 percent. Nutritional specialties, $16 million of sales, up 14 percent and vaccines about a $10 million per quarter sales level, up 46 percent over last year. So, in total those three product groups drove a 15 percent sales increase. The sales increase was largely volume driven. There were some selected pricing actions in the quarter that benefitted the sales growth. But, the vast majority of that 15 percent was volume related. In MFA's and others we saw growth really across almost all of our markets and countries where we do business. We've called out two regions that were the particular drivers of the growth in this quarter. And that's Asia Pacific and Latin America.

Asia Pacific includes countries such as China, the Southeast Asia countries. Latin America would include Mexico on down through Brazil and other countries in South America. Our dairy nutritionals really was led by our two flagship products OmniGen and Animate. We operate in the United States and in selected countries in Europe. Strong volume growth there again a little bit behind the trend that we saw in the first half of the year as we saw just some timing of certain orders in some of our European countries basically soften that rate a bit. But, the business continues on the trend. And, finally, vaccines, again, volume growth driven by new product introductions that we introduced over the last several quarters. And we saw volume growth in most of the markets where we operate with our vaccine business. So with that sales growth and with the gross profit improvement, you saw that on a consolidated basis, but most of that gross profit improvement is, of course, related to the animal health segment, offset by the increased spending on SG&A. The segment adjusted EBITDA grew 25 percent over last year. So, it was about $25.5 million of EBITDA, 23.7 percent operating margin, that's a 200 basis point expansion over last year. And in addition to the volume and pricing mix benefits, we did continue to see some gross profit benefit from production efficiencies, as we were able to lower cost of goods with some capex investments. The other segment performance on page seven looking first at mineral nutrition, about $50 million sales level in the quarter, down 4 percent from last year. EBITDA just under $3 million, down $600,000 from last year, 18 percent. Volumes actually in this business were up slightly year-over-year, but on this dollar line, sales were down due to commodity pricing. At the bottom line, margins were compressed on competitive conditions. So, we saw--you know, we saw a 5.6 percent operating margin here for this segment. This is--this business, although it's down from last year, is really stable sequentially from what we've seen through the beginning or through three-quarters of this year. Performance Products, $15.5 million of sales, about a million dollars of EBITDA, down both at the sales and profit lines. Again, we had some volume decline, some pricing pressures in this business, but it's broadly also stable with what we've been seeing year to date. And, finally, corporate expense of almost $7 million, an increase of about $800,000 over the prior year. And that's in part the increases due to--we were beginning to see the costs of--the incremental costs of being a public company come through. So if I go to guidance now looking forward to our June quarter on page eight. Our guidance at the sales line is $174 million to $177 million, 6 percent to 8 percent increase at the sales line over last year. Guidance on adjusted EBITDA is $23 million to $24 million, 15 percent to 20 percent improvement in adjusted EBITDA. And proforma adjusted EPS $0.19 to $0.21, that compares to $0.30 last year on the same basis, so it's down and that first bullet point on the left explains the major reason it's down is one of the adjustments we've been presenting is to put income taxes on a cash basis. Essentially our GAAP effective rate has been very choppy. And so, we've gone to a cash basis of presenting income taxes for this adjusted method. And in our fourth quarter we will be seeing about six--well, we'll see about $8 million total of cash taxes. And that's $2 million of routine level, as well as we'll have about $6 million of unusual or non-recurring items relating to foreign withholding taxes on some repatriated cash and, in addition, we settled a tax audit during the June quarter. And that will also be a cash cost. Those two items are about 50 percent each of that $6 million. That $6 million would represent about a $0.15 per share EPS cost. And then just continuing down, a couple of notes on what we'll be reporting in the fourth quarter. We will report interest expense around $6.7 million in the quarter and that's because we'll continue to have on our books the senior notes until they're actually redeemed May 16. So, we won't have the benefit on a reported basis of our new debt capital structure until we get into our new fiscal year. And then we will also have an almost $24 million loss on extinguishment of debt in the June quarter. And that comes fundamentally from paying off the senior notes early, both redemption premiums, as well as writing off costs that were on the balance sheet, deferred financing and some OID. Just for clarity our share base today is outstanding shares 38.8 million and then for dilution purposes the options and the warrant outstanding on a net basis would add about 600,000 additional shares to get to a fully diluted share base. If I go back to the table then and look at the fiscal year with the fourth quarter guidance that'll put net sales for the year in the $682 million to $685 million, that'd be a consolidated sales growth of 4 percent to 5 percent. It'll put adjusted EBITDA in the $89 million to $90 million range, a growth of 17 percent to 19 percent. And proforma adjusted diluted EPS $1.19 to $1.22, similar, you know, similar growth to EBITDA. And then the last note we make here is that we will provide guidance for our next fiscal year, fiscal year ending June 2015. We will provide that guidance when we release our actual results for June 2014. And that release will come sometime middle of September is our current timing. And turning to capitalization and capital allocation, just a few other points here. Our proforma leverage at March was 3.4 times, that’s using the new term B debt that is the only piece of debt we now have outstanding after the refinancing, compared with $86 million of LTM adjusted EBITDA. And that’s a first step when--in the S-1 it was 3.5 times, you know, looking at LTM December EBITDA. So, it's comes down a tick just based on the increase in EBITDA. And it's a first step toward midterm improvement going forward. In our proforma's for the IPO and the refinancing we had $17 million of cash at March. We're forecasting about that same level of cash at the end of June as there will be one final payment of interest during the June quarter that will use up what otherwise would have been some positive cash flow for the quarter. In addition, we're affirming our intention to pay a dividend. We plan the first payment in September of 2014. Most likely with an August 2014 record date. Our plan is to pay a $0.10 per share quarterly dividend. That’s approximately $15.5 million annually. And that translates into about a 30 percent payout, based on proforma adjusted net income. And at yesterday's market close that was about a 2.2 percent yield on the share price. So that's the end of our prepared remarks. So, operator if you'd open it up for question and answers.

QUESTION AND ANSWER SECTION

Operator: Okay, thank you very much. At this time, if you'd like to ask a question, please press star then the number one on your telephone keypad. If you'd like to withdraw your question please press the pound key. We'll pause for just one moment for the Q&A roster. Our first question comes from the line of Louise Chen. You may go ahead.

Ms. Louise Chen
Analyst, Guggenheim

Hi. Thanks for taking my questions. I had a few. So, the first question I had is what is driving your faster than market rate growth in the animal health business? Maybe if you could give us more specifics, either products or markets or what have you. The second question I had was on M&A. You noted tuck in deals. But, I'm wondering if you would consider larger scale M&A given the fact it looks like there's some consolidation in the animal health space happening. And then lastly a question that we often get is what key factors distinguish Phibro from its competitors and I was hoping you could help us provide more color there. Thanks a lot.

Mr. Jack Bendheim
Chairman, President, Chief Executive Officer

Hi, Louise. It's Jack Bendheim

Ms. Louise Chen
Analyst, Guggenheim

Hi.

Mr. Jack Bendheim
Chairman, President, Chief Executive Officer

So, what we've said on the road and what we continue to say is unlike some of our larger competitors we focus just on production animals. So, we're not in the universe of both the pets as well as production animals. So, in other words, we need to be compared pretty much to what both these guys are having in their production animal business around the world, number one. And we are active in those markets that grow a lot of animals. I mean our ultimate goal is healthy animals creates safe food. There is a worldwide push and growth in consumption of animal protein. And literally that's the markets we serve and we're enjoying that growth. Besides that, we're focusing on some new areas that I think are unique to us, specifically in our dairy business and some of these specialty nutritional products that we spoke about. Again, the consumption of dairy products around the world I think are at an all-time high, pricing is an all-time high. And our products helps the dairy cow farmers produce a higher quality milk at a higher level of productivity with the animals staying healthier longer. So, again, it's all these secular trends that are really driving our growth a bit faster than Vetnosis puts out for the industry. I think you're question had to do with M&A with some of the larger acquisitions that are out there. You know, I think looking at our size and looking at the size of our competitors, I think we're gonna stay pretty focused on, as we said before, tuck in acquisitions, smaller acquisitions that we can handle both in terms of our financial strength and our ability to absorb. So, we will not be competing for the larger assets that are out there. And, finally, the key factors, I think I already pretty much covered it in the first answer. I mean we absolutely focus in markets and in countries and on poultry, on swine, on dairy cattle and cattle in some selective markets. And those customers are doing great. And our products perform well for them, so we're--we've done well this quarter. We've done well this year. And we--you know, the plan is to continue to do well going forward.

Ms. Louise Chen
Analyst, Guggenheim

Thanks a lot.

Operator: Our next question comes from the line of Erin Wilson, Bank of America. Your line is live.

Ms. Erin Wilson
Analyst, Bank of America

Great. Thanks so much for taking my questions. How would you characterize the fundamental dynamics across the production animal business right now in light of the weather conditions that we saw over the past several months? And how would you characterize, I guess, the varying species groups there and how should we think about it over the next couple of quarters and beyond?

Mr. Jack Bendheim
Chairman, President, Chief Executive Officer

That's a great question, Erin. I mean, first of all, the drought that had existed and so much affected many people's business in the United States, it has subsided a bit. So, we are seeing the--at least on the cattle market, a very, very slow repopulation of feed lots. I mean the other side of that factor is the prices of beef are so high that a lot of people are selling off their cows before they get to feed lots. So, the growth is happening, but it's happening a lot slower. And, again, sticking to the United States, I think a bigger effect of the protein side is this virus in the swine population, which we all read about and which we see. I mean they're literally I think, from what we hear, the availability of pork will be down 4 percent to 5 percent for the year. But, the reality is that is a combination of higher weights for the live pigs. But, you're talking about the death of piglets running at maybe 10 percent or larger. So, that will have an effect. What it's doing is it's keeping prices high. I think it's causing a bit more positive trend on the poultry side. As you know, you can cycle poultry a lot faster. So, we see poultry numbers, both in terms of weights and actual heads, increasing slightly at least in the short-term. I think that will accelerate going out to the next two or three quarters. And back to the pig market, this virus is far from being over, so we're going to continue seeing those pressures. The other side of the world is you have a big drought down in Brazil. It's not exactly clear the full effect of what's going to happen because Brazil is the largest producer and exporter of beef in the world. So, you know, we all talk about weather a lot and we're going to continue talking about weather as we go out for the rest of the year.

Ms. Erin Wilson
Analyst, Bank of America

Okay, great. And you mentioned some fluctuations in ordering patterns in the nutritional specialty segment. Is that something that we potentially benefit the fourth quarter or how should we--or could you just elaborate on the dynamics there?

Mr. Jack Bendheim
Chairman, President, Chief Executive Officer

Yeah, we had, in our European business especially, Erin, we do business through distributors there. So, as we were ramping up a year ago we were seeing some startup orders and just so the overlap against that now I think it's mostly a one quarter effect. We would expect to see better growth in our next quarter.

Ms. Erin Wilson
Analyst, Bank of America

Okay, great, thank you so much.

Operator: Our next question comes from the line of David Risinger from Morgan Stanley. Your line is live.

Mr. David Risinger
Analyst, Morgan Stanley

Thanks very much. Good morning, Jack and Dick, and congrats on your first quarter as a public company. My two questions are first for Jack at a high level, could you just frame for us your growth opportunities in Europe and in Asia in particular. You know, it appears that you're in very early innings of growing your poultry vaccine franchise in Asia and also your dairy cattle franchise in Europe. But, if you could help frame that for us that would be helpful. And then, Dick, if you could just talk about key variables that we should think about for the fiscal fourth quarter sequentially versus the March quarter that you just reported, you know, what are the sort of puts and takes that we should be thinking about that could drive the results slightly better or slightly worse than how you're expecting them today? Thanks so much.

Mr. Jack Bendheim
Chairman, President, Chief Executive Officer

Thank you, David. It's Jack. So, firstly, our business in Europe is pretty singular where we're focusing on the dairy cattle market. And we're focusing with our nutritional specialty products. Europe is different than the United States because the Europeans are--first of all, they have, say, twice, more than twice the amount of heads of dairy cattle than we have in the United States, number one. But, number two, Europe is now as price supports start decreasing in Europe as they go to, I think at the end of '17, where there are no--where it looks like there will no longer be support for the dairy industry across the EU. The Europeans are fine to go through with some of the stuff we've gone through in the United States and the need I would say tend to fall to larger farms and these farms will be more productive. The tools that we're offering them, which we've done--sold quite successfully in the United States, allows for the productivity increases of the dairy cow. It allows it to remain in production out of the sick bay, so to speak, for a longer period of time. And it increases the quality of the milk. Dairy farmers get paid on somatic cell count numbers, SCC. Europe is a huge cheese production. Most of the milk ends up not in liquid form, but for cheese. You need a higher quality milk for that. So, the demand and the product that we have is unique and have experience in the United States with over 400--we have sort of documented experience of over 400,000 cows that we watched. We sell to over 20 percent of the U.S. 9 million dairy cows. It gives us a lot of experience. So, we're just ramping up. It is new territory. It's new markets for us. So, that will continue to grow as we go forward. To the poultry side, our vaccines, you know, we're relatively newcomers in that business. And we have a quite small share of what is the billion dollar poultry vaccine market in the world. And we're concentrating in Asia. We see some of the same diseases in Asia, a lot of the diseases that we see in Israel, which is a country where we produce most of these vaccines, so it's just a question, again, of ramping up our sales and technical teams in these countries to increase our sales of the vaccines. And besides that, Europe--I mean the Far East is where we see most protein growth. It's the fastest rising population. It's the fastest raising middle class within the population. So, all those articles we read all the time, whether it's milk consumption in Europe or protein consumption, pigs, chicken, you know, hogs et cetera, I mean that’s where we're growing and that’s where we'll keep pressing on.

Mr. Richard Johnson
Chief Financial Officer

Yeah, and to your second question on key variables sequentially looking at the June quarter, you know, we've given you 6 percent to 8 percent sales of sales growth guidance. We're quite comfortable with that. I don't see any major downside risks to the bottom of that range. And maybe we have an opportunity to do a little bit better at the top end. But, nothing major there. You know, we're--business is going along in the fourth quarter much as it was in the third quarter with a little bit of a pickup of just sequentially. We've seen the Brazil currency strengthen against us in the last maybe six weeks. So, that won't have a major effect on our fourth quarter. It could influence our thinking on where we'll be for next year. But, you know, nothing in the June quarter of any magnitude. There's always the unknown, but I can't think of any other major items, David.

Mr. David Risinger
Analyst, Morgan Stanley

Great. Thanks very much Jack and Dick.

Operator: Our next question comes from the line of Matthew Korn of Barclay's. Your line is live.

Mr. Matthew Korn
Analyst, Barclays

Good morning, everybody. And I'll second the congratulations for getting through such an active quarter. A question on the tax impacts, Dick, that you'd talk about coming up for the next quarter. It looks like this is about a $3 million from a repatriation of cash that you decided to do and then another, like you said, there's a tax settlement from retroactively. Could you give us a little more detail? It sounds as though you believe this should kind of close the loop on those issues and I just wanted to make sure if there's any remaining exposure there? And then secondly, if you could just give us an update for the partnership with Epitopix and how the penetration to the U.S. market is going. And then I guess lastly, you know, any update on what you've been finding and how things with Aquavet are going. Thanks.

Mr. Richard Johnson
Chief Financial Officer

First to taxes, the withholding taxes, on cash repatriation was an absolute one time item. There's--you know, we hadn't done that in 15 years and we have no plans to do it again anytime in the foreseeable future. So, that’s a one time. And the tax audit. This was in Israel. It settled four years of open items. And sometimes it's better to just settle rather than fight. We thought we had good defensible positions on many of these issues, but we reached what we thought was a number we could live with. And so we went ahead and settled. There are--there is another piece of our Israel operations that did not close. There's a couple of other subsidiaries. Those are still under audit. We expect those to be done fairly soon. But we don't expect any meaningful cash cost to come out of those audits, at least that’s our current reading. And we don't have any other significant audits in process anywhere else in the world. And, generally the tax authorities have looked at our returns and have not had major issues. So, yeah, I don't see any other major items on the tax side. On the Epitopix question, I'll turn that one over to Jack, okay?

Mr. Jack Bendheim
Chairman, President, Chief Executive Officer

Right, okay, thank you. The business with Epitopix is going well. I think we're a little over three months into the sales of this product and we're gaining market acceptance across the poultry market that we've been calling on. So, sales are growing. I mean we'll have more to say about this thing in future quarters. But, the results and the acceptance of the product is very, very gratifying. We like to say inshala, we thank God for helping this--that business growing. It's been great. The Aquavet business, I mean this is--it's a new venture for us, as you know. Aqua is the fastest growing protein in the world. And we are currently screening--the team over there is screening our current portfolio of products against the various Aqua diseases and we're putting together an aggressive business plan. But, so far there are no sales.

Mr. Matthew Korn
Analyst, Barclays

All right, thank you, gentlemen.

Operator: Just as a reminder, if you'd like to ask a question, please press star and the number one your telephone keypad. And there are no further questions in queue.

Mr. Richard Johnson
Chief Financial Officer

All right, we thank everyone for listening in this morning. And we'll be in touch again with our year-end results at some point in September. We'll firm up the date as we get closer. Thanks and have a good day everyone, bye, now.