September 17, 2014

**Phibro Animal Health Corporation (PAHC)**

Q4 2014 Earnings Call

**Corporate Participants**

Jack Bendheim
*Chairman, President, Chief Executive Officer*

Richard Johnson
*Chief Financial Officer*

**MANAGEMENT DISCUSSION SECTION**

**Mr. Richard Johnson**
*Chief Financial Officer*

Operator: Good day, ladies and gentlemen, and welcome to the Phibro Fourth Quarter Financial Results Conference Call.

At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will follow at that time. If anyone should require operator assistance, please press star then zero on your touchtone tone telephone.

As a reminder, this call is being recorded. I would now like to introduce your host for today's conference, CFO Richard Johnson. Please go ahead, sir.

Richard Johnson: Thank you, operator. Good morning, everyone. Welcome to the Phibro Animal Health earnings call. We're going to be talking about both our fourth quarter and fiscal year ended June 2014 today.

We'll provide an overview of our quarterly and annual results for 2014. We'll also talk about our guidance for our FY15; and then we'll – after our presentation, as the operator said – we'll open it up to your questions. On the call today are Jack Bendheim, Chief Executive Officer; and myself, Richard Johnson, CFO.

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 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 today will also 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.

With that, I'll turn it over to Jack Bendheim for some introductory remarks.

Jack Bendheim: Thank you, Dick, and thank you to all of you for joining us on this call today. I'm proud that we once again are able to deliver strong top- and bottom-line performance in our fourth quarter, capping off a truly transformational year for Phibro Animal Health.

The transition from a private to a public company is understood to be a difficult one. But it's a testament to the work and focus of my colleagues throughout the organization that we were able to meet and exceed our targets despite many distractions.

At the end of this call, Dick will be sharing with you some of our goals for the fiscal year we embarked upon in July. We continue to see multiple opportunities across all of our Animal Health business units, and have tremendous confidence in our ability to deliver both top- and bottom-line growth, while at the same time continuing to invest substantially in growing our sales organizations related to our key initiatives.

I will now turn it back to Dick, and look forward to answering any questions you may have at the end of the call.

Richard Johnson: Thanks, Jack. Turning to Page 5, let's look at our consolidated results for the fourth quarter. We had net sales of $183.7 million. That was $19.5 million of sales growth, or 12% over the same quarter last year. That sales growth was driven by our Animal Health segment – better than $13 million of growth, and 13%.

In addition, our Mineral Nutrition business had very nice sales growth in the quarter, over $6 million, again, 13%. Our Performance Products business was stable year on year.

Dropping down through gross profit and operating expenses, gross profit, 29.5% of sales, grew at the same rate of – roughly the same rate, slightly faster than sales, grew 13% overall. SG&A, about $41 million. That includes a loss on an insurance claim that I'll talk a bit more about later. The good chunk – well, of the $8-million increase in the fourth quarter, $5.3 million of that increase was that one-off insurance claim. Ex that claim, $2.6 million, or 8% growth in SG&A for the quarter.

Coming down to adjusted EBITDA, $24.2 million of adjusted EBITDA in the quarter. $4.6 million of growth, or 23%. Really, all segments contributed nicely to that EBITDA growth. Then coming to a pro forma adjusted EPS number, $0.22 for the quarter. You'll see the footnote on – if you're looking at the webcast slides or also in the press release – we have shown you EPS on a pro forma basis as if the IPO and refinancing had been in place for the entire periods.

In addition, we've adjusted out certain either one-time or ongoing expenses to come to an adjusted EPS number. We also, in the adjusted EPS, we are reflecting cash income taxes because our GAAP income tax rate has been so volatile, due to a number of one-time adjustments. We did have substantial cash income taxes paid in the fourth quarter, $7 million paid of a $12-million annual number. That was what brought adjusted EPS down for the quarter.

Turning to page 6, looking at our Animal Health segment again for the June quarter. Sales of $114 million, 13% sales growth. We give you a break-out of product groups within that. You see that MFAs grew 12%, nutritional specialties 17%, and vaccines 21%. Double-digit growth across all of our product groups during the quarter. Largely it was volume growth driven.

In the MFA business, most of the growth came out of international markets, including Brazil, other Latin America countries, which would include Mexico, and across our Asia-Pacific region. Nutritional Specialties continue to be driven by the dairy focus, primarily in the U.S., with expansion into Europe. Vaccines, we continue to see volume growth in most markets where we operate, as we introduced some new products in various markets over the course of the last year.

Adjusted EBITDA, $26.1 million, just under 23% of sales, grew in line 13% with the sales growth. The operating margin remains stable. Most of the EBITDA growth was due to the volume increase and the margin coming off of those volumes – coming out of the sales increase, and the margin coming off of the sales increase. We did continue to make significant investments in our operating expenses to continue to drive these growth initiatives as we move forward.

If we turn to Page 7 and look at the other segments of our business, for the June quarter Mineral Nutrition was up very nicely, 13% on the top line, which dropped down to a 26% increase at the adjusted EBITDA line. The operating margin improved to 6.4%. Volumes were up. This is – the sales gain was volume-driven. In fact, there was a small offset by commodity pricing. The margins in the business was really driven by increased demand.

Just as a reminder, this is fundamentally a U.S. business. It was demand across most species in the U.S. business. Performance Products, as I said earlier, really a stable sales performance in the quarter – right what has been running now for a number of quarters, plus or minus.

We did see – we saw the nicest operating margin of the year at 10.4% for the quarter. That was just a mix of products within that overall sales mix that gave us a little better operating margin. On the year-over-year comparison, we had some significant environmental costs a year ago. Those were not repeated, so we picked up better than $3 million at the EBITDA line on that overlap.

Last, corporate segment, which is certain expense categories, $6.9 million in the quarter is now reflecting the cost of being a public company. In our GAAP reported numbers, that segment is where we include the loss on the insurance claim. In this adjusted EBITDA presentation that is excluded from these numbers.

Now turning to Page 8, and just very briefly summarizing our fiscal year. $692 million of sales, 6% sales growth, driven completely by growth in the Animal Health segment, as Mineral Nutrition was roughly flat, and Performance products was down somewhat from the year earlier. Within Animal Health, again if we look at those product groups, MFAs for the full year grew 8%, nutritionals grew 21%, and vaccines grew 44% for the year.

Down at the bottom line, adjusted EBITDA, $90.6 million of adjusted EBITDA, a 13.1% operating ratio, 150 basis points stronger than a year earlier, and 20% growth over the prior year. Really driven by that Animal Health sales growth and getting operating leverage down through gross profit and SG&A.

It was a year I think that we were happy with overall, and a year that was on expectations. As a result, down at pro forma adjusted EPS, $1.22 for the year. Again, doing those same pro forma and other adjustments that I discussed for the quarter.

Turning to Page 9, looking at just the balance sheet and cash flows for a moment. We ended June at a 3.2 times leverage ratio. Total debt was just our Term B loan outstanding – that's $290 million of principal, and then a very small amount of capital leases in addition to that, over the adjusted EBITDA gives the 3.2 ratio.

That continues to come down. We ended June with $12 million of cash on the balance sheet. We're forecasting $25 million of CapEx for the coming fiscal year. Then the dividend we have announced, and it will be payable in the next few days. I guess it's September 24, the $0.10 a share dividend. We are targeting to continue that dividend quarterly, and that would equate to a $15.6 million annual rate.

Let's turn to the guidance for FY15. That's on page 10. Let's just look at the chart first. We are forecasting sales between $735 million and $755 million. That's a 6% to 9% increase over what we reported for this fiscal year. That sales growth, in part offset by continuing investment in operating expenses – that sales growth will generate adjusted EBITDA between $99 million and $103 million.

That's a 9% to 14% EBITDA growth target. Bringing that down through interest expense, cash taxes, shares outstanding, it should – it would equate to pro forma – it won't be pro forma, actually, it will just be adjusted EPS of $1.46 to $1.51, so an EPS growth of 20% to 24%.

Animal Health will continue to be the primary growth driver of the business. Within Animal Health, the product groups, we see that the MFA business will – the growth will remain strong, nutritionals will continue to grow at double-digit rates, and we see vaccine growth continuing. However, we think the growth will moderate somewhat as we overlap some of the growth we had this year in markets and new product introductions.

In addition, benefiting 2015 will be $4 million of revenue and EBITDA coming from the licensing of our proprietary vaccine delivery technology. These are milestone payments that are due during the course of our fiscal year. Those numbers are included in this guidance, not guaranteed, but our expectation is they will be realized over the course of the year. Mineral Nutrition sales and profit will also contribute to the overall growth of the business in 2015.

With that, I don't have any more prepared comments. So operator, if you would open up the line for questions, please?

Operator: Certainly. Ladies and gentlemen, if you have a question at this time, please press star then one on your touchtone telephone. If your question has been answered or you wish to remove yourself from the queue, please press the pound key.

Our next question comes from Erin Wilson from Bank of America-Merrill Lynch. Your line is now open. Please go ahead.

Erin Wilson: Great, thanks for taking my questions. Can you speak to the fundamental demand trend across the livestock industry in the U.S., particularly as it relates to the poultry and dairy markets? What's embedded in your guidance as it relates to that fundamental utilization trend or demand trend?

Jack Bendheim: Erin, it's Jack. Good morning. What we're seeing, especially in the United States, is a continuing growth in poultry. I think a quite strong growth in poultry. This is pretty much generated by the higher cost of both the pork market as well as the cattle market.

We're seeing combination, definitely weight's up in poultry, as well as numbers. People are putting on – first time in a long time – putting more birds down in the market. We're seeing a growth as well in the swine business. The industry's still fighting PEDs. I think up to date, something like 60% of the herds have already gone through it.

I think the expectation in the industry is in the course of the year the rest of the swine herds will see it. That will be a combination of growth in weights, as well as replacements. We're seeing the cattle market, we're seeing growth there as well in numbers, as people are looking to restock after the last couple of years.

In the dairy market, dairy market continues to be strong. We don't see a lot of new cows being placed, but we see lots of efforts in increasing the productivity of the herd. Generally growth, and we don't really see – dangerous to answer a question you didn't ask, but we don't see a big effect of the Russian ban on the U.S. poultry industry.

Erin Wilson: Thanks. That was a question. But on that note, on dairy in particular, what are you seeing as far as traction with OmniGen in the U.S. but as well as in Europe, and where do you stand with approval in China?

Jack Bendheim: We're close. We expect within the next six months to have our approvals in China. We continue to see traction, continuing traction in the United States. As we add sales people we increase our sales.

We are – I think Europe is running a little bit behind where we had wanted to be at this moment, but we're getting growth month on month, and we're still quite optimistic to see good growth in the European markets. All the reasons we laid out, both in S-1 and the road show and in our conversations.

Erin Wilson: OK, great. Then just one last one. You have substantial operations in Israel. Can you give us a sense of what sort of exposure there is to the recent turmoil across that region? If you could comment on that, if you're at all exposed?

Jack Bendheim: I think the best answer for that is we're all very much aware of all the activity that went on this past summer. I don't think we missed a beat.

In other words, we delivered to our customers on time. We export our products on time. We produce continually in our factories there. We didn't – we saw no effect as far as running our operation in Israel.

Erin Wilson: OK, great. Thanks so much.

Operator: Thank you. Our next question comes from Irina Koffler from Cantor Fitzgerald. Your line is now open. Please go ahead.

Irina Koffler: Hi. Thanks for taking the questions. I wanted to explore your initiative to improve margins. Can you just comment on what else you're continuing to work on?

It looks like CapEx guidance maybe ticked up from what we were expecting earlier. I just wanted to see if there was any relationship between that increase and improved efficiencies?

Richard Johnson: That's spot on, Irina. We do – we are continuing to spend CapEx to improve our cost-of-goods position, whether it's by cost savings projects to just lower the cost of manufacturing for existing quantities, or it's adding marginal capacity at marginal rates.

We can add another 5%, 10%, 15% capacity, and add that at a relatively low incremental rate. That's really a large part of what our capital spending has been in the past, and what we would expect it to be going forward into 2015. That will give us some margin leverage.

Irina Koffler: OK. The $4 million milestone on the vaccines business, what quarter is that expected to come out in?

Richard Johnson: We would expect $2 million of that in our September quarter, and the remainder will be some time later this fiscal year, depending on when the milestone is achieved, et cetera.

Irina Koffler: OK. Then the final question is this. Can you just make a broader comment about M&A in your space, and your own interest and appetite for additional products, as well as opportunities for the Company itself to be – consider a potential take-out?

Jack Bendheim: That's a great question. We continually look to add products to the portfolio that fit into where our core strength is. As we've done in the past, we're not looking at all in the pet space, but in the production animal space across all the species. We are always looking to add products and relationships.

Acquisitions, again, if we see something that would bring some interesting products, I think we would do tuck-in acquisitions. Right now we're not looking at any transformative acquisitions or disposals.

Irina Koffler: OK, thank you.

Operator: Thank you. Our next question comes from Louise Chen from Guggenheim. Your line is now open. Please go ahead.

Louise Chen: Hi. Thanks for taking my questions. My first question is just on the sales growth. I know you said it was mostly volume. I was wondering if there's any way you could break that out more – how much actually percent was volume and how much was price?

Just wondering if there's potentially more room for price increases here? I think some of your competitors cite that there's a lot of pricing power in the Animal Health industry – just wondering what you think of that?

Secondly, another question we get a lot is just on your margins. I know you're just livestock versus some of your competitors who have a combination of livestock and companion animal, and how to compare them apples to apples. I was wondering if you'd give more color there?

Lastly, just on your antibiotic labeling changes, any update there? Thank you.

Richard Johnson: Sales growth, let's see. For the fourth quarter, overall let's just focus in on the Animal Health segment – or maybe let's just say that Mineral Nutrition and Performance Products, basically 100% of the sales change is volume related. It's very little pricing in either of those in the fourth quarter.

Animal Health grew $13.4 million in the fourth quarter, and $2.5 million of that was due to pricing, so $11 million of it was due – basically due to volume. So whatever percentage that is, $11 million out of $13 million, 80 percent-ish, was volume growth.

Louise Chen: Is there room for more pricing increases here, just because I think some of your competitors just say that pricing is very strong in the industry? But I'm just curious what you think.

Richard Johnson: I think we evaluate – we evaluate our pricing routinely on a segment, on a – I'm going to give you a very generic answer here, by product, by region. We look for pricing opportunities wherever they are. We certainly keep an eye on what our competition is doing.

The second part of your question was sort of companion animal versus pets and how do we compare. We don't really know the companion animal business at all, so it's hard to say. We think our Animal Health margins are competitive with the other companies in the industry, people we compete with, and don't really have a lot more insight than that.

Then the third piece on the antibiotic label …

Jack Bendheim: On the antibiotic changes, we continue. The whole industry, as the FDA announced I think three, four months ago, has written and agreed to go forward with the voluntarily changing labels, and giving up growth promotion claims, and changing the labels that will allow vet prescription, and just prevent, control, and treat claims.

That's continuing. It's requiring data. It's requiring some field work, and we're in the midst of it. I think that's the overall trend, and that's where we'll be I think when these regulations go into effect, which is I think sometime at the end of 2015, maybe early 2016.

Louise Chen: Thank you.

Operator: Thank you. Our next question comes from Douglas Tsao from Barclays. Your line is now open. Please go ahead.

Douglas Tsao: Thanks. In terms of the volume growth that you saw in the medicated feed business, obviously you sort of highlighted most of it came from volume. I'm just curious if we sort of dig down into that volume component, how much was just overall growth of herd size or flock size, versus the expansion in terms of the number of accounts you're selling into?

Jack Bendheim: The thing we have to deal with is we are – this is a global business, and we are preventing and treating certain bacterial diseases. All of this really at the end of the day is a combination of disease pressure in what kind of animals, where in the world.

It moves around all the time. I think what we try to do, and we try to as a goal, is overall at the end of the day if you're ask us where do we want this business to be, we want to be – I guess I overly use the word agnostic – but agnostic of who's growing the animals, where they're being grown. As long as there's constant growth and consumption, we want to be able to provide our products to create healthy animals, which will turn into wholesome food.

It's a long answer to saying – it's hard for me to say whether it's directly in poultry or in this market or that market. It moves around all the time, and our job really is to be there with the right solutions at the right times.

Richard Johnson: Maybe a little more numerically, Doug, we grew – Animal Health sales grew 13% in the quarter, call that 11% volume growth. If you look at it the other way around, the number of animals in the world didn't grow 11% year over year. We're treating more animals for diseases, for other new applications, et cetera, et cetera.

Douglas Tsao: I guess as a follow-up, though, in terms of trying to understand some of the dynamics of that 11%, how much is that perhaps opportunistic in terms of conditions in particular regions that might necessitate your products, versus just expansion of your core customer base, if you will, that we can count on seeing consistently?

Jack Bendheim: It's a great question. Our efforts are in expanding. It's the money we're investing in our SG&A around the world, and we're looking to go into markets.

The trend of the world, we come back to looking at the highest level. The population is growing, and in order to continue feeding and meeting the demand for poultry, the only way to do it is what we want to call modern agriculture, which is basically raising lots of animals together.

The end result of that is it uses less water. It uses less land. It creates less pollution. It creates much less global warming. It does all that and delivers protein to a growing world population at a reasonable price. If you do that, then you need our products.

China, just as one example, has 400 million pigs, but they have it – they historically – the bulk of those pigs are raised in backyard farms – two, three, four, five pigs. The trend in China, in order for them to get the kind of control over the quality of food and healthy animals, is to move those to farms that have minimum of 500 or 5,000. As they do that, and they can start counting, is where our products fit in.

We're out there, and we see basically – let's call it secular growth across the world. That's where the growth will come from. It's going to be in China and in Latin America and in Africa and in the Far East, is the bulk of where the growth's going to come from. Yes, that's the future of this business.

Douglas Tsao: OK, great. Thank you.

Operator: Thank you. Our next question comes from David Risinger from Morgan Stanley. Your line is now open. Please go ahead.

David Risinger: Thanks very much. Jack and Dick, sorry, I had to step off for a minute when I was first queued in there. You've gone through a lot of commentary that's extremely helpful. I wanted to ask a couple of specific financial questions.

Maybe you could talk about the tax rate for 2015 in a little more detail, including the benefit of NOLs next year. It would be helpful if you could remind us when you expect the NOLs to be exhausted?

With respect to cash flow, obviously cash flow is set to increase in 2015. I was hoping that you could maybe provide some detail around your forecast for EBITDA, and then what you're ultimately expecting in terms of free cash flow for 2015. Thank you.

Richard Johnson: Sure. Let's talk taxes first. In our adjusted EPS numbers for 2015, I've given guidance of $10 million to $12 million of cash income taxes. That would represent a 15% to 17% effective rate on pretax income. That's really because we're benefiting from our net operating losses, net operating loss carry-forwards in the United States, where we're not a cash tax payer in the United States.

Given the size of those NOLs, we have somewhere between over two and perhaps three years before we become a tax payer in the U.S.. We've said in the S-1 and other guidance that we have several years yet before we run out those NOLs. I think that answers your question on taxes.

Cash flow, we've given you all the pieces to build an expectation of cash flow next year. We've said interest expense is going to be $14 million. There's some smaller piece of that is non-cash, but most of that's cash. You've got cash taxes.

We've given you CapEx forecast. I would say on working capital, our expectation is working capital will grow in line with the sales growth. From that, I don't have it in front of me, I'm sorry, but it's pretty easy to construct a cash-flow model.

David Risinger: Great. Thank you very much, Dick, and congrats.

Richard Johnson: All right, thank you.

Operator: Thank you. Once again, ladies and gentlemen, if you do have a question, please press star then one and we'll give it one moment.

And I'm not showing any further questions in queue at this time. I would now like to turn the call back to Richard Johnson for any further remarks.

Richard Johnson: Well, we thank you for listening in this morning, and we'll be back at you with our September quarter discussion, which will come in the first half of November. We haven't set the exact date yet, but be back – in less than 60 days we'll be talking to you again. Until then, take care everyone.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Everyone have a great day.

**END**