



Omega Protein Corporation
Fourth Quarter and Full Year 2016 Earnings Conference Call
March 2, 2017
8:30 a.m. ET

John Held - EVP, General Counsel and Secretary

Good morning, and welcome to Omega Protein's fourth quarter and full year 2016 earnings conference call. By now, everyone should have had access to the earnings release for the fourth quarter and year ended December 31, 2016. For a copy of the release, please visit Omega Protein's website at www.omegaprotein.com under Investor Relations. This call is being webcast, and a replay as well as a transcript of the prepared remarks will be available on our website for 30 days.

Before we begin, we would like to remind everyone that comments made by management during today's call will contain forward-looking statements. These forward-looking statements discuss plans, expectations, estimates, and projections that might involve significant risks and uncertainties. Actual results may differ materially from the results discussed in these forward-looking statements.

Additional information about risk factors and the uncertainties associated with Omega Protein's forward-looking statements can be found in the Company's earnings release, the Company's Form 10-K for 2016, and in the Company's other filings with the SEC. Because of these risks and uncertainties, investors should not place undue reliance on forward-looking statements. Omega Protein disclaims any intention or obligation to update or revise any forward-looking statements, except as required by law.

Please also note that on today's call, management will be discussing non-GAAP financial measures, including adjusted EBITDA, adjusted earnings per share and other metrics. Historical non-GAAP financial measures are reconciled to the most directly comparable GAAP measures in our press release, which is available on our website. Some of the information presented is derived from third-party sources. And while we believe this information to be reliable, we have made no independent investigation of these third-party sources or attempted to verify the veracity of the third-party data in any way.

I would now like to turn the call over to our President and Chief Executive Officer, Bret Scholtes, for opening remarks.



Bret Scholtes - President & CEO

Thank you, John. Good morning everyone, and thank you for joining us today. I will begin with a brief summary of our annual business and financial performance. Our CFO, Andrew Johannesen, will then provide you with a more detailed review of fourth quarter and full financial results. Finally, we will open the call to take questions.

2016 was a strong year for Omega Protein. Our team executed on our strategic initiatives while managing the controllable aspects of our business to report the strongest gross profits in the Company's history. We also initiated programs to return capital to shareholders.

We reported consolidated revenues of approximately \$391 million, adjusted earnings of \$2.01 per diluted share and adjusted EBITDA of \$95 million for the year.

Our animal nutrition segment performed well throughout 2016 and continued its strong, multi-year success. This is largely a result of continued high demand for our products, solid harvest results, and improved operational efficiencies. Our human nutrition segment underperformed for the year, but we are encouraged by recent results of our specialty oils and nutraceutical categories. We continue to focus on execution throughout our Company, including the previously announced strategic alternatives review of our human nutrition business segment. We remain committed to building a stronger nutrition company and taking the steps required to increase shareholder value.

We believe the Company is well positioned to capitalize on the macro-economic and industry trends that drive demand for our products. In our opinion, this competitive position, combined with our products, supply chain and customer relationships are the keys to creating or maintaining the competitive advantages needed to further enhance our operational and capital efficiencies. We expect this formula to generate increased profitability and cash flow over time and enhance shareholder value.

I would now like to provide a more detailed update of our business segments, beginning with animal nutrition. As a reminder, this segment includes sales of specialty ingredients to formulators of companion and production animal diets. We measure the animal nutrition segment's success by three primary drivers: production volumes, revenue per ton and cost per ton.



Production volumes are the result of our harvest and product yields. Total production in 2016 was approximately 170,000 tons, which is consistent with our three-year average, but less than our production in 2015 when we saw record fish catch at both of our Gulf facilities.

Our Gulf fishery ended its 2016 season on November 1, and our Atlantic season ended on December 16, after catching 96% of our Atlantic quota. Our Western Gulf and Atlantic operations ended the year with good harvest results despite challenging sea conditions for extended periods during the fishing season. Our eastern Gulf operation had one of its best seasons ever in 2016. We made investments at our Moss Point plant during the off-season to improve operations, including a project to move, refurbish and then install a dryer we previously operated at our Cameron facility. This additional equipment partially led to the outstanding production results at Moss Point during the year, notably increased meal yields and better quality product. For the year, our total yield for the Company was 38%, an increase compared to both 2015 and the three-year average.

We are encouraged by the regulatory decisions made in October of 2016 that reaffirmed the health of both the Atlantic and Gulf Menhaden populations and the decision to raise the Atlantic Menhaden quota by 6.45% beginning this year. This increase is still quite conservative, and we believe that the peer-reviewed science supports further increases.

The second driver of success for the animal nutrition segment is revenue per ton which reflects the global supply and demand dynamics of fishmeal and fish oil. For 2016, we realized \$1,455 of revenue per ton, the highest in our Company's history. This metric has increased over time as evidenced by the five year and ten year compounded annual growth rate of approximately 7%. Our product development has played a role in the increase. For example, we have developed a market for our naturally-stabilized fish meal which has a greater revenue per ton than standard meal. This protein ingredient is sold to the natural pet food manufacturers in the USA, and we sold over 20,000 tons in 2016.

Despite the growth rate trend for revenue per ton, we are seeing some weakness in current market prices compared to the prices realized in 2016, but we have not been impacted significantly because our current inventory is mostly sold forward at prices similar to those realized in 2016. It is too early to predict pricing for 2017, but we will continue to monitor prices as the global demand and supply picture becomes clearer in the coming months and we begin discussions to sell



forward more of our 2017 production. Global demand remains strong, and industry consumption data reflects the increasing demand from customer segments that most highly value the nutritional benefits. For these reasons, we remain optimistic about the long term prospects for fish meal and fish oil pricing.

The third driver of success for this segment is our cost per ton which is calculated by dividing the cost to catch and process fish by our annual production. We continue to strategically invest capital in our fishing operations which has allowed us to harvest fish and manufacture our products more efficiently, notably by upgrading vessels to allow for increased catch-per-vessel over historical averages, increasing plant throughput capacity, and continuing to upgrade our processing equipment. Our average per ton cost of sales was \$912 in 2016, and this metric has grown at a 5-year compound annual growth rate of only 2%. Our ability to control costs has been an important contributor to our higher margin profile over the last few years.

We are moving forward with our planned strategic initiatives to build upon our solid foundation. Several of the capital projects announced in 2016 are on track to contribute in 2017. In addition to completing these projects, we expect to invest at least an additional \$10 million of growth capital to strengthen our animal nutrition business. Some of these projects aim to reduce operating costs at our processing plants and shipyard. Another project seeks to increase the geographic range of our western Gulf fishing operations for our Abbeville plant by purchasing an Offshore Supply Vessel and converting it to a carry vessel. We will convert this vessel at our shipyard which is a competitive advantage for our company. Another project will increase naturally stabilized meal storage capacity at our Moss Point plant to increase operational and sales flexibility.

I will now turn to our Human Nutrition segment, which includes sales of nutritional ingredients and products to food and supplement manufacturers and retailers. For the year, the human nutrition segment continued to face challenges in our dairy operations, but we are encouraged by the recent results in our specialty oils and nutraceuticals operations. Exiting our oil concentration facility will also be positive going into 2017. As I have stated previously, we do not plan to make meaningful additional investments near term in this segment as we focus on driving sales growth, operating efficiencies and increased profitability.

Our specialty oils business which has in recent years accounted for approximately 75% of segment sales recorded one of its best quarters in fourth quarter of 2016. Highlights for the



quarter included additional volumes from a large, mass merchant customer and opportunistic sourcing. We are encouraged by our customer discussions, supply chain improvements, increased focus on product mix and customer diversification.

Our dairy business which in recent years accounted for approximately 10% of sales continued to struggle with commodity pricing, limited scale and excess capacity.

Throughout 2016 we have carefully reviewed the performance of the human nutrition segment given the challenges we have experienced. As a result, the Board and our management team believe this is an appropriate time to undertake a comprehensive strategic review

With that business overview, I would now like to turn the call over to our Executive Vice President and CFO, Andrew Johannesen, to discuss our financial results in more detail.

Andrew Johannesen - EVP and CFO

Thank you, Bret, and good morning everyone. I will begin by reviewing our fourth quarter and full year financial results, followed by some balance sheet highlights and thoughts on 2017.

At a consolidated level, revenues for the fourth quarter of 2016 were \$85 million, an increase from \$82 million in the same period a year ago due to higher human nutrition revenues.

Gross profit for the fourth quarter was \$23 million, consistent with the prior year's fourth quarter. Gross profit as a percentage of revenues, or gross margin, decreased from 28% in the prior year period to 27%, as a decrease in the animal nutrition segment was partially offset by an increase in the human nutrition segment.

Looking further into the animal nutrition segment results, revenues were consistent at \$53 million on sales volumes of approximately 36 thousand tons. Lower sales volumes of fish meal were partially offset by higher volumes of fish oil, and the resulting shift in product mix led to an increase in revenue per ton from \$1,323 a year ago to \$1,466 despite relatively flat underlying prices.

Total 2016 production of 170 thousand tons came in at the low end of the range provided on last quarter's call, contributing to a modest increase in cost per ton for our 2016 season production. This cost per ton increase resulted in a \$1.4 million fourth quarter adjustment for prior period sales of 2016 production. For the quarter, animal segment gross margin was 34%, or 36% excluding the prior period true-up, compared to 39% a year ago.



In the human nutrition segment, revenues increased \$2.5 million from the fourth quarter of 2015 due to increased sales of specialty oils and protein products. Segment gross margin for the fourth quarter increased from 7% to 15% due primarily to improvements in specialty oils.

Returning to the consolidated results, fourth quarter selling, general, and administrative expenses, including research and development, were \$12 million, up from \$11 million in the same period a year ago. The increase reflects accruals related to the Bioriginal earn-out and other miscellaneous expenses.

Net income for the fourth quarter was \$4.3 million, or \$0.19 per diluted share, compared to net income of \$2.9 million, or \$0.13 per diluted share, for the same period a year ago. After making certain adjustments, which are detailed in our earnings release, adjusted net income for the fourth quarter of 2016 was \$6.8 million, or \$0.30 per diluted share, up modestly from \$6.5 million, or \$0.29 per diluted share in the previous year.

As a reminder, GAAP requires us to use the “two class method” of calculating EPS as explained in the footnotes to our 10-K. The same EPS results can be derived by applying an average diluted share count of 22.7 million shares to net income.

Wrapping up the quarterly review, Adjusted EBITDA was \$17 million, compared to \$19 million for the prior year period.

For the full year, revenues increased 9% from 2015 to \$391 million, and gross profit grew from \$99 million to \$114 million. Consolidated gross margin increased from 28% to 29%, reflecting improved animal nutrition results. In the animal nutrition segment, average revenue per ton edged up from \$1,453 to \$1,455, while average per unit cost of sales fell slightly from \$919 to \$912. As a result, animal nutrition gross margin improved from 36.8% to 37.3%.

In the human nutrition segment, gross margin decreased slightly from 12.8% to 12.5% due primarily to the dairy protein business.

Net income for the year ended December 31, 2016 was \$33 million, or \$1.46 per diluted share, compared to \$24 million, or \$1.07 per diluted share, in the prior year. On an adjusted basis, net income for 2016 was \$45 million, or \$2.01 per diluted share, compared to \$33 million, or \$1.50 per diluted share.



Adjusted EBITDA totaled \$95 million for 2016, a 20% increase from \$80 million in 2015.

Turning to our balance sheet, strong operating cash flow allowed us to pay down \$23 million of debt in 2016, and we ended the year with \$37 million of cash. We believe we are well-positioned to fund growth and other capital projects in our animal nutrition business, as well as our recently initiated quarterly dividend program.

Looking ahead, our animal nutrition segment ended the year with approximately 65,000 tons of product in inventory, or about 10,000 less tons than a year ago. We expect to sell most of this inventory in the first half of 2017, including approximately one-third in the first quarter.

As of December 31, 2016 we had sold forward roughly 52,000 short tons of fish meal and 7,000 metric tons of fish oil for anticipated 2017 delivery at prices generally in-line to slightly below those realized in 2016. We expect sales of 2016 production under these contracts to provide gross margins near the mid-30% range that we have experienced in recent quarters, and to comprise the majority of sales volumes in the first half of 2017. As is typical at this time of year, we have much less visibility into the volumes, prices and unit costs of 2017 production, which we typically begin to sell late in the second quarter. Prices will be determined by future market conditions, and volumes and unit costs will be heavily influenced by 2017 fish catch and yields.

In the human nutrition segment, performance will continue to be influenced by sales volumes, product mix, prices and raw material costs. Segment gross margins have generally ranged from the low to mid-teens over the last several quarters, and are likely to continue to experience some variability quarter-over-quarter.

That concludes our financial review. I will now turn the call back to Bret for some brief closing remarks.

Bret Scholtes - President & CEO

Thank you, Andrew.

In closing, we believe the fundamentals driving the specialty protein and oil sectors, especially as the fish meal and fish oil markets remain favorable. We believe that Omega Protein has a strong foundation to fuel future growth and enhance shareholder value. We are confident in our



opportunities ahead and plan to continue to use the strength of our balance sheet and cash flow generation to prudently invest in our business and return value to shareholders.

This concludes our prepared remarks for today. On behalf of Andrew, John and myself, we would like to thank everyone for their interest in Omega Protein. The three of us, along with other members of our management team, are now available to take your questions. Operator?

NOTE: A Question and Answer session follows the above prepared remarks. For the content of the Question and Answer session please listen to the webcast of the call, which is available at www.omegaprotein.com under the Investors tab.