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Phibro Animal Health Corporation (PAHC)

Q4 June 2018 Earnings Call

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Richard G. Johnson *Phibro Animal Health Corporation – Chief Financial Officer*

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Erin Elizabeth Wilson Wright *Crédit Suisse AG, Research Division - Director & Senior Equity Research Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Phibro fourth quarter financial results. (Operator Instructions)

I would now like to introduce your host for today's conference, Mr. Richard Johnson, CFO. Sir, you may begin.

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

Well, thank you, operator and good morning, everyone and welcome to the Phibro Animal Health earnings call for our fourth quarter ended June. I will also talk about -- briefly, about our full fiscal year ended June 2018, and then get into our guidance for our new fiscal year, 2019.

On the call today are Jack Bendheim, our Chief Executive Officer; and, me, Richard Johnson, Chief Financial Officer.

Before I begin, let me remind you that the earnings press release and financial tables can be found on the Investors section of our website at pahc.com. We are 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 will 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 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 earnings press release.

With that, here is Jack Bendheim with some introductory comments. Jack?

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

Thank you, Dick, and thank you everyone for joining us on today's call. We completed our fiscal year with strong results and good momentum, and as we enter our new fiscal year, we have a number of development initiatives planned for 2019. But first a few words about our results.

For the fourth quarter, we saw 9% growth in sales and 12% growth in adjusted EBITDA. For the full year, consolidated sales and adjusted EBITDA each grew 7%. For the year, international sales growth of 21% in the Animal Health segment was a key contributor to the results. Overall, Animal

Health sales grew 7% for the full year as the international growth was offset by domestic decline due to reduced antibiotic sales, a continued weak dairy industry and other factors. We believe our domestic business is poised for growth in fiscal 2019, as we overlap some of the negative trends. Animal Health's adjusted EBITDA margin expanded for the year due to sales growth and a favorable product mix and despite substantial increases in operating expense. The Mineral Nutrition segment also saw good profitability growth for the full year.

Our strategy in Animal Health is to focus on the profitable growth of our portfolio, primarily led by nutritional specialties and vaccines. We plan to make strategic investments in our business in fiscal 2019 that we expect will lead to longer-term, broader growth. Let me describe the major initiatives.

We plan to fund new developments, additional registrations and additional geographic expansion of our existing nutritional specialties and vaccines.

We also expect to invest in new, novel technologies for the nutritional specialties categories to expand our portfolio and strengthen the offerings to our customers.

We will invest in developing additional vaccine production capacity in our newly acquired Ireland facility. This will enable regional expansion and give us access to markets we do not serve today.

Finally, we will continue product development and refining our go-to market strategy for the companion animals space, where we see unmet needs through in-licensing of novel technologies.

These investments will take time to bear fruit. We expect it to -- it will be approximately 18 to 24 months before we see the financial results. While we remain open to acquisitions, we believe these investments offer better return. These investments show my confidence in our business, our technologies and our people.

Because these events will require significant P&L expense dollars, our earnings guidance for fiscal 2019 is approximately even with our fiscal 2018, despite strong sales growth and gross profit improvement.

Our fiscal 2019 financial guidance shows sales growth of up to 7% and adjusted gross profit is expected to improve more than the sales growth. However, an increase of up to 14% in operating expense, in large part relating to the spending for future growth initiatives, will largely offset the sales growth and gross profit improvement. As a result we expect fiscal 2019 adjusted EBITDA to be approximately the same as or slightly better than the prior year.

While we see good momentum in our business, we also recognize pressures on our customers from the potential ongoing disruption in international trade and from the volatility of certain international economies and currencies.

Also, I am pleased to announce the planned 20% increase in our dividend, effective with the December 2018 payment. The consistent positive cash flow of the business, the strength of our balance sheet and the tax changes support this increase. I remain very positive about these opportunities ahead of us, and I look forward to answering your questions later in the session.

Now, back to Dick for more details on the numbers.

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

Thanks, Jack. Before we get into the numbers, we want to remind everyone that we present our results on a GAAP basis and on an adjusted basis. Our adjusted results exclude acquisition-related items, various items listed on the slides, unusual, non-operational or nonrecurring items, including stock-based compensation. Last year we had pension-settlement costs, the gain on the insurance settlement and a loss on extinguishment of debt. Other items as separately recorded in the P&L including currency gains and losses and finally, income tax effects related to any pre-tax adjustments, plus any unusual or nonrecurring income tax items.

So with that, let me step into the numbers.

Looking at the highlights for the June quarter, net sales were approximately $212 million, that was a $17 million or 9% increase over the prior year. We saw good sales growth across all segments of our business. We will look at the sales growth by segment in more detail in a couple of slides.

GAAP net income increased substantially, 44%, driven by both the operating results as well as favorable tax items and we have the one-off loss on extinguishment of debt last year, and GAAP diluted EPS of $0.55 increased at about the same percent due to the same reasons.

Our adjusted EBITDA was $33 million in the quarter. That was a 12% growth, so we grew adjusted EBITDA faster than we grew sales and obviously, thereby, expanded our margins. With that adjusted EBITDA growth, plus the additional benefits of favorable interest expense and a favorable income tax effective rate, we saw adjusted net income and adjusted diluted EPS grow by 20% and 18% respectively. So adjusted diluted EPS in the quarter was $0.46, a $0.07 increase over last year.

Looking at selected line items for Q4, this gives a little more of a picture of the full P&L. Adjusted gross profit was up 7% on the 9% sales increase. We saw a good favorable mix from Animal Health, but declining or reduced margins in Mineral Nutrition brought the overall gross profit increase down. Adjusted SG&A was a modest increase of only 4% for the quarter, mostly on the timing of expenses. We have continued to make investments in development cost to position ourselves for the future growth.

As I mentioned a minute ago, interest expense, was nicely favorable compared with the year earlier. This reflected mostly the benefits of a refinancing we did in June 2017, and the effective income tax rate was favorable compared to last year, largely due to the benefits of the tax reform. So that was -- all of those factors drove the adjusted diluted EPS of $0.46, again, an 18% increase year-over-year.

Turning to the Animal Health segment for the fourth quarter. About $138 million in sales overall, $9 million or a 7% growth. Just looking at the individual categories -- product categories, first looking at nutritional specialties, roughly flat with last year as we saw good growth in the poultry sector of our products for the poultry sector. However, the weak industry conditions in dairy, primarily in the U.S., -- offset that poultry growth. I think the point we will make here is that we continue to diversify this category, both geographic diversification, moving these products into some of our international markets, as well as diversifying beyond dairy.

The vaccines, 7% growth in the quarter. Good volume growth in the international markets, lower domestic growth. I would note that for the full year, our vaccines grew 11%. This is a relatively small category, so we will see larger or smaller percentage increases one quarter versus another. Then MFAs and other, the biggest component of the Animal Health segment, grew almost $8 million or 9% and driven by international sales growth, the same thing we saw for most of the year, that international growth was driven by penetration into the cattle sector in a number of international markets where we operate. There was also a small benefit from a recent acquisition -- that was the Argentina acquisition we did in September of last year. Domestic sales of MFAs and other were roughly level with the prior year, as we have essentially seen, we believe, the stabilization of antibiotic sales in the United States. We continue to have other parts of our MFA portfolio perform strongly, largely in the anticoccidial area, where there continues to be a good demand.

So dropping down to adjusted EBITDA for the Animal Health segment. Adjusted EBITDA was almost $37 million, an 18% year-over-year increase, mostly driven by the sales growth, which in turn drove a $5 million gross profit increase, and SG&A in the segment was slightly favorable on the timing of expenses.

Turning to other segments. Looking first at Mineral Nutrition, good sales growth, 14% sales growth, largely driven by commodity pricing, which as we've mentioned many times, this is a transparent pass-through type of business. But at the profit line, whether it is gross profit or adjusted EBITDA, we saw a decrease due to some unfavorable product mix, and we also saw some tighter margins in the quarter.

Performance Products was modest sales growth and a slight profit increase of about $400,000, and our corporate expenses, which are unallocated expenses -- we don't allocate to the business segments -- increased on development cost as well as higher professional fees.

On Slide 9, I have put up one slide here on the full year and this is selected items for the full year, the full 12 months. Net sales, overall, grew 7%, driven by the Animal Health segment, the biggest part of our business, also grew 7%. Within that, as Jack mentioned, we saw a 21% growth on the international part of the Animal Health segment, in part, offset by a decline in domestic sales.

Adjusted gross profit across the entire company grew by 8% -- faster than sales -- and really driven by a favorable mix in Animal Health. For the full year, operating expenses or adjusted SG&A grew 8%, largely due to investments in these development costs that we've been talking about.

Interest expense was favorable for the full year. Taxes were favorable for the full year on the benefit of tax reform. And so, as a result for the full year, we reported $1.74 of adjusted diluted earnings per share. That was a 15% increase year-over-year.

Looking briefly at our capitalization. Our leverage continues to improve and was 2.4x at the end of June, based on $314 million of total debt. We had $79 million of cash and short-term investments on the balance sheet, and we generated a good, solid cash flow, both in the quarter and for the full year. $5 million in the quarter and $50 million for the full year, which is before any financing types of activities and setting aside the business acquisition and the use of cash to invest in short-term investments, which shows up in the cash flow statement.

Quarterly dividend, we have declared the typical $0.10 dividend to be paid in late September. And then, as Jack called out, we expect to increase our quarterly dividend by 20% to $0.12 a share, effective with the December dividend payment. Of course, it will be subject to approval by our Board of Directors prior to when we declare it. It does reflect the positive cash flow and balance sheet strength.

So turning now to guidance on Page 11. We have given you a much more detailed set of guidance in terms of P&L line items in the attachment to the press release, but here are the key line items. At the revenue line, we expect our Animal Health segment sales to grow to up to $565 million, that could be as much as a 6% sales growth, and we expect consolidated sales for the entire company of up to $875 million or up to 7% growth year-over-year.

Adjusted EBITDA is expected to be, approximately, even with 2018, a range of $129 million to $131 million. At most, a slight increase in our guidance, and that's due to the spending and operating expenses that I will get into that Jack discussed earlier, and I'll also talk about in another slide or two.

That will bring us to adjusted earnings per share on a diluted basis to between $1.72 and $1.77. Again, plus or minus, roughly equal with this year.

Looking at Page 12. We have talked about the first item. Within the Animal Health segment, we expect, for the full year, that nutritional specialty categories will continue to grow at double-digit rates. We expect the vaccine category to grow at a high-single digit rate, its international sales will contribute most of the growth. The domestic vaccine business will be partially offset by the loss of a distribution arrangement that we previously had. That will happen in early part of our fiscal year.

The MFA and other category, we expect to increase at low- to mid-single digits, with continued international growth and stabilized domestic business.

Mineral Nutrition, we expect to grow at high single digits, primarily due to volume and new product introductions, new product growth. Performance Product revenues are expected to increase slightly.

We do expect adjusted gross profit to increase faster than sales by up to 9%, compared to an up to 7% sales growth, driven by the favorable mix. That would drive a 50 to 60 basis point improvement in the gross profit ratio.

Looking at Page 13. This is the expectation for operating expenses, or what we call, selling, general and administrative. We expect these expenses to increase by up to 14%, primarily as we make strategic investments for future growth. Jack called these out. It's: new developments, additional registrations, increased volumes of existing products and including expansion into new geographic markets; increasing and further strengthening our nutritional specialties portfolios with new technologies; developing additional vaccine production capacity at our Ireland facility to enable regional expansion; and continued development in the companion animal space. We expect that it will take some time, 18 to 24 months before we see the commercial benefits of the investments and where we see these as having a better return than some of the business acquisition opportunities we think might be out there. Due to the investments, adjusted EBITDA is expected to be approximately even with the prior year. So good sales growth, even better gross profit growth, substantial spending on operating expenses, resulting in adjusted EBITDA roughly flat year-over-year.

Finally, just some technical notes, our adjusted income tax effective rate. We expect a rate of 26% to 27% for this coming year. We will have the full benefit of tax reform in our fiscal 2019, because of our fiscal year we had a blended 28% rate in fiscal 2018. So we will see some additional benefit from income taxes year-over-year. In bringing all that to the bottom line, we expect the adjusted diluted EPS in that $1.72 to $1.77 range, similar to what we reported for this year.

On a cash flow basis, we expect to generate positive cash flows after satisfying all of our needs, whether it be for working capital, CapEx, dividends or scheduled debt repayments. We do expect to spend, substantially more on CapEx in fiscal 2019, slightly more than double of what we spent this year. We are going to increase capacity for some products, to in-source productions of certain products and for ongoing efficiency and cost reduction initiatives as well.

That's the end of my prepared remarks. Operator, if you would open the line for questions, please. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Erin Wright of Crédit Suisse.

Erin Elizabeth Wilson Wright - *Crédit Suisse AG, Research Division - Director & Senior Equity Research Analyst*

I guess, how would you characterize the ongoing dynamics in livestock demand? How do the trends differ between the domestic and international markets? And I understand there are still many variables at play here, but how should we be thinking about NAFTA global trade dynamics? And have you thought about any of these? Or contemplated these in your fiscal '19 expectations? Or how should we think about your exposure there?

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

Great question. I think we always come back to look at demand as being generated by where people live and the ability for them to have the money to buy the food. And while all these other factors that you mentioned, whether it's NAFTA -- or formerly named NAFTA, or whether it's trade wars and currencies and everything else, the bottom line is that it's the job of whatever country and whatever leadership of the country is to get food at decent prices to their population. So we're going to see shifts along the way, and it's one of the reasons that's driving us to expand some of our productions, because I think what we're going to see is some countries, in reaction to what they've seen this past year, bring more production in country. Because they're not going to want to risk not being able to get food or food prices going out of hand, so even though it might be more expensive to raise a pig in country “X” than in the United States, I think we are going to see some of those shifts. So that's our preparation, that's why we're expanding to various markets, that's why we're looking to expand some of our production, and we're going to see a little bit longer supply lines, et cetera, et cetera. But at the end of the day, how many people will be what drives our business and that trend continues.

Erin Elizabeth Wilson Wright - *Crédit Suisse AG, Research Division - Director & Senior Equity Research Analyst*

Okay, that's helpful. And then how should we be thinking about the timing and magnitude of the incremental development expenses in the coming quarters, from a modeling perspective? And when we think about the 18 to 24 months, how much could new products or -- is it new geographies or other developments contribute? How should we be thinking about kind of the size of the contribution in longer term?

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

So I think -- the returns that we'll see earliest are the returns that will come from our increasing -- our capacity in various markets, or are entering various markets, because there we're focusing on existing products that we have registrations, so we have a lot of product information. So I think that will see maybe towards the last quarter of this coming fiscal year, maybe even a bit earlier. The longer developments will be like in the companion animal space, (inaudible) dealing with what view as unmet needs, we're dealing with newer molecules and we're taking those molecules into the lab or into the -- just to get to see how and what the effect will be, so they will be the longest. But for that we'll see I think towards the end of the 18 to 24 months. I think, it will be -- the rest will sort of fall somewhere in between.

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

And to your modeling question, Erin, we're calling EBITDA to be roughly equal year-over-year and I would say just the quarterly pattern will be similar, will be roughly equal on a quarterly basis.

Operator

And our next question comes from the line of Kevin Kedra of G. Research.

Kevin Kedra - *G. Research, LLC - Research Analyst*

Just wanted to ask two quick ones. One, on companions, just how aggressively do you want to move into that market? And do you feel that you need to have a certain level of scale to readily compete there? Can you do it with one-off type products? And then secondly, I think you mentioned some of the increased CapEx including some in-sourcing opportunities, how should we be thinking about what that could do longer term to your gross margin?

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

So I think our view is that we can enter the companion animal business without having to have scale. I mean, we are up against a lot of very well-known and very successful competitors, but the market is so large that some products which for them might not be interesting because it might only be a $20 million or a $30 million opportunity. For us, starting from where we're starting, could be very, very exciting. So I think, we're looking, again, at innovative technologies, maybe innovative products and with the changes also especially in the U.S. and growing around the world, in how these products get marketed. We see more opportunities to get products to market. So I think yes, there's a lot of competition but I think with the product movement to market, I don't think we'll have any problems in selling. To the second half of the question, the reason we bring products in-house is partly driven by the margins, but more driven by the security of having these products. I mean we've seen so many disruptions this last year, trade wars, environmental protection in China, et cetera, et cetera, that we feel more confident on the long term in these important products for us to have it sort of under our own belt or in our own control.

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

Controlling our own destiny.

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

Yes. So I think it's more of that than driven by margins.

Operator

Our next question comes from the line of Derik De Bruin of Bank of America Merrill Lynch.

Michael Leonidovich Ryskin - *BofA Merrill Lynch, Research Division - Associate*

This is Mike Ryskin on for Derik. A couple of quick questions on some of the various components of the Animal Health business in 2019 and some of your outlooks there. I'll start with nutritional specialties you highlighted in the quarter, that you had some challenges in dairy. Obviously, we've all been following what's been going on in that end market. And then you called out you expect to return to double-digit growth in nutritional specialties. Is this more about strength in poultry than in some of the other sort of end markets there? Or are you seeing early signs of stabilization in dairy markets? Could you just talk us through what's contributing to that double-digit growth for the year?

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

So the growth is coming from, and as Dick mentioned earlier, I think we are moving more product to more species in more countries. So it's across the board. Dairy remains weak, both in the U.S. and around the world, and it's going to be a while, maybe not fast enough clearly if you're in the daily business, but maybe a year, may be even a bit longer till this thing sort of settles out. And so, we're not looking for a lot of growth in dairy, but we are continuing to expect growth in our poultry line and cattle business around the world.

Michael Leonidovich Ryskin - *BofA Merrill Lynch, Research Division - Associate*

Okay, that's helpful. And on the MFAs and other segment. You talked about the different dynamics of international versus domestic and particularly about the Medicated Feed Additives versus some of the other components. What's your expectation for the U.S. market, sort of longer term? Especially now that it's sort of rebased at a lower level. Do you still think that the space can recover to sort of a low single-digit, mid-single digit growth profile over the long run, not just this fiscal year?

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

I think about it when we make the presentations. One of the products with the category MFA, is everyone thinks that A stands for antibiotic. It does not. These are Medicated Feed Additives and it's just the way the industry for a very, very long time gets products to the animals in the most efficient way. And the A is not -- again, it's not just an antibiotic there are anticoccidials. There's a whole range of products in there, and the U.S. is still, in many areas, the largest producer of those species and is the most efficient and exports a major part of the business. So we will see -- continue to see growth even in the U.S. of the MFA category. What we won't be seeing growth in is antibiotics that were used for growth promotion in the United States, those products are pretty much off the market, and -- so there's no growth obviously when it's off of the market but everything else, we will see growth including therapeutic use. And one of the things which is very hidden when we begin talking only about the financial side is that business is driven by animal diseases. If the farmer or the grower sees the animals are healthy, they're not going to put anything into the animal. But there are lots of challenges, there are viruses, there are bacteria, there are -- you can name, I mean there are 50 different challenges in raising animals, and raising – people, and the farmers do a great job. And you just don't know necessarily a lot of it is driven by weather, a lot of different various other conditions. So overall, we raise a lot of animals, we're going to have a lot of challenges and some of the best solutions are handled by putting it through this MFA category. So the long answer to your question. But yes, we continue to see growth as long as the U.S. remains a major producer of animals.

Michael Leonidovich Ryskin - *BofA Merrill Lynch, Research Division - Associate*

Great, thanks and then one last one on the companion animal. You mentioned that, that was one of the areas where you're focusing the investments over the next couple of years. Are you -- when you talk about in-licensing of the companion animals, is it technologies and platforms? Or is it more towards completed products that are ready to go to market? And then at the same time, could you give us an update on what you announced the last quarter on the canine Lyme disease vaccine development, I realize it's early but curious if there's any updates.

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

So we're not going to be licensing technologies as such or ideas that -- would be years and years. But we are looking to licensed products. One, we have called out I think last quarter or the quarter before was the potential for Lyme disease. And these products, assuming that product is still in the early testing mode and we haven't thrown it out, meaning it's hitting when it's supposed to be hitting but that's about all I can say about it.

Operator

(Operator Instructions) Our next question comes from the line of David Risinger of Morgan Stanley.

David Reed Risinger - *Morgan Stanley, Research Division - MD in Equity Research and United States Pharmaceuticals Analyst*

I have a couple of questions. I guess, first, it would be helpful to understand how you're thinking about investment spending growth a little bit further out, so beyond 2019. Obviously, you're making these investments to grow the company for the longer term, so I'm assuming that the spending growth will continue to be above revenue growth in fiscal 2020, but I'd love to hear your comments on that. And then I have a couple of other questions.

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

I think, David, is -- and we've known each other for a long time. I mean, we would not be opposed to doing acquisitions and we've done a lot of acquisitions in our past. And right now, we don't see, for us, interesting opportunities where we would believe to be the right price. So we are looking at these other avenues, but this is a sort of a short term. I think this is to bring us up -- everything goes in step changes. I think we've done a, I want to be more modest, we've done a pretty good job with our portfolio in these last 10, 15 years, considering the time when you took us out public to today. We've grown this business very, very nicely. But now to get up to another level we have to sort of spend money, we can't acquire it. We need to spend money, it's the most prudent thing to do for our shareholders and for ourselves to get this business up. But I don't think some day we're going to be planning to going after the next 10, 15 years. This is, we're seeing a bunch of opportunities. We can do this now we can do it over this fiscal year, make it carry somewhat over the next fiscal year, but I think then we'll start mining the results of this and be at a high level. I mean that's what we're doing.

David Reed Risinger - *Morgan Stanley, Research Division - MD in Equity Research and United States Pharmaceuticals Analyst*

Okay. That's very...

David Reed Risinger - *Morgan Stanley, Research Division - MD in Equity Research and United States Pharmaceuticals Analyst*

So then just pivoting to the next question on dairy, could you just talk a little bit more about when you might see that pressure in U.S. dairy dissipating? And some improvement in prospects?

Jack Clifford Bendheim - *Phibro Animal Health Corporation - Chairman, President & CEO*

The kind of business we're in is the optimistic world. All of our customers every day go to bed and every morning wake up, praying that the dairy economics will get better, so we can pray with them. So I don't think anyone really knows. I mean dairy is a truly international business. I mean, so much of dairy, I mean a lot of new investments, I'm sure, unlike you think about dairy in terms of liquid milk. That's the smallest part of the business. I mean a lot of it is powdered milk, a lot of it is cheese. As long as it can be shipped, it is a truly international business. And again, some of the things we've been caught up in over the last 6 months, because some of the biggest exports markets and I'd say in dairy business is Mexico and China very, very important part. So if you asked me last week, people would be more depressed. If we really have a renewed NAFTA and Mexico opens up and maybe opens up more products in the dairy business can get better. So this is a changing business but overall, it's openly driven by supply and demand. The supply in the dairy side internationally is very strong against a broken up demand, and our daily farmers both in the U.S. and around the world are producing more today than ever produced historically, and with fewer cows. And that trend will continue, I mean I'm not sure how much (inaudible) it's in the U.S. but it definitely can be true around the world. So it can take a while and some of the smaller producers, I mean people with 500 dairy cows might not be able to make it, unless they become sort of a boutique. We had a meeting here about a month ago -- in a room with a lot of people, some people were raising 30,000 cows, some people were raising 500 cows. The guy with the 500 cows is doing well, because he was in Upstate New York and he found some barista in some coffee shop in Brooklyn, that was -- had a sign on who was just supporting his milk. And that guy was getting a higher price of milk than the guy with the 10,000 or 20,000 had. So this is a changing business. You see, you can't just sort of blankly say the big guy is going to make it and the little guys are not. But overall, this trend we're in, it's gone a long time in a low price and it will be there for a couple of years.

David Reed Risinger - *Morgan Stanley, Research Division - MD in Equity Research and United States Pharmaceuticals Analyst*

Okay, that's extremely helpful. And then Dick, I have a few financial questions. Could you just provide a little bit more color on the loss of the distribution agreement in the U.S. early in fiscal '19? If you could quantify that at all that would be helpful. And then, if you could comment on the tax rate, the non-GAAP tax rate for fiscal '19.

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

Sure. The distribution arrangement, this is something that we've been selling someone else's product for several years. The supplier was bought by someone else so we will -- they've changed the arrangement and we'll lose that business. It will cost us low single-digit millions in sales '19 compared to '18. For the tax rate, we're expecting 26% to 27%, as much as a 140 basis point improvement over this year. It's driven by the full year of the domestic rate dropping down to 21% from 28% but a substantial part of our income is generated in a number of international locations or jurisdictions. So as we put together the blended rate, that's our best estimate at this point.

Operator

And I'm showing no further questions at this time. I would now like to turn the call over to Mr. Richard Johnson for closing remarks.

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

All right, everyone. We thank you for your time and attention, and we'll talk again on our next quarterly earnings call. Bye for now.

Operator

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