Mike: Mike Ryskin with Bank of America and joining me now, Richard Johnson, CFO of Phibro Animal Health.

Richard: Thank you Mike.

Mike: Thank you for coming out here and joining us. I want to start with just a quick overview, the business is 100%, from the animal health side, 100% of livestock, production animals, exposure to all the main protein sources and end markets. Could you give us just a brief overview of where you view the market conditions today, what's your outlook for 2019? What's going on in the industry?

Richard: By and large, I think the industry is doing fine in most markets around the world. You always have to segment by species. The poultry producers are still doing – are still doing well. They're not making the money that they made a few years ago. In pork production, beef production, as we've – I think you've probably heard from a number of different animal health companies, the dairy industry is struggling. Aquaculture continues to be a growing industry and something that we're more and more interested in being in.

Underlying market conditions, there's always ups and downs in individual markets, but if you go back to the underlying driver of our industry, which is the growth of the global middle class and increasing protein consumption, whether that be meat or dairy or any other product. Those drivers are still there and there are more animals in production every day, which is really what our business is about.

Mike: And then anything you can talk about in terms of US versus international? Generally, international growth has been a little bit better; and I think if anything, have gotten even stronger for you because of the MFAs and other business. How do you see that trending over the last couple of years? When can we expect US market to sort of return to low to mid-single-digit growth?

Richard: Our US market has been heavily levered historically to what in the industry are called MFAs, medicated feed additives. An important component of that product category is antibiotics. There has been a move in the United States, it began with regulatory, but it's really the consumer preferences and marketing that has pushed it now. The sales of those products are down in the US. Our sales have essentially stabilized. They're significantly lower than they were three or four years ago. And where we're seeing growth is in the substitute products for – because if you take away a tried and true, well-known tool that has been used for decades, the disease and the health challenges are still there. Producers are looking for alternative products.

We have been successful in putting some of those products out there. We have had good traction and we expect to see those products we already have, continue to grow, as well as adding more products to those portfolios. We are not looking for the MFA category to come back, per se, but we are looking for growth in the other parts of the business.

Mike: And those other parts of the business, you're talking about the nutritional specialties and the vaccines. I mean any particular product you can highlight there? Sort of what's driving that growth? Is it more broad portfolio, any particular blockbuster or big growth driver?

Richard: In the nutritional specialty space we've had a product for poultry for the last few years that has shown very nice growth and has become an important, a meaningful product for us. And it's a product that's plant-based. These are lightly regulated. You sell the product through field trials and developing data. For example, we just launched recently a probiotic that's for various species – there are others in the market, but ours we believe, has some differentiation and benefits that is going to have a place in the market. That's the type of thing we're working on as we move along.

Mike: And is the growth you're seeing in those products, again, is that primarily in the US because that's where the Veterinary Feed Directive was put into place and where people are looking for alternatives? Or you seeing any response from some international markets, especially developing markets?

Richard: We're seeing some response in the developing markets. The European market which has attitudes and regulations similar or maybe even more restrictive than the US, we're seeing one set of circumstances there; but then in call it Latin America or the Asia-Pacific markets, we're seeing a place for these products alongside our traditional MFA products.

Mike: And yet, if we look at historically the last couple years in nutritional specialties, vaccines, you've had 20% growth for multiple quarters. You've had a little bit of a rough patch the last couple quarters. Part of that is a stacked comps multiyear. Part of it is that it's usually highlighted in dairy, for example, that's where you're a little bit more exposed with those products. And longer term if we skipped the rest of the year and we go to 2020, 2021, is double digit sort of a good way to think about growth in these areas? What's the sustainable level these days?

Richard: We think a combination of some of the repositioning we're doing today with the dairy products, international growth with our existing portfolio, as well as adding additional products to that category that we can bring that back to double-digit growth. And exactly when I can't say, but in the timeline you mentioned is probably reasonable.

Mike: Great. And then when we think about the MFAs in the United States, granted your MFAs and other category has more than just medically important anti-bacterials. It has more than just MFAs. It's a broad mix of products. But part of that is still clearly being affected by the Veterinary Feed Directive in the United States and then also just the Clean Food Movement, the antibiotic free chicken, etcetera. That second part of it is not going away. It's already gone to a certain extent in the United States; there's still a believe it's going to either get worse or sort of retrace your steps a little bit.

Beyond the medically important anti-bacterials, can you talk about how your portfolio is affected for that – by that and sort of what your expectations are for the Clean Food Movement going forward?

Richard: The bulk of our MFA business in the United States today is perfectly acceptable with the clean food movement. The amount of sales remaining for Phibro – the sales remaining for Phibro is, in June it was down to $12 million of sales in the US. We have seen the decline. Could that 12 go a bit lower? Sure. But we've basically seen most of the decline. I think we've comped that out and now it's – now we're going to see stability and some growth in the other parts of our portfolio.

Mike: And is there any fear that some of these are going to move – you already talked about Europe, how it is far ahead of the United States in some regards. But what about Latin America, parts of Asia? Is that something we're going to be seeing down the road?

Richard: The international, from a regulatory point of view, I think regulators around the world look for leadership to the United States, to Europe and so yes, we'll continue to see regulatory evolution, but it's really not regulatory so much as it is the consumer preferences and what's the tradeoff between healthy, affordable protein versus all the labels that are on a package.

Mike: And going into the business, the legacy business is more MFA than other in antibiotics, now you're shifting into these other growth areas. Part of that shift mix is what I think is one of the key kind of – the Phibro story. If we think about beyond just product class, there's also looking at it in terms of species. You've got an aquaculture business, you've got a very large presence in poultry which are two of the growth-ier parts of the industry. If you could sort of think about your ideal mix from a species, is there any area where you're underexposed, where you are really focusing on the growth areas?

Richard: Our growth focus is – I'd say our growth focus is really across all species – for example, we've had a lot of growth success in the beef industry, beef production industry in a number of international markets, where historically our – and this is mostly in the MFA category where mostly our products were really only used for poultry and swine. And we've been able to demonstrate to producers that it makes all kinds of economic sense to use a product like ours, keep their animal healthier and it really increases their return.

In addition, we just had somewhat of a breakthrough finding that one of our nutritional specialty products – that has typically only been for dairy -- obviously, a cow is a cow -- that in certain markets where you get intense heat duirng parts of the production cycle, that it's very effective in helping that cow fight off heat stress – that beef steer fight off heat stress. And so we're seeing opportunities to cross what have been more traditional separate channels.

Beef is nice. We see a lot of growth potential in aqua. We have – we acquired a small consulting practice about four or five years ago. They have been developing aqua applications of our existing products and our existing portfolio and we're beginning to see nice penetration into the aqua industry. Aqua is – they have the same health challenges as any other producer, which essentially is when you raise a lot of animals close to each other, you get health challenges and disease pressures. And you need tools to keep your animal healthy. Whether it's a shrimp or a beef cow.

Mike: Thinking about expansion into additional species, additional markets, you highlighted a few quarters ago that you're looking into developing a companion animal product. Can you sort of talk about what led you to that decision, give us an update on the development.

Richard: We see an opportunity and as Mike said in his introduction, we're strictly production animal focused today. We have, call it a white space or a blank – sort of a blank canvas to selectively go after some companion animal opportunities. There are people out there with interesting products, differentiated products who may not be able to get those products to market through the typical channel, so they're looking for somebody to partner with them, help them take that product to market. And then we also are not tied to any one go-to-market strategy. We can pick and choose a go-to-market strategy that's going to make economic sense.

We think there's opportunity there. We continue to test a handful of products. The testing is progressing nicely. We continue to spend P&L dollars on the opportunity.

Mike And then is there – I mean it sounds like this is more of a 2020, 2021 opportunity in terms of go-to-market.

Richard: Yeah, within the next, certainly within the next 12 months we could potentially – things are not absolutely defined yet, but we could potentially have products on the market in the next 12 months.

Mike: And then how do you think about – I mean you mentioned that there's multiple distribution strategies, go-to-market strategies. But does it present an additional challenge in that you're not going at it with the whole portfolio and you're only going to have a handful of product? Does it sort of limit you in what you can pursue? Possibility of doing a co-licensing or partnership with a bigger player?

Richard: We think there's room for just going out with a handful of differentiated products. So, we think there's opportunity there.

Mike: All right. Any questions from the audience? Talking about your other two segments outside of Animal Health. Not the focus of the company, but still, a sizable portion of revenues, Mineral Nutrition and then Performance Products. Mineral Nutrition tends to be a little bit more volatile, susceptible to the underlying prices and commodities. Anything that's changed there in terms of your ability to sort of control that or to maintain some of that visibility going forward? And how does that fit into the overall strategy?

Richard: Our Minerals business is – we consider it a very important part of the company. It's a domestic business. We're selling to the same customers that we sell our Animal Health products to. These are the trace minerals that supplement an animal's diet, just like many of us will take a daily supplement that has all of the trace minerals in it, just to make sure that we get all of the individual minerals that are needed in a diet. The top line is volatile, as Mike said, because it moves with commodity pricing. But the industry is transparent and prices move up and down. What we attempt to do is make a margin on volume, X cents per pound or X hundred dollars per ton kind of margin.

Recently, and we've seen, if you look at our history, we've seen steadily growing profitability in the business year after year after year. This year, industry conditions have tightened and toughened. Our margins have been squeezed and profitability is down year on year. We see it as something we need to work through. We still have faith in the long-term trajectory of the business and think it's an important part of our business.

Historically, it was the platform for us to launch a number of these nutritional specialty products. That's not really the case anymore, but it still gives us another touch point with a lot of -- all of our customers, really.

Mike: Is there a reason why primarily in the US, not international…?

Richard It is a heavily – it's a different business. If you look, our animal health business on a segment basis makes 25% or 26% EBITDA margin. The Minerals business makes a 6, 7, 8% EBITDA margin. It's a logistics business. It's sourcing, logistics, a little bit of blending where we add our value. So the reason it's primarily in the United States is, it doesn't travel well from a logistics point of view. We would have to set up a similar business in other countries and it just doesn't make sense.

Make: And then on the other segment, the Performance Materials?

Richard: These are a small collection, as we call it, it's our Performance Product segment. It's a small collection of legacy specialty chemical businesses that they really came from the legacy part of the company, not core, not strategic. We're running them for cash flow and we've rationalized the business over time and we'll continue to do that, if and when it makes sense. Right now it's having, it had a real nice I think a couple of quarters of sales and profitability growth. But it's really on the margins of the total company.

Mike: And then speaking about the EBITDA margins for the Animal Health business, how should we think about that going forward? I mean you've got a couple different stories to the mix, to the margin story. One is you've got investments. You're doing a Companion Animal business and some other growth drivers. But on the flip side, you're getting the evolution of the top-line mix, shifting from some of the legacy products and your drivers that should have higher margins?

Richard: That's right.

Mike: But how does it all come together?

Richard: Yeah, I think we'll – putting aside strategic investment dollars, we will continue to grow the margins in the Animal Health segment, no question. But then it will be the discretionary investment dollars as to whether they hold those margins more constant or have an effect in the short run. But those are going to be somewhat discretionary type investments.

Mike: Those discretionary investments, thinking about the Companion Animal products, is there anything specific that you can call out where you're focusing…?

Richard: Well, we're very interested in growing our Vaccine business and we acquired an idle vaccine plant in Ireland and are fitting it out to make our product line. That will take another 18 to 24 months before products come out of that plant. But once they do, it gives us access to a number of additional markets that we didn't have access to before, both from a regulatory point of view – Ireland is in the EU and so it would, from a regulatory standpoint, it would open up the EU market. And then from other – some other markets that we don't have access to today that it will give us access to.

We see product coming out of this new production facility as – and then, of course, in addition, it will give us production capacity, more capacity. But we see it as really giving us a leg up on the growth in that part of the business.

Mike: The shift in the mix, is it more portfolio driven or is there any particular product that we should be keeping an eye out on? Is there, I don't want to say blockbuster specifically, but is there any one thing or just a bunch of singles and doubles?

Richard: It's going to be portfolio driven and it's going to be – it will be in the, you use the expression singles and doubles. It'll be things that – it'll be a – because you don't – by the time you take a product and then in individual markets, a $1 or a $2 or a $5 million product in a market is a nice product. And so that might aggregate into the $10 or $20 kind of million. But overall, those are real nice products for us and for the industry.

Mike: At the same time, thinking about the mix, is there anything that we should keep an eye out in terms of patent expiry, IP issues? I realize that generics in this industry, a lot of times they're able to maintain a lot of share, a lot of market share; but still, any regulatory events that are upcoming or product-specific events?

Richard: Short answer is no. Our products, patents and regulatory – patent protection is a barrier to entry – is a very minor part of our business. Regulatory barriers are a definite -- definitely keep other players out because the cost to come in from a regulatory standpoint is high. And for the same reason that I describe products -- you don't get blockbuster products. To spread that regulatory cost against relatively small products, that's a difficult equation to make work. And that's why you don't see that many generics, anyway.

Mike: Any questions from the audience? And then on the balance sheet from the capital deployment optionality, you've talked in the past about being a little bit more willing to pursue deals. And I know you've pursued some. Could you just give us an update on the balance sheet and how you think about valuation?

Richard: Our free cash flow is absolutely focused on growth. Whether we have to fund the growth with P&L dollars, which is more of a build strategy, or whether we're able to do some M&A and do a buy strategy, we're focused on growth. On a net leverage basis today, we're about two times levered. We have positive cash flow routinely. And valuations, assets are scarce and one of the reasons, and because they're scarce, prices tend to be pretty high. That is lately why we've gone more with a build strategy. But we continue to be very – have our eyes open to acquisition opportunities, definitely.

Mike: And it would be more on the Companion Animal side, Vaccines you mentioned, you mentioned international.

Richard: It could be any of those, right. It would be focused on either the faster growing parts of the Animal Health, which are Nutritional Specialties or Vaccines, or it could be something in the Companion Animal space. Unlikely, much less likely that it would be something in kind of the more traditional MFA category.

Mike: Is there any other questions? All right, I think I'll end with our customary one sort of, what's underappreciated, what's misunderstood? What do you think people aren't paying enough attention to as far as the story goes? Tough question I know.

Richard: Well, just kind of the pitch for Phibro is, the underlying macro drivers are there and that is the desire and demand for increased protein around the world. And then you match that up with - we have an excellent product portfolio. We continue to develop our products. We've got an excellent group of people around the world. We continue to move into -- selectively we're moving into additional growth markets. And so I think all of those put together really paint a good bright future for Phibro.

Mike: Thank you very much.

Richard: You're welcome. Thank you.

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